

# GUIDELINE ANSWERS

## PROFESSIONAL PROGRAMME

*(New Syllabus)*

DECEMBER 2019

MODULE 3



**THE INSTITUTE OF  
Company Secretaries of India**

**भारतीय कम्पनी सचिव संस्थान**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**

Statutory body under an Act of Parliament

(Under the jurisdiction of Ministry of Corporate Affairs)

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

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

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

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**PROFESSIONAL PROGRAMME EXAMINATION**  
**DECEMBER 2019**  
**CORPORATE FUNDING & LISTING IN STOCK EXCHANGES**

Time allowed : 3 hours

Maximum marks : 100

**NOTE :** Answer ALL Questions.

**PART A**

**Question 1**

(a) On the basis of following information, calculate the limit for Letter of Credit (LC) for the Financial Year 2019-20 of M/s Madhukar Enterprises :

(i) Estimated Raw Material purchase for the FY 2019-20	₹172.64 Crore
(ii) Estimated purchase under Letter of Credit for FY 2019-20 (LC)	₹69.41 Crore
(iii) Lead time i.e. time from order placement to shipment	10 days
(iv) Transit Time	20 days
(v) Credit (Usance) Period available	3 months

(b) Following data relates to M/s ABC Pvt. Ltd. :

	Amount (₹ in lakh)		Amount (₹ in lakh)
Creditors for purchases	200	Raw Material	380
Other Current Liabilities	100	Work in Process	40
		Finished Goods	180
		Receivables	110
		Other Current Assets	30

Calculate the Maximum Permissible Bank Finance (MPBF) as per the Tandon Committee Recommendations using the norm of a current ratio of 1.33.

(c) Explain the eligibility criteria for listing on Innovators Listing Growth Platform. (5 marks each)

**Answer 1(a)**

Sr. No.	Particulars	
A	Annual Consumption of Raw Material (RM) to be purchased under Letter of Credit (LC)	Rs. 69.41 Crore
B	Average monthly purchase of Raw Material	Rs. 69.41/12
		Rs. 5.78 Crore
C	Lead time i.e. time from order placement to shipment	10 days

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D	Transit Time	20 days
E	Credit (Usance) Period available	3 months
F	Total Period (C+D+E)	4 months
G	Requirement of LC (BX F) i.e. Rs. 5.78 x 4	Rs. 23.14 Crore.
	i.e. LC limit recommended	Rs. 23 Crore

### Answer 1(b)

Working Note:

Particulars	Amount (Rs. In lakhs)
Raw Material	380
Work in Process	40
Finished Goods	180
Receivables	110
Other Current Assets	30
Total Current Assets	740

Calculation of Maximum Permissible Bank Finance (MPBF) as per 2nd Method of Lending (Tandon Committee Recommendations) are as under:

Particulars	Amount (Rs. in lakh)
1 Total Current Assets (TCA)	740
2 Less : Current Liabilities other than banking borrowing	300
3 Working Capital Gap (WCG) (1 -2)	440
4 Less : 25% of Total Current Assets (25% of I)	185
5 Maximum Permissible Bank Finance (MP BF) (3-4)	255

With this additional borrowing the Current Liabilities shall become Rs. 555 lakhs (300 + 255) and the new Current Ratio shall become 1.33 (740/555).

### Answer 1(c)

Eligibility criteria for listing on Innovators Listing Growth Platform are as under:

An issuer which is intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition shall be eligible for listing on the innovators growth platform, provided that as on the date of filing of draft information document or draft offer document with the Board, as the case may be,

twenty five per cent of the pre-issue capital of the Issuer Company for at least a period of two years, should have been held by:

- I. Qualified Institutional Buyers.
- II. Family trust with net-worth of more than five hundred crore rupees, as per the last audited financial statements.
- III. Accredited Investors for the purpose of Innovators Growth Platform.
- IV. The following regulated entities:
  - a. Category III Foreign Portfolio Investor
  - b. An entity meeting all the following criteria:
    - i. It is a pooled investment fund with minimum assets under management of one hundred and fifty million USD.
    - ii. It is registered with a financial sector regulator in the jurisdiction of which it is a resident.
    - iii. It is resident of a country whose securities market regulator is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to Bilateral Memorandum of Understanding with the Board.
    - iv. It is not resident in a country identified in the public statement of Financial Action Task Force as:
      - (a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply or
      - (b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

*Explanation:*

- (a) The following entities shall be eligible to be considered as accredited investors for the purpose of innovators growth platform:
  - (i) any individual with total gross income of fifty lakhs rupees annually and who has minimum liquid net worth of five crore rupees; or
  - (ii) anybody corporate with net worth of twenty five crore rupees.
- (b) Not more than ten per cent of the pre-issue capital may be held by Accredited Investors.
- (c) For the purpose of accreditation: The persons /corporate bodies who wish to get accreditation for the purpose of innovators growth platform, shall approach the stock exchanges or depositories and follow the procedures prescribed by the Board and / or such stock exchange or depository for the purpose of accreditation as an Accredited Investor, from time to time.

An issuer shall be eligible for listing on the institutional trading platform if none of the promoters or directors of the issuer company is a fugitive economic offender.

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

- (a) *Shaurya Ltd. a company dealing with glass molding and peripherals has plans to go public and raise ₹1,000 crores. They appoint CFQ Financial Services as their lead managers. The company's directors having no knowledge of rules and regulations argue with the lead managers that 40% of shares are to be allotted to public, 40% to QIBs, 10% to HNI clients and balance to be taken by underwriters. As a Company Secretary, explain to the directors the Regulations 40 & 136 of underwriting.*
- (b) *As per SEBI Regulations, explain the eligibility criteria for the Public offer of Securitized Debt Instruments.*
- (c) *Discuss the measures taken by Government and Regulators to develop a vibrant Corporate Bond Market in India. (5 marks each)*

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

*Distinguish between the following :*

- (i) *Bills Finance and Project Finance*
- (ii) *Private Placement and Preferential Allotment*
- (iii) *Commercial Paper and Inter Corporate Deposit. (5 marks each)*

**Answer 2(a)**

The directors of the company are not correct as the rules pertaining to issue states that allotment of shares has to be made based on the following regulation:

**(Regulation 40 & 136 of SEBI (Issue of Capital and Disclosure Requirements)****Regulations, 2009**

- If an issuer makes a IPO/FPO other than through the book building process, desires to have the issue underwritten, it shall appoint the underwriters in accordance with the SEBI (Underwriters) Regulations, 1993.
- If the issuer makes a public issue through a book building process:
  - (a) the issue shall be underwritten by lead managers and syndicate members. However, at least 75% of the net offer to the public is proposed to be compulsorily allotted to the QIBs, and such portion cannot be underwritten.
  - (b) the issuer shall, prior to filing the prospectus, enter into an underwriting agreement with the lead manager(s) and syndicate member(s) which shall indicate the number of specified securities which they shall subscribe to at the predetermined price in the event of under-subscription in the issue.
  - (c) if the syndicate member(s) fail to fulfil their underwriting obligations, the lead manager(s) shall fulfil the underwriting obligations.

- (d) the lead manager(s) and syndicate member(s) shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.
- (e) in case of every underwriting issue, the lead manager(s) shall undertake minimum underwriting obligation as specified in the SEBI (Merchant Bankers) Regulations, 1992.
- (f) where the issue is required to be underwritten, the underwriting obligations should at least to the extent of minimum subscription.

**Answer 2(b)**

Following are the eligibility criteria for the Public Offer of Securitized Debt Instrument as per SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008:

A person cannot make a public offer of securitized debt instruments or seek listing for such securitized debt instruments unless:

- (a) it is constituted as a special purpose distinct entity
- (b) all its trustees are registered with the SEBI under the SEBI (Issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008; and
- (c) it complies with all the applicable provisions of these regulations and the SEBI Act.

The requirement of obtaining registration is not applicable for the following persons, who may act as trustees of special purpose distinct entities:

- (a) any person registered as a debenture trustee with SEBI;
- (b) any person registered as a securitization company or a reconstruction company with the RBI under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- (c) the National Housing Bank established by the National Housing Bank Act, 1987
- (d) the National Bank for Agriculture and Rural Development established by the National Bank for Agriculture and Rural Development Act, 1981.
- (e) any scheduled commercial bank other than a regional rural bank
- (f) any public financial Institution as defined under clause (72) of section 2 of the Companies Act, 2013 and
- (g) any other person as may be specified by SEBI.

However, these persons and special purpose distinct entities of which they are trustees are required to comply with all the other provisions of the SEBI (Public Offer and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008.

**Answer 2(c)**

A vibrant capital market, both equity and bond, has to play an increasingly pivotal role to facilitate fund mobilization for sustaining India's projected economic growth

momentum. The role of corporate bond market becomes even more important now, given the stress on the banking sector.

Keeping in view the larger complementary role that corporate bonds have to play along-side bank credit for financing economic activities, several policy measures have been taken by the Government and the Regulators to develop a vibrant corporate bond market.

Some important measures include:

- Framework for allowing banks to provide Partial Credit Enhancement for enhancing creditworthiness of corporate bonds.
- Information Repositories developed by Exchanges and Depositories to provide consolidated information on primary issuance and secondary market trades in corporate bonds.
- Electronic Book Building mechanism for providing enhanced transparency in issuance of debt securities on private placement basis.
- Enhanced standards for Credit Rating Agencies for timely monitoring of credit quality of bonds
- Specifications related to International Securities Identification Number (ISINs) for debt securities to encourage liquidity and reduce fragmentation of issues.
- Tri-Party Repo trading on Exchanges to enhance liquidity and price discovery in corporate bonds.
- Time taken for listing of public issue of bonds reduced from 12 days to 6 days.  
And
- Doing away with the requirement of 1% security deposit for public issue of debt securities.

### **Answer 2A(i)**

#### **Bills Finance and Project Finance are two different methods of financing**

##### **Bills Finance**

Bills finance is short term and self liquidating finance in nature. The bills can be classified as Demand Bills and Usance Bills. Demand Bill is purchased and Usance bill is discounted by the banks. The credits available to the seller against the bills drawn under Letter of Credit either on sight draft or usance draft are called bills negotiated by the banks. The advantage of bills finance is that the seller of goods (borrower) gets immediate money from the bank for the goods sold by him irrespective of whether it is a purchase, discount or negotiation by the bank. The 'Demand Bills' can be documentary or clean. Usually banks accept only documentary bills for purchase. However, clean bills from good parties also purchased by the banks.

The 'Documentary Bills' may be drawn by a Seller of Goods ('Drawer') on D/P (Delivery against payment) or D/A (Delivery against Acceptance) terms. In case of D/P terms the documents of title to goods are delivered to the buyer of the goods (drawee) against



payment of bill amount. In case of D/A bills, the documents to the title of goods are to be delivered to the drawee (Buyer) against acceptance of bills. These types of bills are called "Usance Bills" which means bills are maturing on a future date and payment will be made on due date. In case of 'Usance Bills' bills become clean after it is delivered to drawee on acceptance.

Therefore banks take into consideration the credit worthiness not only of the borrower but also of the drawee.

**Project Finance** : It is the long-term financing of infrastructure and industrial projects based upon the projected cash flows of the project. Usually, a project financing structure involves a number of equity investors, known as 'sponsors', a 'syndicate' of banks or other lending institutions that provide loans to the operation. They are most commonly loans which are secured by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors. The financing is typically secured by all of the project assets, including the revenue-producing contracts. Project lenders are given a lien on all of these assets and are able to assume control of a project if the project company has difficulties complying with the loan terms.

Generally, a special purpose entity is created for each project, thereby shielding other assets owned by a project sponsor from the detrimental effects of a project failure. As a special purpose entity, the project company has no assets other than the project. Capital contribution commitments by the owners of the project company are sometimes necessary to ensure that the project is financially sound or to assure the lenders of the sponsors' commitment. Project finance is often more complicated than alternative financing methods. Traditionally, project financing has been most commonly used in the infrastructure industry.

### **Answer 2A(ii)**

Following are the main difference between private placement and preferential allotment:

1. Private Placement can be described as an offer or invitation to offer made to specified investors by issuing securities, so as to raise funds. On the contrary, Preferential Allotment is the issue of shares or debentures to a particular group of persons is made by a listed company, to raise funds.
2. Private Placement is governed by section 42 of the Companies Act, 2013. Conversely, in the case of Preferential Allotment section 62 (l) of the Companies Act, 2013 will apply.
3. In the case of private placement, 'Private placement offer letter' is sent to the investors for inviting them to subscribe for shares. As against, in the case of preferential allotment, no such offer document is issued to people.
4. In private placement, application money can be received through cheques, demand draft or any other banking modes but not cash. Unlike, preferential allotment in which the money is received in cash or kind.
5. In private placement, the application money is kept in the separate bank account of a scheduled commercial bank. On the contrary, no such account is required in case of preferential allotment.

6. The private placement must be authorized by the articles of association of the company. In contrast, no such authorization is required in case of preferential allotment.

**Answer 2A(iii)**

Following are the differences between Commercial Paper and Inter Corporate Deposits:

**Commercial Paper (CP)** : It is an unsecured money market instrument issued in the form of a promissory note to enable highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors.

Companies, Primary Dealers and financial institutions (FIs) are permitted to raise short-term resources under the umbrella limit fixed by the Reserve Bank of India (RBI) are eligible to issue Commercial Paper.

A company would be eligible to issue Commercial Paper provided:

- (a) the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crores;
- (b) the company has been sanctioned working capital limit by bank/s or FIs; and
- (c) the borrowal account of the company is classified as a Standard Asset by the financing bank/ institution.

**Inter Corporate Deposits**

Corporates also have access to another market called the Inter Corporate Deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as a refuge for low rated corporates, this market allows corporates with surplus funds to lend to other corporates facing shortage of funds. Another aspect of this market is that the better-rated corporates can borrow from the banking system and lend in this market to make speculative profits. As the cost of funds for a corporate is much higher than that of a bank, thus, the rates in this market are higher than those in the other markets. ICDs are unsecured, and hence the risk inherent is high. The ICD market is an unorganised market with very less information available publicly about transaction details.

**Question 3**

- (a) *An established company maintaining power projects in India, raised ₹11,000 crores from Indian Stock market with an issue price of ₹450 (FV of ₹10 per share) on 15th January, 2008. Anticipating a huge returns on the share price, the issue was subscribed 27.5 times and a huge response received to the company's IPO. The company at the time of listing only owned a land for its six power projects which were to be developed for generation of electricity, and there was no revenue income at the time of listing. On 15th February, 2008 the company listed its shares but due to the stock market meltdown, the stock fell to ₹320 per share, i.e. a discount of ₹130 from its issue price of ₹450. Facing huge criticism from its investors, the company decided to issue bonus shares in the ratio of 3 shares for 5 shares held. A Public Interest Litigation was filed challenging the issuance of bonus shares without any revenue income. The case was rejected and dismissed.*

*Discuss the merits of the case and also the conditions for issue of bonus shares.  
(5 marks)*

- (b) *Explain the circumstances under which an Investment Manager of an Infrastructure Investment Trust (InvIT) can apply to SEBI and the designated Stock Exchange for delisting of its units.  
(5 marks)*
- (c) *State the procedure laid out for issuance of ADRs/GDRs.  
(5 marks)*

### **Answer 3(a)**

#### **Conditions for issue of Bonus Shares**

- (i) In terms of section 63(2) of the Companies Act, 2013, no company shall capitalize its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless — it is authorised by its articles.
- (ii) It has been authorized by the shareholders in a general meeting of the company, on the recommendation of the Board of Directors.
- (iii) It has not defaulted in the payment of interest or principal in respect of fixed deposits or debt securities, if any issued by it.
- (iv) It has not defaulted in respect of the payment of statutory dues of the employees, such as contribution to provident fund, gratuity and bonus.
- (v) The partly paid up shares, if any outstanding on the date of allotment have been made fully paid up.

#### **No Bonus shares in lieu of dividend**

The bonus shares shall not be issued in lieu of dividend. [Section 63(3) of the Companies Act, 2013].

According to Rule 14 of Companies (Share Capital and Debentures) Rules, 2014 states that the company which has once announced the decision of its Board recommending a bonus issue shall not subsequently withdraw the same.

Since the company has complied with all the conditions required to be satisfied, the court was correct in awarding the judgment in favour of the company.

### **Answer 3(b)**

The investment manager shall apply for delisting of units of the InvIT to SEBI and the designated stock exchanges if,-

- (i) the public holding falls below the specified limit under the InvIT Regulations.
- (ii) the number of unit holders of the InvIT falls below the limit as prescribed in the InvIT Regulations.
- (iii) if there are no projects or assets remaining under the InvIT for a period exceeding six months and InvIT does not propose to invest in any project in future. The period may be extended by further 6 months, with the approval of unit holders
- (iv) SEBI or the designated stock exchanges require such delisting for violation of the listing agreement or these regulations or the Act.

- (v) the sponsor(s) or trustee requests such delisting and such request has been approved by unit holders in accordance with these regulations.
- (vi) unit holders apply for such delisting in accordance with these regulations.
- (vii) SEBI or the designated stock exchanges require such delisting in the interest of the unit holders.

**Answer 3(c)**

Following are the procedure for the issuance of ADRs/GDRs

**(i) Approvals Required**

The issue of ADRs/GDRs requires the approval of a Board of Directors, shareholders, "In principle and Final" approval of Ministry of Finance, approval of Reserve Bank of India, In-principle consent of Stock Exchange for listing of underlying shares and In-principle consent of Financial institutions.

**(ii) Approval of Board of Directors**

A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro Capital market. A board resolution is to be passed to approve the raising of finance by issue of GDRs/FCCBs. The resolution should indicate therein specific purposes for which funds are required, quantum of the issue, country in which issue is to be launched, time of the issue etc. A director/Sub-Committee of Board of Directors is also to be authorised for seeking Government approval in connection with Euro issue and signing agreements with depository, organising road shows for fixation of price of GDRs. The Board meeting shall also decide and approve the notice of Extraordinary general meeting of shareholders at which special resolution is to be considered.

**(iii) Approval of Shareholders**

Proposal for making Euro issue, as proposed by Board of Directors require approval of shareholders. A special resolution under Section 62 of the Companies Act, 2013 is required to be passed at a duly convened general meeting of the shareholders of the company

**(iv) Approval of Ministry of Finance - "In Principle and Final"**

With respect to ADR/GDR, guidelines issued on the subject dated 19-1-2000 brought ADR/GDR under the automatic route and therefore the requirement of obtaining approval of Ministry of Finance, Department of Economic Affairs has been dispensed with.

Further, private placement of ADR/GDR will also not require prior approval provided the issue is managed by investment banker.

**(v) In-Principle Consent of Stock Exchanges for Listing of Underlying Shares**

The issuing company has to make a request to the domestic stock exchange for in-principle consent for listing of underlying shares which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian stock exchanges like any other equity shares.

**(vi) In-Principle Consent of Financial Institutions**

Where term loans have been obtained by the company from the financial institutions, the agreement relating to the loan contains a stipulation that the consent of the financial institution has to be obtained. The company must obtain in-principle consent on the broad terms of the proposed issue.

**Question 4**

- (a) *“Achieving a prosperous, inclusive, resilient and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty” — Justify the mission of Asia Development Bank in your own words.*
- (b) *Explain the term ‘Strategic Investor’ with reference to the public issue of REITs and InVITs.*
- (c) *Explain the categories of Private Equity Investment.*
- (d) *Explain the relevant applicable requirements as specified by SEBI for an issuer proposing to issue Non-Convertible Redeemable Preference Shares to the public through the online system of the stock exchange.*
- (e) *Explain the conditions under which a bank can grant non-funded facilities to customers (not availing fund based facility from any bank in India).*

*(3 marks each)*

**Answer 4(a)**

The Asian Development Bank (ADB) was conceived in the early 1960s as a financial institution that would be Asian in character and foster economic growth and co-operation in one of the poorest regions in the world.

The Asian Development Bank is committed to achieving a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. It assists its members and partners by providing loans, technical assistance, grants, and equity investments to promote social and economic development.

Asian Development Bank in partnership with member governments, independent specialists and other financial institutions is focused on delivering projects in developing member countries that create economic and developments impact.

As a multilateral development finance institution, Asian Development Bank provides:

- Loans
- Technical assistance
- Grants

Asian Development Bank maximizes the development impact of its assistance by:

- Facilitating policy dialogues,
- Providing advisory services, and
- Mobilizing financial resources through co-financing operations that top official, commercial, and export credit sources.

**Answer 4(b)**

'Strategic investor' means:

1. an infrastructure finance company registered with RBI as a NBFC ;
2. a Scheduled Commercial Bank;
3. an international multilateral financial institution;
4. a systemically important NBFC with RBI;
5. a foreign portfolio investors;

who invest either jointly or severally not less than 5 % of the total offer size of the InvIT or such amount as may be specified by SEBI with applicable provisions of the FEMA Act, 1999 and the rules or regulations or guidelines made there under.

Following other aspects shall also be considered –

- Holding by strategic investors – Minimum 5%, maximum 25%.
- Holding by public, other than strategic investors and sponsors – Minimum 25%
- Holding by sponsor – Minimum 5%, maximum 70%
- The price at which units are offered to the strategic investors must not be less than the price determined in the public issue.
- It must be ensured that the subscription amount is kept in the separate account until the public issue is opened.
- The units subscribed by strategic investors, pursuant to the unit subscription agreement, will be locked-in for a period of 180 days from the date of listing in the public issue.

**Answer 4(c)**

Private equity investments can be divided into the following categories:

- (i) **Leveraged Buyout (LBO)** : This refers to a strategy of making equity investments as part of a transaction in which a company, business unit or business assets is acquired from the current shareholders typically with the use of financial leverage. The companies involved in these type of transactions that are typically more mature and generate operating cash flows.
- (ii) **Venture Capital** : It is a broad sub-category of private equity that refers to equity investments made, typically in less mature companies, for the launch, early development, or expansion of a business.
- (iii) **Growth Capital** : This refers to equity investments, mostly minority investments, in the companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business.

**Answer 4(d)**

The issuer may provide the facility for subscription of application in electronic mode.

An issuer proposing to issue non-convertible redeemable preference shares to the public through the on-line system of the designated stock exchange shall comply with the relevant applicable requirements as may be specified by SEBI, which are as under:.

All the investors applying in a public issue shall use only Application Supported by Blocked Amount (ASBA) facility for making payment i.e. writing their bank account numbers and authorising the banks to make payment in case of allotment by signing the application forms. An investor, intending to subscribe to a public issue, shall submit a completed bid-cum application form to Self-Certified Syndicate Banks (SCSBs), with whom the bank account to be blocked is maintained or any of the following intermediaries:

- (i) A syndicate member (or sub-syndicate member)
- (ii) A stock broker registered with a recognised stock exchange
- (iii) A depository participant ('DP')
- (iv) A registrar to an issue and share transfer agent ('RTA')

#### **General Conditions to issue non-convertible redeemable preference shares**

1. No issuer shall make any public issue of non-convertible redeemable preference shares if as on the date of filing of draft offer document or final offer document,
  - (a) the issuer or the person in control of the issuer or its promoter or its director is restrained or prohibited or debarred by the Board from accessing the securities market or dealing in securities; or
  - (b) the issuer or any of its promoters or directors is a wilful defaulter or it is in default of payment of interest or repayment of principal amount in respect of non-convertible redeemable preference shares issued by it to the public, if any, for a period of more than six months.
2. No issuer shall make a public issue of non-convertible redeemable preference shares unless the following conditions are satisfied, as on the date of filing of draft offer document and final offer document:
  - (a) it has made an application to one or more recognized stock exchanges for listing of such securities being issued and where the application is made to more than one recognized stock exchange, the issuer shall choose one of them as the designated stock exchange. In case any of such stock exchanges have nationwide trading terminals, the issuer shall choose one of them as the designated stock exchange. The issuer is however free to choose a different stock exchange as a designated stock exchange for any subsequent public issue.
  - (b) it has obtained in-principle approval for listing of its non-convertible redeemable preference shares on the recognized stock exchanges where the application for listing has been made.
  - (c) it has obtained a credit rating from at least one credit rating agency registered with SEBI and is disclosed in the offer document. In case the issuer company has obtained credit ratings from more than one credit rating agency, all the

ratings, including the unaccepted ratings, shall be disclosed in the offer document.

- (d) it has entered into an arrangement with a depository registered with SEBI for dematerialization of the non-convertible redeemable preference shares that are proposed to be issued to the public, in accordance with the Depositories Act, 1996 and regulations made there under.
  - (e) the minimum tenure of the non-convertible redeemable preference shares shall not be less than three years.
  - (f) the issue has been assigned a rating of not less than AA- or equivalent by a credit rating agency registered with SEBI
- (3) The issuer shall create a capital redemption reserve in accordance with the provisions of the Companies Act, 2013.
  - (4) The issuer shall not issue non-convertible redeemable preference shares for providing loan to or acquisition of shares of any person who is part of the same group or who is under the same management, other than to subsidiaries of the issuer; Explanation: For the purpose of this regulation, the terms “part of the same Group” and “under the same management” shall have the same meaning as provided in the explanation to Regulation 23 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.
  - (5) In case of public issue of non-convertible redeemable preference shares, the issuer shall appoint one or more merchant bankers registered with SEBI at least one of whom shall be a lead merchant banker.

#### **Answer 4(e)**

Banks can grant non-funded facilities including partial credit enhancement to customers, not availing fund based facility from any bank in India under following conditions:

1. Banks are to ensure that the borrower has not availed any fund based facility from any bank operating in India. At the time of granting non-funded facilities, bank to obtain declaration from the customer about the non-funded credit facilities already enjoyed by them from other banks.
2. Banks are to undertake similar credit appraisal as for fund based facilities.
3. Credit information relating to such facility shall be mandatorily be furnished to the Credit Information Companies.

### **PART–B**

#### **Question 5**

- (a) *Explain the relevant SEBI Regulation regarding prior intimations to Stock Exchanges, which are required for Board Meetings, where certain proposals, e.g. financial results and fund raising, are to be considered.*
- (b) *Explain briefly the Professional Securities Market and the provisions relating to listing of Depository Receipts thereon.*



- (c) *“If going public is a complex process, being public is all the more complex as it assumes tremendous responsibilities on the managements and promoters of the company once listed” — Comment on the statement and the responsibilities it imposes on the management in terms of procedures and compliances.*
- (d) *Explain the benefits to a company from listing its security on an international stock exchange. (5 marks each)*

**Answer 5(a)**

Provisions related to prior intimation of Board Meeting where any of the following proposals is to be considered are included in Regulation 29 of SEBI (LODR) Regulations, 2015 are:

- (i) At least 5 clear Days (excluding the date of the intimation and date of the meeting):
- (a) financial results viz. quarterly, half yearly, or annual, (Intimation with Date of Board Meeting).
- (ii) At least 2 clear Working Days excluding the date of the intimation and date of the meeting):
- (a) proposal for buyback of securities
  - (b) proposal for voluntary delisting
  - (c) fund raising by way of –
    - Further public offer
    - Rights Issue
    - American Depository Receipts
    - Global Depository Receipts
    - Foreign Currency Convertible Bonds
    - Qualified institutions placement
    - Debt issue
    - Preferential issue and
    - Determination of issue price.
  - (d) Any AGM or EGM or Postal Ballot proposed to be held for obtaining shareholder approval for further fund raising indicating type of issuance.
  - (e) Declaration/recommendation of dividend, issue of convertible securities including convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend.
  - (f) The proposal for declaration of bonus securities, if part of Agenda papers.
- (iii) At least 11 Working Days before:
- (a) Any alteration in the form or nature of any of its securities or in the rights or privileges of the holders thereof.

- (b) Any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

### **Answer 5(b)**

The Professional Securities Market is an innovative, specialised market designed to suit the specific needs of issuers. It facilitates the raising of capital through the issue of specialist debt securities or depository receipts (DRs) to professional investors.

Companies wishing to raise capital may do so without the additional cost of following a retail or equity regime. As a listed, exchange-regulated market, the Professional Securities Market enables issuers to enjoy the benefits of a flexible and pragmatic approach to regulatory requirements.

Issuers of debt or DRs are not required to report historical financial information to IFRS or an equivalent standard, either in listing documents or as a continuing obligation. Instead, issuers can use their domestic accounting standards.

### **Listing of Depository Receipts on the Professional Security Market**

DRs are typically held in US dollars and issued by a depository bank. Several forms of DRs can be listed and traded in London, including Global Depository Receipts (GDRs) and American Depository Receipts (ADRs).

Admitting DRs to the PSM involves a two-step, simultaneous process. A company submits its 'Listing Particulars' to the UKLA, while also applying to the Exchange for admission of its DRs to trading on the PSM.

*Trading platform* : All DRs admitted to the PSM are traded on the International Order Book (IOB), the world's leading electronic order book for DRs.

### **Answer 5(c)**

If going public is a complex process, being public is all the more complex as it assumes tremendous responsibilities on the managements and promoters of the Company once listed. The reason being, that the new set of shareholders would have acquired the ownership in the Company and the management has more responsibility towards outside shareholders as well as Regulators. Further, being publicly listed ownership of shareholding can change any time without the knowledge of the promoters & Company. In fact once the Companies are listed, responsibility of the management towards the shareholders enhance manifold and managements shall continue to strive for maintaining good governance standards, implementing ethical business practices and continue to comply with applicable Regulations in a sustained manner.

Some of the important functions in the organization after listing can be enumerated as follows :

- **Board Procedure**

On listing, Companies will have additional responsibility of complying with various disclosure and other requirements as specified by SEBI (Listing Obligations and Disclosure Requirements), 2015 besides those required under Companies Act, 2013. The stock exchanges will have a standard list of compliances to be

followed by listed Companies at predetermined schedules. Notice of every proposed Board meeting which is likely to consider any decision which is considered as “price sensitive”, must be given in advance as prescribed. The outcome of the Board Meeting must be intimated to the stock exchanges within 30 minutes of conclusion of the Board Meeting. Every listed Company must have a qualified Company Secretary holding a certificate from ICSI who besides being Key Managerial Personnel as defined under Companies Act is also a designated ‘Compliance Officer’. The Board process should be such streamlined that the calendar of proposed dates of Board Meeting in the financial year is required to be prepared in advance and intimated. Provisions related to Corporate Governance becomes applicable to the listed company which includes the requirement of having independent directors and women directors. The exchanges have developed robust disclosure systems wherein even the time of dissemination of information is mentioned on the stock exchanges.

- **Compliance Requirements**

The listed Companies are required to comply with continuous listing norms and have to adhere to periodic disclosures to the stock exchanges. The listed Companies basically will have to comply (besides provisions of Companies Act 2013) with applicable requirements of : – SEBI (Listing Obligation & Disclosure Requirements) Regulations 2015 (Listing Regulations) – SEBI (SAST) Regulations 2011 (Takeover Regulations) – SEBI (Prohibition of Insider Trading) Regulations 2015 (Insider Trading Regulations) The stock exchanges have standard ‘Compliance Calendar’ to be followed by the Company Secretaries/ Management of the listed Companies

### **Answer 5(d)**

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

1. **Increased Market Liquidity**

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

2. **Market Segmentation**

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

Their access to these stocks may otherwise be restricted due to international investment barrier.

**3. Capital needs and growth opportunities**

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

**4. Wider shareholder base**

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

**5. Better Investor Protection**

Companies need to comply with the provisions of all the regulatory aspects of the listing of those countries, where sought to be listed. Investors will therefore find themselves more protected and comfortable to invest in these companies.

**6. Secure Clearing**

A stock exchange provides a reliable and secure clearing mechanism. Listing on a foreign stock exchange is possible only after creating robust and advance clearing system.

**7. Other benefits**

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

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

**Question 6**

- (a) Explain the manner in which a listed entity, before issuing securities, shall obtain an 'in-principle' approval from recognised stock exchange(s).
- (b) Explain the Regulatory Framework for an IPO and Scope of Due Diligence.
- (c) Explain the requirements and process for listing of Shares/GDRs on the Euro MTF.
- (d) For listing and trading on SME-Initial Public Offer (IPO), what are the documents to be submitted BEFORE T+4 days ? (5 marks each)

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

**Question 6A**

- (i) Bring out the differences between Bourse de Luxembourg (BdL market) and Euro MTF Market.
- (ii) Give the list of documents and information required to be submitted to holders of Non-Convertible Preference Shares.
- (iii) ABC is a company intending to issue Preferential Shares to Rakesh Bansal. List out the Pre-Issue Formalities for this Preferential Issue.
- (iv) Explain the role of "Nomads". (5 marks each)

**Answer 6(a)**

As per Regulation 28 of the Listing Obligation and Disclosure Requirements, 2015 issued by Securities and Exchange Board of India, the listed entity, before issuing securities, shall obtain an 'in-principle' approval from recognised stock exchange(s) in the following manner:

- Where the securities are listed only on recognized stock Exchange having nationwide trading terminals from all such stock exchanges.
- Where the securities are not listed on any recognised stock exchange having nationwide trading terminals, from all the stock exchange(s) in which the securities of the issuer are proposed to be listed.
- Where the securities are listed on recognised stock exchange(s) having nationwide trading terminals as well as on the recognised stock exchange(s) not having nationwide trading terminals, from all recognised stock exchange(s) having nationwide trading terminals.
- The requirement of obtaining in-principle approval from recognised stock exchange(s), shall not be applicable for securities issued pursuant to the scheme of arrangement for which the listed entity has already obtained No-Objection Letter from recognised stock exchange(s) in accordance with regulation 37 of the Listing Obligation and Disclosure Requirements, 2015 issued by Securities and Exchange Board of India.

**Answer 6(b)**

- The Regulatory framework governing an IPO are :
  - o Companies Act, 2013 and Rules made there under
  - o SCRA, 1956
  - o SCRR, 1957 specially Rule 19(2)(b) which deals with minimum number of shares to be offered to the public in an IPO.
  - o SEBI(Issue of capital and Disclosure Requirements) Regulations, 2018
  - o Circulars issued by SEBI from time to time governing IPO process such as timeframe within which an IPO should be completed, modes of making payments in an IPO, roles and responsibilities of various intermediaries involved in an IPO etc.
- The SEBI Regulations requires a Merchant Banker, amongst other things, to exercise due diligence, ensure proper care and exercise independent professional judgment. Further, it requires Merchant Banker to ensure that adequate disclosures are made to potential investors in a timely manner in accordance with the applicable regulations and guidelines so as to enable them to make a balanced and informed investment decision. The SEBI Regulations requires Merchant Banker to maintain records and documents pertaining to due diligence exercised in pre-issue and post-issue matters. The ICDR Regulations require that Offer Documents should contain all material disclosures, which are true and adequate to enable prospective investors to take an informed decision.

Furthermore, the SEBI ICDR Regulations, 2018 require due diligence certificate to be issued by the Merchant Banker.

- Whilst the regulatory framework does not specifically define what constitutes due diligence, as a matter of practice, the objective of due diligence is to collect information about the issuer company that helps the Merchant Banker draft as well as assess disclosures that are made in the Offer Document. It is pertinent to understand that while the Merchant Banker continues to be responsible for due diligence, external expert assistance is necessary. Whilst under the applicable Code of Conduct, the Merchant Bankers are required to demonstrate that all reasonable steps were taken to exercise due diligence and ensure adequate disclosures were made to potential investors, they should have the flexibility regarding the manner in which the due diligence exercise is conducted as they may not possess the expertise with respect to certain aspects of due diligence, such as technical, legal and accounting matters.
- In terms of the ICDR Regulations, the Merchant Bankers are required to submit due diligence certificate to SEBI and the formats for such certificate have been provided in the ICDR Regulations. An examination of the format of the due diligence certificate provides clarity of expectations from the Merchant Bankers, to a certain extent, and can act as guiding principles for the diligence to be exercised.

#### **Answer 6(c)**

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

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

File a prospectus: To begin the listing process, the following documents to be sent to LuxSE:

  1. A copy of your prospectus;
  2. Application form
  3. Undertaking letter
  4. Articles of association

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

#### Answer 6(d)

In case of listing and trading on SME-Initial Public Offer (IPO) following documents are required to be submitted before T+4 days (i.e. within 4 working days from the closure of the issue):

1. Copy of Prospectus (also in soft copy CD).
2. Copy of the ROC filing acknowledgement for filing of Prospectus.
3. Certified true copy of the additional material contracts and documents (mentioned in the final offer document/Prospectus) which have not been submitted earlier with the Exchange. (Soft copy for all the material contracts and documents)
4. Certified true copy of Table showing region- wise collection of application money.
5. Certificate from the bankers to the issue regarding the collection of application money.
6. Certified true copy of the basis of allotment approved by the Designated Stock Exchange.
7. Copy of the letter from Registrar addressed to Merchant bankers regarding the details they have verified with the depositories (NSDL/ CDSL).

**Answer 6A(i)**

<b>BdL market</b> <b>EU-regulated market</b>	<b>Euro MTF market</b> <b>Exchange-regulated market</b>
<p>The CSSF, Luxembourg's supervisory authority, is in charge of prospectus approval.</p> <p>Eligible for a European passport.</p> <p>Entry for issuers is subject to the Prospectus and Transparency Obligation Directives.</p> <p>Issuers subject to International Financial Reporting Standards (IFRS), or an equivalent, for non-EU issuers</p>	<p>The Luxembourg Stock Exchange is in charge of prospectus approval.</p> <p>No European passport provided.</p> <p>Outside the scope of the Prospectus and Transparency Obligation Directives .</p> <p>Financial reporting is in line with IFRS However, other accounting standards, such as Generally Accepted Accounting Principles (GAAP), are accepted.</p>

**Answer 6A(ii)**

As per Regulation 58 of the Listing Obligations and Disclosure Requirements, Regulations, 2015 issued by SEBI following are the list of documents and informations required to be submitted to holders of Non-Convertible Preference Shares:

- (a) Soft copies of full annual reports to all the holders of Non-Convertible Preference Shares who have registered their email address(es) for the purpose;
- (b) Hard copy of statement containing the salient features of all the documents, as specified in Section 136 of Companies Act, 2013 and rules made there under to those holders of Non-Convertible Preference Shares who have not so registered;
- (c) Hard copies of full annual reports to those holders of Non Convertible Debt Securities and Non-Convertible Preference Shares, who request for the same.
- (d) Half yearly communication, to holders of Non Convertible Debt Securities and Non-Convertible Preference Shares.
  - To send the notice of all meetings of holders of Non Convertible Debt Securities and Non-Convertible Preference Shares specifically stating that the provisions for appointment of proxy as mentioned in Section 105 of the Companies Act, 2013, shall be applicable for such meeting.
  - To send proxy forms to holders of Non Convertible Debt Securities and Non-Convertible Preference Shares which shall be worded in such a manner that holders of these securities may vote either for or against each resolution.

**Answer 6A(iii)**

Following are the Pre-Issue formalities for the Preferential Issue:

1. Certified copy of the resolution passed by the Board of Directors of the company for the proposed preferential issue



- 2 Printed copy of notice of AGM/EGM
3. Where allotment is:
  - (I) for consideration other than cash:
    - (a) Certified copy of valuation report
    - (b) Certified copy of Shareholders Agreements.
    - (c) Certified copy of approval letters from FIPB and RBI if applicable.
  - (II) pursuant to CDR Scheme/ Order of High Court/ BIFR:
    - (a) Certified copy of relevant scheme/ order
  - (III) pursuant to conversion of loan of financial institutions:
    - (a) Certified copy of the Loan Agreement executed by the company.
4. Brief particulars of the proposed preferential issue.
5. In case if the prior holding of the allottee is under pledge with banks/ financial institution(s), company needs to provide an undertaking/ confirmations from the banks/ financial institutions, company and allottee(s).
6. Confirmation by the Managing Director/ Company Secretary.
7. Certificate from Statutory Auditors/ Practicing Chartered Accountant/ Practicing Company Secretary.
8. Pricing certificate by Statutory Auditor/ Practicing Chartered Accountant/ Practicing Company Secretary.  
  
In case the securities of the company are infrequently traded pricing certificate as prescribed under the SEBI (CDR) Regulation, 2018.
9. Non-refundable processing fees.

#### **Answer 6A(iv)**

The Nominated Adviser (Nomads) are corporate finance advisers approved by the London Stock Exchange to act in this capacity. To obtain approval as Nomad, a firm must meet the eligibility criteria set out in the AIM Rules for Nominated Advisers.

A Nomad is responsible for advising and guiding a company on its responsibilities in relation to its admission to AIM as well as its continuing obligations once on market. To help fulfil this role, the Nomad will:

- undertake extensive due diligence to ensure a company is suitable for AIM.
- provide guidance throughout the flotation process.
- prepare the company for being on a public market.
- help prepare the AIM admission document.
- confirm appropriateness of the company to the Exchange.
- act as the primary regulator throughout a company's time on AIM.

## MULTIDISCIPLINARY CASE STUDIES

Time allowed : 3 hours

Maximum marks : 100

**NOTE :** Answer ALL Questions.

### Question 1

**NOTE :** Answer ALL Questions.

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

*The automobile industry in India is world's fourth largest, with the country currently being the world's 4th largest manufacturer of cars and 7th largest manufacturer of commercial vehicles in 2018. Indian automotive industry (including component manufacturing) is expected to reach ₹16.16 - 18.18 trillion (US\$ 251.4-282.8 billion) by 2026. Two-wheelers dominate the industry and made up 81% share in the domestic automobile sales in Financial Year 2018-19. Overall, Domestic automobiles sales increased at 6.71 per cent CAGR during Financial Years between April 2012 and March 2018 with 26.27 million vehicles being sold in Financial Year 2018-19. Indian automobile industry has received Foreign Direct Investment (FDI) worth US\$, 21.38 billion between April 2000 and March 2019.*

*Domestic automobile production increased at 6.96 per cent CAGR during the Financial Years between April 2012 and March 2019 with 30.92 million vehicles manufactured in the country in Financial Year 2018-19. In Financial Year 2018-19, commercial vehicles recorded the fastest pace of growth in domestic sales at 17.55% year-on-year, followed by three-wheelers at 10.27 per cent year-on-year. The passenger vehicle sales in India crossed the 3.37 million units in Financial Year 2018-19 and is further expected to increase 10 million units by Financial Year 2019-20.*

*The government aims to develop India as a global manufacturing as well as a research and development (R&D) hub. It has set up National Automotive Testing and R&D Infrastructure Project (NATRIP) Centre as well as a National Automotive Board to act as facilitator between the government and the industry. Under (NATRIP), five testing and research Centre have been established in the country since 2015.*

*The Indian government has also set up an ambitious target of having only electric vehicles being sold in the country. Indian auto industry is expected to see 8-12% increase in its hiring during Financial Year 2019-20. The Ministry of Heavy Industries, Government of India has shortlisted 11 cities in the country for introduction of electric vehicles (EVs) in their public transport systems under the FAME (Faster Adoption and Manufacturing of (Hybrid) and Electric Vehicles in India) scheme. The first phase of the scheme has been extended to March 2019 while in February 2019, the Government of India approved the FAMEII scheme with a fund requirement of ₹10,000 crore (US\$ 1.39 billion) for Financial Years 2020-22. Number of vehicles supported under FAME scheme has increased to 192,451 units in March 2018 from 5,197 units in June 2015.*

*Automotive industry globally is at the cusp of a major transformation. Growing concerns for environment and energy security clubbed with rapid advancements in technologies*

*for power train electrification, increasing digitalization, evolution of future technologies and innovative newer business models and ever-increasing consumer expectations are transforming the automotive business. One of the key facets of such a change is the rapid development in the field of electric mobility which might transform the automotive industry like never before. With an ambition to be among the top 3 in automobile manufacturing by 2026 (as per the Automotive Mission Plan 2016-2026), Indian auto industry needs to consider an innovative and pragmatic approach to ride this transformative wave.*

*Today, with continued efforts of more than a decade, many major economies such as US, China, Netherlands, Norway etc. have promoted electrification of vehicles through various fiscal and non-fiscal incentives and have now gathered momentum in terms of demand, charging infrastructure and manufacturing eco-system. Such countries are perhaps more ready with pure electric vehicles to achieve their regulatory and strategic targets.*

*India has started late on the electrification path and needs a strong policy to catch-up and move rapidly towards the stated goal of total pure electric technology regime. Pure electric vehicle penetration currently remains quite low in India due to several reasons including significant affordability gap and low level of consumers' acceptance (i.e. lack of demand), low level of electric vehicle manufacturing activities (i.e. lack of supply), lack of comparable products (especially in the 2W category), non-existent public charging infrastructure etc.*

*Taking cognizance of the advancements in the electric vehicle technology, markets development globally and a dire need to reduce energy demand and de-carbonization of the auto sector in India NITI Aayog's transformative mobility report of 2017 has set out a desirable and ambitious roadmap for pure electric vehicles, wherein, it is said that if India adopts a transformative solution of shared-connected electric mobility, 100% public transport vehicles and 40% of private vehicles can become all electric by 2030. This vision needs to be expanded to have a future of all electric vehicles.*

*To make sure that this vision is realized, the industry, government and various stakeholders will need to collaborate and invest. Most importantly, the long-term plan for the country for such an endeavor will have to be implemented with full conviction, hundred percent commitment and total perseverance. As the electric vehicle technology is evolving rapidly, it could be possible that transition to hundred percent electric vehicle regime might evolve earlier than envisaged in the stated vision. Therefore, the policy will need to be necessarily adaptive while at the same time must not bring sudden changes so as to allow outcomes in a planned manner and to ensure that the necessary transformation takes place with the minimum of disruption which may have socio-economic impact in terms of industrial growth, employment and livelihood of people in the auto-industry.*

*Auto-industry will invest with a proper business case even with a certain degree of risk around market readiness of electric vehicles. In not so distant future, such investments are likely to turnaround the electric vehicle scenario in an opportunity. Such investments will run into thousands of crores for the auto-industry towards creating a sustainable market place and a robust manufacturing eco-system for*

*electric vehicles. Already, many automobile manufacturers and auto-component manufacturers in India have launched or announced their plans to develop electric vehicles and related components. Businesses, including the public sector companies, will be looking at setting-up the entire supply chain including cell manufacturing in the country.*

*It is important to understand the consumers' outlook and concerns as to why growth of market for electric vehicles has been sluggish. The single major factor for slow penetration of EVs is their high price which is around 2 to 2.5 times more than a comparable conventional vehicle. The other important concern of EVs is their range per charge. To offer a higher range, higher battery capacity in the vehicle is needed which lead to increase in the EV price proportionately and increases the price gap. At the same time, however, EV offer a significant advantage on operating cost (running plus maintenance cost) which could be as low as 1/4th of that of a conventional vehicle. As compared to a personal vehicle, commercial vehicles like taxi fleets, bus fleets, 3-wheelers run 4 to 5 times longer distance per day. Therefore, for such higher mileage vehicles savings on operating cost will pay-back the initial high purchase price faster than low mileage vehicles. Attractive power tariff can play a significant role to offset capital cost of buying EV with lower operating cost at faster pace. Most of the personal vehicle buyers consider upfront purchase price, fuel efficiency, maintenance and service cost, comfort features as the key buying criteria. However, commercial vehicle buyers consider capital expenditure (CAPEX) plus operational expenditure (OPEX) cost economics as the most important buying criteria.*

*It may be noted that automobiles have product development gestation of minimum of 3 years and product manufacturing life-cycle of around 8 to 10 years. Therefore, it is important to understand the level of effectiveness of each policy measure and acceptability of the policy measures from a long-term implementation perspective.*

*In this respect, a mix of policy measures which are equitable, implementable and can be sustained on a long-term basis with minimum fiscal burden and maximum impact and outreach. It may be noted that various policy measures have different level of impact on the market and their criticality. The policy measures which result in acceptance of electric vehicle technology are the most critical.*

*Questions :*

- (a) Explain in detail the components of SWOT analysis and also discuss in brief the SWOT analysis of present Automobile Industry ?*
- (b) "In a country like India, electric vehicles are need of the hour". Outline the opportunities for electric vehicles in India.*
- (c) What should be the policy measures and recommendations to provide impetus to the Electric Vehicle industry that would counter the impending threats.*
- (d) As a Company Secretary, what would be your suggestions for the Government for increasing the usage of Electric Vehicle in the Country through regulatory initiatives. (10 marks each)*

**Answers 1(a)**

A SWOT analysis is of immense assistance for brainstorming, strategic planning and decision making. It is a very important tool for starting of new projects, ensuring their proper progress by monitoring their stages of development and implementing changes in the project, whenever required. This tool allows multidimensional analysis of the current subject's conditions of a business organization as well as internal and external factors to maximize the benefits, minimize negative consequences of certain actions and the most importantly to ascertain whether the objective is attainable or not. It is an effective strategic development procedure that links internal organizational strengths and weaknesses with external opportunities and threats. The following are the components of SWOT analysis:

**Building on Strengths**

SWOT analysis involves identifying the strengths of a company in comparison to its competitors. Strengths come from the knowledge, abilities, and resources available to the firm that gives it a competitive advantage in the industry. Some of the major strengths are an excellent sales staff with strong knowledge of products, robust customer relationship, innovation, etc.

Major strengths, in the present case of Automobile Industry, are as under:

- Growth in sales of commercial vehicles, three wheelers and passenger vehicles.
- Size of the market and forecasted growth.
- Foreign Direct Investment in Indian Automobile Industry since April, 2000.
- Infrastructure set-up by Government i.e. National Automotive Testing and R&D Infrastructure Project (NATRIP) Centre as well as National Automotive Board.
- Sanctioning of huge corpus of funds for quick implementation of Faster Adoption and Manufacturing of (Hybrid) and Electric Vehicles in India (FAME India) scheme.

**Minimizing Weaknesses**

Weaknesses are any limitation or deficiency in the firm's resources and competencies that could hinder its performance. A business needs to identify the vulnerabilities within its organization that competitors could exploit. Common reasons of a Company's weakness include ineffective management, paucity of resources and assets, inefficient processes, etc.

Major weaknesses, in the present case of Automobile Industry, are:

- High Price of Electric Vehicles as compared to conventional vehicles.
- Non-existence of Public Charging Infrastructure.
- Significant affordability gap and low level of consumers' acceptance.
- Low supply of electric vehicles.
- Lack of comparable products.

### **Seizing Opportunities**

A business is required to determine potential opportunities to be pursued in the industry. There may be plentiful opportunities in an industry that may call for pondering over opportunities by the management of a company while evaluating their effectiveness. Potential opportunities can result from identifying an overlooked market segment, changing industry regulations, advancements in technology, improvement in buyer supplier relation, etc. Moreover, a business can exploit the weakness of its competitors by targeting their frail position to gain market share.

Major opportunities, in the present case of Automobile Industry, are:

- Government targets for 100% public transport vehicles and 40% of private vehicles by 2030, indicate that near future is full of opportunities in Electric Vehicle (EV) sector. Government is announcing several benefits and subsidies to increase usage of EVs.
- Setting-up of entire supply chain including cell manufacturing in the country.
- Commercial vehicles like taxi fleets, bus fleets, 3-wheelers run 4 to 5 times longer distance per day which would lead to increase in demand for commercial vehicles and also, the less cost burden on the passenger/goods will trigger the demand for commercial vehicles.

### **Counteracting Threats**

Any situation that puts a company in an unfavorable position or impedes its efficient operations can be classified as a threat. To adequately identify these situations, the organization needs to evaluate the macro-environment and assess the industry's social, economic, political, technological, natural and international segments. For instance, changes in customer preferences or advancements in technology can render a product or service obsolete. Additionally, economic and regulatory changes or the exhaustion of natural resources can make production infeasible. Global competitors are entering into the Company's market which tends to increase competition in domestic market.

Major threats, in the present case of Automobile Industry, are:

- Government Policy to bring sudden change may have socio-economic impact in terms of industrial growth, employment and livelihood of people in the auto industry.
- Many major economies like US, China, Netherlands, Norway, etc. whose EV products are well developed with a decade of continuous efforts may enter in the Indian market.
- Low level of consumer acceptance of electric vehicles may impact the sales growth of this industry. If government makes it mandatory to purchase EV then scrapping of huge quantity of conventional vehicle will pose a challenge.
- Slow diffusion of technology leading to lack of capacity utilization.

### **Answers 1(b)**

Opportunities for electric vehicles in India are as under:

1. Government targets for 100% public transport vehicles and 40% of private vehicles by 2030 thereby giving an indication that near future is full of opportunities in EV sector.

2. Rapid urbanization has increased the demand for energy and transport infrastructure.
3. India's commitment to address the issue of climate change necessitates the adoption of alternative fuels for environmental sustainability.
4. The shift towards renewable energy sources has led to cost reduction from better electricity generating technologies, thereby creating the possibility of clean, low-carbon and inexpensive grids.
5. Setting-up of entire supply chain including cell manufacturing in the country provides another set of opportunities. Advances in battery technology have led to higher energy densities, faster charging and reduced battery degradation from charging. Combined with the development of motors with higher rating and reliability, these improvements in battery chemistry have reduced costs and improved the performance and efficiency of electric vehicles.
6. EVs with their fully developed ecosystem of charging and maintenance are key to the concept of smart cities in India.
7. High expenses on oil import in the changing geopolitical conditions require India to ensure its energy security by moving towards alternative energy sources.
8. The existing mode of transport for last mile connectivity like auto-rickshaw and feeder buses suffers from capacity constraint. These vehicles need better management and should be considered as the first area of transformation to e-vehicles.
9. Commercial vehicles like taxi fleets, bus fleets, 3-wheelers run 4 to 5 times longer distance per day which leads to increase in commercial vehicles on road and also, the less cost burden on the passenger/goods as well.
10. To create awareness among the general public about the key benefits of electric vehicle provides a big opportunity for media and advertising agencies.
11. Automobile sector giants which have expertise can support the government initiatives and get the benefit of Government schemes like FAME, NATRIP, etc.

### **Answers 1(c)**

It is very much critical to bridge the gaps for each vehicle segment as well as for different types of users. Therefore, a multi-pronged, segment and customer specific policy is needed. The policy should collectively aim at improving affordability and acceptance of electric vehicles by the following approaches mentioned below:

#### **Bridging the viability gap**

Demand incentives or cash subsidies can at best be a short-term measure to kick-start the process. However, tax rebates and other fiscal & non-fiscal measures can be sustained over a longer term and will have a greater impact and outreach. For next few years, there will be a need for all such measures to collectively bridge the gap and make EVs a preferred choice for the consumers.

#### **Creating infrastructure to charge electric vehicles**

Proper and suitable charging infrastructure will need to be in place. Based on use,

location and density of electric vehicles, a combination of slow and fast chargers will be required.

Charging infrastructure requires substantial installation, operation and maintenance costs and can also incur significant costs for land procurement (in India land is a premium). Demand aggregation of home and workplace chargers (AC charging) can act as a lever to reduce prices as well as to have such charges installed at a mass level. Energy Efficiency Services Limited (EESL) and other such government agencies can run a program for procurement of AC chargers in bulk and offer at affordable prices to individual users, RWAs and Corporate.

### **Encourage domestic manufacturing - Make in India**

A world class manufacturing base with a competitive strength in terms of scale, quality, cost and technology for electric vehicles and their critical components will be a must to achieve the stated goal of hundred percent electric regime. Production of Battery at lower cost and higher efficiency will make EVs cheaper as Battery constitutes one third of the cost of EVs. Without Indigenous battery production, India will be constrained to bring about EV revolution.

### **Public awareness**

Studies have suggested that awareness of electric vehicles is low which included familiarity with technology, lack of knowledge related to government's schemes, lack of awareness of economic benefits, etc. For the technology to be known and its impression to get formed, a multi-dimensional approach is needed to create the awareness.

### **Answers 1(d)**

Suggestions to the government for increasing the usage of Electric Vehicles in the country through regulatory initiatives:

- Through support and regulations, launch home, multi-units dwelling and work place charging schemes/policies. Demand aggregation of home and workplace chargers (AC charging) can be a great lever to reduce prices as well as to have such chargers installed on a mass scale.
- For corporates/employers, accelerated depreciation on such infrastructure can be provided as a tax relief measure. Individual users can be provided income tax relief to the extent of the cost incurred on procuring charging equipments.
- At workplaces, employers can be incentivized to allow employees to charge at subsidized rate. Creation of charging infrastructure may be considered as part of Corporate Social Responsibility (CSR) to encourage investments by corporates.
- Regulations should be passed that will mandate provision of AC slow charging points in parking areas of residential buildings, workplaces spaces, shopping malls, commercial complex, etc. Considering "Smart Cities" to have charging infrastructure as an integrated component of development.
- Electricity related Acts need to be amended to allow resale of electricity by third party for facilitating setting-up of charging infrastructure.
- Regulations need to be put in place to ensure availability of stable and good quality power for EV charging.



- Different segment of vehicles (2W, 3W, PVs, CVs) may require different type of charging standard (& connector), however, the charging infrastructure, at-least at public places, should be common to the extent possible to reduce the infrastructure cost.
- Energy companies (like IOCL, HPCL, IGL, NTPC, BHEL, GAIL, etc.) may invest in providing a charging network, specially the fast charging stations at inter-city routes like State and national highways. This could also be based on renewable electricity sources.

### Question 2

- (a) *ABC Limited is an unlisted public Company, is part of ABC group of Companies with its business ranging from paper to pharmaceutical manufacturing. The Company's Pharmaceutical manufacturing division was under scanner of US Foods and Drug Administration (USFDA) and there were pending investigations against the said unit.*

*As a part of its corporate restructuring, the Board of ABC Limited has decided to demerge its pharmaceutical manufacturing business to a new Company and merge another paper manufacturing Company with ABC Limited.*

*A Composite scheme of amalgamation was filed under section 230 of the Companies Act, 2013 read with the rules thereunder. The National Company Law Tribunal (NCLT) rejected the Company's application on the ground that investigations are pending against the demerged unit.*

*Is the ground for rejection by NCLT justified ?*

- (b) *An appeal was filed by X, a minority shareholder against M/s XYZ & Sons Limited alleging oppression and mismanagement by majority shareholders. As per the shareholding pattern, X and another shareholder held less than 10% and the rest by shareholders who individually held more than 10%. The National Company Law Tribunal passed an Order, granting waiver in favour of X under proviso to Section 244(1) of the Companies Act, 2013 for the petition alleging oppression and mismanagement in the Company. An appeal was preferred against the said Order by M/s XYZ & Sons Limited.*

*Evaluate the validity of the appeal in the background of decided case law, if any. (6 marks each)*

### Answer 2(a)

#### **The ground of rejection by NCLT is not justified.**

The present case is similar to the Case of *Mel Windmills Pvt. Ltd. v. Mineral Enterprises Limited & Anr* [NCLAT] Company Appeal (AT) No. 04 of 2019 [Decided on 27/05/2019] wherein the NCLT Bengaluru Bench declined to sanction the scheme of demerger on the ground that several issues were pending finalization and certain investigations were pending in relation to the business of the demerged company.

#### **Reference Section: Section 230 of the Companies Act, 2013**

Section 230(1) states that the Tribunal may, on the application of the company, order a meeting of the creditors or class of creditors, or of the members or class of

members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

As per Section 230 (2), the company or any other person, by whom an application is made under section 230(1), shall disclose to the Tribunal by affidavit all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company.

Thus, the Tribunal should have first ordered a meeting of creditors /members and if consent has been accorded in such meeting of creditors/members, then it can go into the merits of proposed scheme of demerger.

### **Answer 2(b)**

The validity of the appeal can be seen with the decision of Appellate Tribunal in *Cyrus Investment Pvt. Ltd. & Anr. Versus Tata Sons Ltd. & Ors., 2017 SCC OnLine NCLAT 261*. In the said case the Appellate Tribunal held that while considering the application for waiver under Proviso to Sub-section (1) of Section 244 of the Companies Act, 2013, the Tribunal may look into the proposed petition under Section 241 and 242 but cannot take into consideration the merit of the said petition to decide the application for waiver. It is only in application where cases of exceptional circumstances is made out by one of the member having less than 10% of shareholding, the Tribunal may allow petition for waiver.

Normally, the following factors are required to be noticed by the Tribunal before forming its opinion as to whether the application merits 'waiver' of all or one or other requirement as specified in clauses (a) and (b) of sub-section (1) of Section 244:

- (i) Whether the applicants are member(s) of the company in question? If the answer is in negative i.e. the applicant(s) are not member(s), the application is to be rejected outright, otherwise the Tribunal will look into the next factor.
- (ii) Whether (proposed) application under Section 241 pertains to 'oppression and mismanagement'? If the Tribunal on perusal of proposed application under Section 241 forms opinion that the application does not relate to 'oppression and mismanagement' of the company or its members and/or is frivolous, it will reject the application for 'waiver'. Otherwise, the Tribunal will proceed to notice the other factors.
- (iii) Whether similar allegation of 'oppression and mismanagement', was earlier made by any other member and stand decided and concluded?
- (iv) Whether there is an exceptional circumstance made out to grant 'waiver', so as to enable members to file application under Section 241, etc.

Accordingly, if the X is able to make out some exceptional case for waiver of requirements of the minimum shareholding, the company may not be able to sustain the appeal before NCLAT.

### **Question 3**

- (a) *N was a senior official of Xeta Limited, a listed Company. He was convicted for involvement in insider trading and manipulation of share price of the Company.*

*The adjudicating officer levied penalty as provided in the Securities and Exchange Board of India Act, 1992, for which the recovery officer issued a certificate of recovery including interest on penalty. N filed an appeal before the Securities Appellate Tribunal challenging that the interest cannot be levied by the recovery officer.*

*Is N's argument tenable ?*

- (b) *Zom entered into a buyer's agreement with EMANKI Land Developers Private Limited in the year 2015. As per the agreement the possession of flat was to be handed over in January 2018. The Company was deferring the handing over of flat for almost a year. In January 2019, Zom filed a consumer complaint before the NCDRC against the Company praying for delivery of possession of the flat, adjustment of excess payment and compensation for deficiency in service. As the agreement also provided for an arbitration clause providing for settlement of disputes between parties under the Arbitration and Conciliation Act, 1996, the Company filed an application under Section 8 of Act for referring the matter to arbitration.*

*Will the Company be successful in having an arbitration in respect of said matter?  
(6 marks each)*

### **Answer 3(a)**

The present case is similar to the case of *PVP Global Ventures Pvt Ltd. v. SEBI [SAT] Appeal No. 451 of 2018 [Decided on 12/04/2019]*. In this case the Securities Appellate Tribunal (SAT) observed that the object and intention of inserting Section 28A to the SEBI Act, 1992 was to provide a mechanism for recovery of the amount due to SEBI. Instead of prescribing an independent mechanism for collection and recovery of the amounts due to SEBI, the legislature deemed it fit to follow the mechanism provided under the Income Tax Act, 1961 and accordingly inserted Section 28A to SEBI Act wherein the provisions of the Income Tax Act, 1961 relating to collection and recovery have been incorporated. Thus, the legislature by inserting Section 28A to SEBI Act, 1992 has provided that if a person fails to pay the amounts referred in Section 28A, then the Recovery Officer shall draw up a statement/certificate and proceed to recover the amounts specified in the certificate by any one or more of the five modes specified therein.

This Tribunal in *Dushyant N. Dalal & Anr. v. SEBI* decided on March 10, 2017 (Appeal No. 41 of 2014) in which judgment was affirmed by the Supreme Court reported in 2017 SCC Online SC 1188, after considering the provision of Section 28A of SEBI Act, 1992 read with Section 220 of the Income Tax Act, 1961 held that the liability to pay interest under Section 28A read with Section 220 is automatic and arises by operation of law.

From the aforesaid, it becomes clear that interest was not only chargeable under Section 28A read with Section 220(2) of the Income Tax Act, 1961 but the provisions of the Interest Act, 1978 could also be taken into consideration and interest could be charged from the date on which the penalty became due.

In the light of the aforesaid, we are of the view that the Recovery Officer was justified in charging interest from the date of the order passed by the Adjudicating Officer.

In view of the aforesaid, we find no merit in these appeals and are dismissed. In the circumstances there shall be no order on costs.

Hence, N's argument is not tenable.

### **Answer 3(b)**

The present case is similar to the case of *Emaar MGF Land Limited v. Aftab Singh [SC] Review Petition (C) Nos. 2629-2630 of 2018 in Civil Appeal Nos.23512-23513 of 2017*. The Supreme Court in the series of judgments considering the provisions of Consumer Protection Act, 1986 as well as Arbitration and Conciliation Act, 1996 laid down that complaint under Consumer Protection Act being a special remedy, despite there being an arbitration agreement the proceedings before Consumer Forum have to go on and no error is committed by Consumer Forum on rejecting the application. There is reason for not interjecting proceedings under Consumer Protection Act on the strength an arbitration agreement by Arbitration and Conciliation Act, 1996. The remedy under Consumer Protection Act is a remedy provided to a consumer when there is a defect in any goods or services. The remedy under the Consumer Protection Act is confined to complaint by consumer as defined under the Act for defect or deficiencies caused by a service provider, the cheap and a quick remedy has been provided to the consumer which is the object and purpose of the Act.

The amendment in Section 8 of the Arbitration and Conciliation Act, 1996 cannot be given such expansive meaning and intent so as to inundate entire regime of special legislations where such disputes were held to be not arbitrable. Something which legislation never intended cannot be accepted as side wind to override the settled law. The submission of the petitioner that after the amendment the law as laid down by this Court in *National Seeds Corporation Limited* is no more a good law cannot be accepted. The words “notwithstanding any judgment, decree or order of the Supreme Court or any Court” were meant only to those precedents where it was laid down that the judicial authority while making reference under Section 8 shall entitle to look into various facets of the arbitration agreement, subject matter of the arbitration whether the claim is alive or dead and whether the arbitration agreement is null and void. The words added in Section 8 of the Arbitration and Conciliation Act, 1996 cannot be meant for any other meaning.

In the event a person entitled to seek an additional special remedy provided under the statutes does not opt for the additional/special remedy and he is a party to an arbitration agreement, there is no inhibition in disputes being proceeded in arbitration. It is only the case where specific/ special remedies are provided for and which are opted by an aggrieved person that judicial authority can refuse to relegate the parties to the arbitration. Hence, no error has been committed by the NCDRC.

Hence, it can be concluded that the consumer disputes are not arbitrable.

### **Question 4**

- (a) *Alkaline Private Limited is a chemical manufacturing company, which had availed many bank loans and other facilities to fund its operations. The company has not been able to repay the loan and interests thereon to the banks due to its dwindling sales and other cost/labor issues. Over a period, as the company was not repaying its loans, its account was classified as Non-Performing Asset (NPA) by the banks. Various negotiations with the banks did not materialize and*

*the banks-initiated proceedings under Insolvency and Bankruptcy Code, 2016 (IBC) against the company.*

*The Company is of the view that IBC does not have constitutional validity and accordingly, it appealed in court of law. Will the Company succeed ?*

- (b) *'Q Cars' was a radio taxi service provider, which was offering customer discounts and royalty programmes, etc., M group was a competitor who alleged that owing to its dominant position, 'Q Cars' group has devised certain abusive practices which inter alia include unreasonable discounts amounting to abysmally low/predatory pricing to consumers etc., to adversely affect and oust its competitor from the relevant market. It was also alleged that under its business arrangement, 'Q Cars' was giving whole trip amount received from the passengers to the respective taxi drivers along with additional incentives in order to get them attached exclusively with the 'Q Cars' network. It also alleged that 'Q Cars' enters into exclusive contracts with taxi owners in violation of provisions of Competition Act, 2002, whereby the taxi drivers are restrained from getting attached on to any other competing 'radio taxi operator' network.*

*Has 'Q Cars' contravened the provisions of the Competition Act, 2002 ?*

*(6 marks each)*

#### **Answer 4(a)**

The present case is similar to the case of the *Swiss Ribbons Pvt. Ltd. v. Union of India [SC] Writ Petition (Civil) No. 99 of 2018 [Decided on 25/01/2019]*. In *Swiss Ribbons Pvt. Ltd.* case the Supreme Court observed that 'the Insolvency and Bankruptcy Code, 2016 (the Code) is a legislation which deals with economic matters and, in the larger sense, deals with the economy of the country. Earlier experiments, as we have seen, in terms of legislations having failed, ultimately led to the enactment of the Code. The experiment contained in the Code, judged by the generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster. To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation. We have also seen that the working of the Code is being monitored by the Central Government through Expert Committees that have been set-up in this behalf. Amendments have been made in the short period in which the Code has operated, both to the Code itself as well as to subordinate legislation made under it. This process is an ongoing process which involves all stakeholders, including the petitioners.

In the working of the Code, the flow of financial resource to the commercial sector in India has increased exponentially as a result of financial debts being repaid. Approximately 3300 cases have been disposed of by the Adjudicating Authority based on out-of-court settlements between corporate debtors and creditors which themselves involved claims amounting to over INR 1,20,390 crores. Eighty cases have since been resolved by resolution plans being accepted. Of these eighty cases, the liquidation value of sixty-three such cases is INR 29,788.07 crores. However, the amount realized from the resolution process is in the region of INR 60,000 crores, which is over 202% of the liquidation value. This shows that the experiment conducted in enacting the Code is proving to be largely successful. The defaulter's paradise is lost. In its place, the economy's rightful position has been regained.'

Based on the above ruling of the Apex Court, it can be concluded in the given case that the constitutional validity of Insolvency and Bankruptcy Code, 2016 cannot be challenged.

Hence, the company will not succeed.

#### **Answer 4(b)**

The present case is similar to the case of *Meru Travel Solutions Pvt Ltd v. Uber India Systems Pvt. Ltd & Ors [CCI] Case No. 96 of 2015 [Decided on 10/02/2016]* wherein the Competition Commission of India held that the definition of relevant geographic market in the radio taxi services market has been dealt with by the Commission in many previous cases. The Commission was of the view that the relevant geographic market in that case would be “Delhi”.

The Commission held – “It has considered the TechSci research report and it is a matter of fact that Uber Group was not interviewed during the collection of data in the TechSci report. Evidently, there are glaring differences in the data and results depicted by the two research reports i.e. research report and TechSci report; casting a serious doubt on their authenticity and neutrality. The conflicting results indicate that either the data relied upon in the said reports is not accurate or the data has been selectively collected and relied upon to reach some predetermined results. Therefore, despite the Informant’s attempt to discredit the results of the research report, the Commission is apprehensive in drawing conclusions with regard to the market share of UBER on the basis of such contradictory research reports. Hence, despite the deficiencies observed above, a conclusion may be drawn from a combined reading of both these research reports that there exists stiff competition, at least between OLA and UBER, with regard to the radio taxi industry in Delhi. Further, both the research reports have acknowledged the presence of other major players in the market, apart from UBER and OLA.

Further, the fluctuating market share figures of the various players show that the competitive landscape in the relevant market is quite vibrant and dynamic. Based on the foregoing discussion, the Commission is of the view that the radio taxi services market in Delhi is competitive in nature and UBER does not appear to be holding a dominant position in the relevant market. Since Uber group does not seem to be dominant in the relevant market, there is no need to go into the examination of its conduct in such relevant market.

Based on the aforesaid, the Commission is of the view that no case of contravention is made out against Uber Group.”

Applying the conclusion of the above case, it can be concluded that 'Q Cars' has not contravened the provisions of Competition Act, 2002.

#### **Question 5**

- (a) *The Statutory Auditor of your Company allegedly got transferred 1000 shares of the Company in his name. However, the matter was ultimately resolved and settled between Auditor and the complainant, despite which Disciplinary Committee of Institute of Chartered Accountants of India (ICAI) took up the case and ultimately found that the conduct of Statutory Auditor was derogatory in nature and highly unbecoming and held him guilty of ‘Other misconduct’ under Section 22 read with Section 21 of the Chartered Accountants Act, 1949.*

*The Council of ICAI removed the Auditor from the rolls for a period of six months. The Auditor appealed against the same. Will he succeed ?*

- (b) *A Kerala based company had a cement unit in Salem in the State of Tamil Nadu. Unit became Sick and the Company was not in position to pay wages to its labours. The workers approached Labour Court. Labour Court passed an award in favour of workers. In the meantime, a lender in Kerala attached Company's properties and sold in public auction. Workers filed writ before Kerala High Court seeking deposit of 50% of their dues by the lender. Single Judge overruled the jurisdiction issue in favour of workers. Lenders preferred an appeal before Division Bench and the same was allowed by the Bench.*

*Aggrieved by the decision, workers appealed before Supreme Court. Will they succeed ?* (6 marks each)

#### **Answer 5(a)**

The present problem is similar to the case of *Council of the Institute of Chartered Accountant [SC] Civil Appeal No. 11034 of 2018 (Arising out of SLP (C) No. 19564/2017)*.

In the case cited above, the Disciplinary Committee has found the Chartered Accountant guilty of practice (similar to the facts in the question) which was not in his professional capacity.

The Council of the Institute of Chartered Accountants of India [ICAI], made its recommendation to the High Court to remove the aforesaid Chartered Accountant for a period of six months from the rolls.

The Council of ICAI was entitled to do so under Schedule I Part-IV sub-clause (2) of Chartered Accountant Act, 1949 if, in the opinion of the Council, such act brings disrepute to the profession whether or not related to his professional work.

However, High Court declined to remove him from the rolls for six months.

Hon'ble Supreme Court held "in the case, it is clear that the impugned judgment is incorrect and must, therefore, be set aside. The matter be remanded to the High Court to be decided afresh leaving all contentions open to both parties."

Applying the rationale of the above decision, it can be decided that the Auditor will not succeed in his appeal.

#### **Answer 5(b)**

The present problem is similar to the case of *Cement Workers Mandal v. Global Cements Ltd. (HMP Cements Ltd) & Ors [SC] Civil Appeal No.5360 of 2010*.

The short question, which arises for consideration in this appeal, is whether the Division Bench was justified in holding that the Special Civil Appeal (SCA) filed by the appellant was not maintainable for want of territorial jurisdiction of the High Court.

The Supreme Court held that the Division Bench erred in not noticing Article 226(2) of the Constitution of India while deciding the question arising in this case. In other words, the question as to whether the High Court has territorial jurisdiction to entertain

the appellants petition (SCA) or not, should have been decided keeping in view the provisions of Article 226(2) of the Constitution read with Section 20 of the Code of Civil Procedure, 1908 (for short, “CPC”).

Article 226(2) of the Constitution further empowers a High Court to issue any order, directions or writ as provided in clause (1) of Article 226 of the Constitution in such writ petition notwithstanding that seat of such Government or the Authority or the residence of such person against whom the writ petition is filed does not fall within the territories of the “A” High Court but falls in the territories of the “B” High Court.

In the light of these three reasons, we are of the view that the part of the cause of action as contemplated in Article 226 (2) of the Constitution has arisen within the territorial jurisdiction of the High Court for filing the petition (SCA) to claim appropriate reliefs in relation to such dispute against respondent No.1 Company.

In our considered opinion, the expression “the cause of action, wholly or in part, arises” occurring in Article 226(2) of the Constitution has to be read in the context of Section 20(c) of CPC which deals with filing of the suit within the local limits of the jurisdiction of the Civil Courts.

In the light of the foregoing discussion, we are of the view that the appellants petition (SCA) was maintainable in the High Court in as much as the part of the cause of action to file such petition did accrue to the appellant herein (petitioner) within the territorial jurisdiction of the Gujarat High Court. In these circumstances, the SCA was required to be decided on merits by the Gujarat High Court.

In view of the foregoing, the appeal will succeed in the given case.

#### **Question 6**

*AB & CD Limited, a Non-Banking Finance Company (NBFC), was a diversified Company having a complex group structure with more than 20 subsidiaries. Each company had its own Finance department which would report to a Central Finance Team headed by the group CFO. All the Companies and different units of AB & CD Limited were functioning in silos, wherein each one was unaware of the performance of other companies. There were inter-corporate loan arrangements between Companies in the group. The top management consisted of few professionals and family members. All the top executives were being paid higher remuneration in comparison with the industry benchmarks including high number of stock options.*

*AB & CD Limited had a whistle blower policy monitored by the Audit Committee. Vyom, a qualified Senior Accountant, working in the Company had approached the Director (Finance) with concerns about the financial statements but he could not get satisfactory answers and so threatened to inform the press. When his threat came to the attention of the Board, he was intimidated to keep quiet.*

*Another employee had written to an independent director stating that the books of the Company had been manipulated. Although this letter was circulated to the Board, no action was taken. The audit committee also failed to take any action.*

*When the group was not able to repay its loan to banks, there were concerns from bank and forensic audit was initiated. The forensic audit revealed a fraud within the Company and the share price of the Company plummeted.*



Based on the above facts, answer the following :

- (a) What is the role of Independent Directors and Audit Committee for effective oversight of matters pertaining to Whistle blower complaints ?
- (b) What are the challenges of effective implementation of a Whistle blower policy in a company such as AB & CD Limited ? Give your suggestion for devising better Whistle blower mechanism. (6 marks each)

### Answer 6(a)

While the ultimate responsibility of vigil mechanism is with the Board as a whole. Audit Committee is tasked with principal oversight of whistle blowing systems with the direct responsibility for anti-fraud efforts generally residing with management including internal audit. Whistle blowing procedures are a major line of defence against fraud and audit committee should ensure such procedures are effective. By focusing on whistle blowing channels and considering it within the context of the organisations overall approach to enterprise risk management - the audit committee can help strengthen internal controls, financial reporting and corporate governance.

The audit committee must be properly informed and actively engaged in overseeing the process while avoiding taking on the role or responsibilities of the Management. To this end, it should seek input from legal counsel, internal/external audit.

The audit committee should seek to ensure that the management has considered all risks that are likely to have a significant financial, reputational or regulatory impact on the organization. For any such risks, a rigorous assessment of the relevant internal controls including their ability to detect or prevent fraud should be made. Effective monitoring of these internal controls and periodic re-assessments of their effectiveness are key elements to stay updated, together with management's active engagement in the process. The audit committee should consider whether effective fraud awareness programmes are in place, updated as appropriate and effectively communicated to all employees.

### Answer 6(b)

Some of the challenges of effective implementation of a whistle blower policy are:

**Operational** : Extent of whistle blowing mechanism within the organization, awareness about it to staff members and whether the hotlines and reporting lines actually work.

**Emotional and cultural** : Whistle blowers are commonly viewed as snitches, sneaks, grasses and gossips. This perception can make it difficult to blow the whistle even though individuals recognize that it is good for the company, employees, shareholders and other stakeholders.

**Potential whistle blowers often fear reporting incidents to Management** : Areas such as legal protection, fear of trouble and potential dismissal all play a part when an individual is considering whistle blowing.

Suggestions for devising better whistle blower mechanism:

- Whistle blowing policies and procedures to be documented and communicated across the organization.

- Whistle blowing policy should ensure that it is both safe and acceptable for employees to raise concerns about wrongdoing.
- The whistle blowing procedures should be arrived at through a consultative process. Management and employees should 'buy into' the process. Success stories to be publicized.
- Concerns raised by employees are responded to within a reasonable time frame.
- Procedures should be in place to ensure that all reasonable steps are taken to prevent the victimization of whistle blowers and to keep the identity of whistle blowers confidential.
- Dedicated person to be identified to whom confidential concerns can be disclosed. That person should have the authority and statute to act if concerns are not raised with or properly dealt with, by the line management and other responsible individuals.
- Management should understand how to act if a concern is raised. They should understand that employees and others have right to blow the whistle.
- Consideration to be given to the use of an independent advice centre as part of the whistle blowing procedures.
- In case, issues are not reported to the management through whistle blowing channel, then management must have a relook on the effectiveness of the whistle blowing procedures.

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**BANKING – LAW & PRACTICE**  
(Elective Paper 9.1)

Time allowed : 3 hours

Maximum marks : 100

- NOTE:** 1. Answer ALL Questions.  
2. Working notes should form part of the answer.

**Question 1**

Case Study :

The banking activities in India are regulated by the Banking Regulation Act, 1949. Any bank which transacts this business in India is called a banking company. However, any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as manufacturer or trader shall not be deemed to transact the business of banking. It may be mentioned that the Banking Regulation Act, 1949 is not applicable to a primary agriculture society, a co-operative society land mortgage bank and any other co-operative society except in the manner and to the extent specified in the Act.

Section 6 of the Banking Regulation Act, 1949 specifies the form of business in which a banking company may engage. As per Section 9 of the Banking Regulation Act, 1949 banking company can only acquire immovable property for its own use. Other immovable properties acquired must be disposed-off within seven years from the date of acquisition.

The General Ledger and Profit and Loss Ledger are two principal books of accounts. Formats for Balance Sheet and Profit and Loss Account are given in the Third Schedule of The Banking Regulation Act, 1949 which includes Form A (Balance Sheet) and Form B (Profit and Loss Account) and eighteen other schedules of which two relates to notes and accounting policies.

The following are the ledger balances extracted from the books of Vaishnavi Bank Limited as on 31st March, 2019 :

(In Rupees thousands)

Particulars	Dr. (₹)	Cr.(₹)
Share Capital		1,90,000
Current Accounts Control		97,000
Employee Security Deposit		7,420
Investments in Govt. of India Bonds	94,370	
Gold Bullion	15,130	
Silver	2,000	
Constituent Liabilities for acceptance and endorsement	56,500	56,500
Borrowings from banks		77,230
Buildings	65,000	

<i>Furniture</i>		5,000	
<i>Money at call and short notice</i>			
— <i>With Banks</i>	= ₹23,000		
— <i>With other Institution</i>	= ₹3,000	26,000	
<i>Commission &amp; Brokerage</i>			25,300
<i>Saving accounts</i>			15,000
<i>Fixed deposits</i>			23,050
<i>Balances with other banks</i>			
— <i>In Current Account</i>	= ₹26,350		
— <i>In other account</i>	= ₹20,000	46,350	
<i>Other Investments</i>		55,630	
<i>Interest accrued on investments</i>		24,620	
<i>Reserve Fund</i>			1,40,000
<i>P &amp; L account</i>			6,500
<i>Bills for Collection</i>		43,500	43,500
<i>Interest</i>			62,000
<i>Loans</i>		1,81,000	
<i>Bills Discounted</i>		12,500	
<i>Interest</i>		7,950	
<i>Discount</i>			42,000
<i>Rents</i>			600
<i>Audit Fees</i>		5,000	
<i>Depreciation Reserve (Furniture)</i>			200
<i>Salaries</i>		21,200	
<i>Rent, Rates and Taxes</i>		12,000	
<i>Cash in hand and with Reserve Bank</i>			
(i) <i>Cash in hand (including currency notes)</i>	= ₹35,000		
(ii) <i>Balance with Reserve Bank of India</i>			
(a) <i>In Current Account</i>	= ₹32,000		
(b) <i>In other account</i>	= ₹8,000	75,000	
<i>Miscellaneous income</i>			3,900
<i>Depreciation reserve (Buildings)</i>			800
<i>Director's Fees</i>		1,000	
<i>Postage</i>		1,250	
<i>Loss on sale of Investments</i>		20,000	
<i>Branch adjustment</i>		20,000	
<b>Total</b>		<b>7,91,000</b>	<b>7,91,000</b>

Note : In the absence of previous year figures, the same is not indicated.

**Other information :**

The Bank's Profit and Loss Account for the year ended and Balance Sheet as on 31st March, 2019 are required to be prepared in appropriate form. Further information (In Rupees thousands) available is as follows :

(a) Rebate on bills discounted to be provided	₹4,000
(b) Depreciation for the year	
Buildings	₹5,000
Furniture	₹500
(c) Included in the current account's ledger are accounts overdrawn to the extent of ₹2,500.	

Based upon the above information answer the following :

- Prepare Balance Sheet of Vaishnavi Bank Limited as on 31st March, 2019.
- Prepare Profit and Loss Account of Vaishnavi Bank Limited for the year ended 31st March, 2019.
- Prepare Schedules of Balance Sheet of Vaishnavi Bank Limited as on 31st March, 2019.
- Prepare Schedules of Profit and Loss Account of Vaishnavi Bank Limited as on 31st March, 2019.
- Explain in detail the basic characteristics of Retail Banking and Wholesale Banking. (8 marks each)

**Answer 1(a)**

**Balance Sheet of Vaishnavi Bank Limited  
as on 31st March, 2019**

('000₹)

<i>Capital and Liabilities</i>	<i>Schedule</i>	<i>As on 31st March, 2019</i>
Capital	1	190000
Reserves & Surplus	2	202400
Deposits	3	137550
Borrowings	4	77230
Other liabilities and provisions	5	11420
<b>Total</b>		<b>618600</b>

<i>Assets</i>	<i>Schedule</i>	<i>As on 31st March, 2019</i>
Cash and balance with Reserve Bank of India	6	75000
Balances with bank and Money at call and short notice	7	72350
Investments	8	167130
Advances	9	196000
Fixed Assets	10	63500
Other Assets	11	44620
<b>Total</b>		<b>618600</b>
<b>Contingent Liabilities</b>	<b>12</b>	
Acceptances, endorsements and other obligations		56500
Bills for Collection		43500

**Answer 1(b)**

**Vaishnavi Bank Ltd**  
**Profit and Loss Account for the year ended 31st March, 2019**

('000₹)

<i>Particulars</i>	<i>Schedule</i>	<i>Amount</i>
I. Income		
Interest & Discount	13	100000
Other Income	14	9800
		<b>109800</b>
II. Expenditure		
Interest Expended	15	7950
Operating Expenses	16	45950
Provisions and Contingencies		-----
		<b>53900</b>
III. Profits/Loss		
Net profit for the year		55900
Profit b/f		6500
		<b>62400</b>
IV. Appropriations		
Transfer to Statutory reserve		13975
Balance carries over to Balance Sheet		48425
		<b>62400</b>

**Answer 1(c)****Schedule 1- Capital**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. For Other Banks Authorised Capital	
Shares of ₹— each	
Issued Capital	
Shares of ₹ — each	
Subscribed Capital	
Shares of ₹ — each	
Called up capital	
Shares of ₹— each	190000
<b>Total</b>	<b>190000</b>

**Schedule 2 – Reserve & Surplus**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I Statutory Reserves	140000
Opening Balance	13975
Additions during the year	153975
Balance in Profit and Loss Account	48425
<b>Total</b>	<b>202400</b>

**Schedule 3 – Deposits**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I Demand Deposits (₹97000 + ₹2500)	99500
II. Saving Bank Deposits	15000
III Term Deposits	23050
<b>Total</b>	<b>137550</b>

**Schedule 4 – Borrowings**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. Borrowings in India in Other banks	77230
<b>Total</b>	<b>77230</b>

**Schedule 5- Other liabilities and provisions**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I Other liabilities including provisions: Rebate on bills discounted	4000
Employees Security Deposit	7420
<b>Total</b>	<b>11420</b>

**Schedule 6 - Cash and Balances with Reserve Bank of India**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I Cash in hand (including currency notes)	35000
II. Balances with Reserve Bank of India	
i. In Current Account	32000
ii. In Other Account	8000
<b>Total</b>	<b>75000</b>

**Schedule 7 - Balances with Banks & Money at Calls & Short Notice**

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I India Balances with banks	
(a) In Current Accounts	26350
(b) In Other Accounts	20000
II Money at call and short notice	
(a) With Bank	23000
(b) With other institutions	3000
<b>Total</b>	<b>72350</b>



**Schedule 8 - Investments**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
Investment in India in	
(i) Government Securities	94370
(ii) Shares (Assumed)	55630
(iii) Gold	15130
(iv) Silver	2000
<b>Total</b>	<b>167130</b>

**Schedule 9 - Advances**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
A (i) Bills purchased and discounted	12500
(ii) Cash Credits, Overdrafts and Loans repayable on demand (₹181000 + ₹2500)	183500
	<b>196000</b>
B (i) Secured by tangible assets	In the absence figures,
(ii) Secured by Bank/Govt. Securities	the same is not indicated
(iii) Unsecured	<b>196000</b>
C. Advances in India	
(i) Priority Sector	In the absence figures,
(ii) Public Sector	the same is not indicated
(iii) Banks	
(iv) Others	<b>196000</b>

**Schedule 10 - Fixed Assets**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. Premises	
At cost as on 31st March 2018 (₹65000 - ₹800)	64200
Depreciation to date	5000
	<b>59200</b>
II. Other Fixed articles (Including Furniture & Fixture) (₹5000 - ₹200)	4800
At cost as on 3st March, 2018 Depreciation to date	500
	4300
<b>Total (I + II)</b>	<b>63500</b>

**Schedule 11 - Other Assets**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. Inter - office adjustments (net)	20000
II Interest Accrued	24620
<b>Total</b>	<b>44620</b>

**Schedule 12 - Contingent Liabilities**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. Acceptances, endorsements and other obligations	56500
<b>Total</b>	<b>56500</b>

**Answer 1(d)****Schedule 13 - Interest Earned**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. Interest/Discount on advances, bills (62000+42000-4000)	100000
<b>Total</b>	<b>100000</b>

**Schedule 14 - Other Income**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. Commission, Exchange and Brokerage	25300
II Profit on Sale of Investments	-
Less : Loss on sale on investments	20000
(I) - (II)	5300
III Miscellaneous Income	
Rent and Other Receipts (₹600 + ₹3900)	4500
<b>Total (I-II) + (III)</b>	<b>9800</b>

**Schedule 15 - Interest Expended**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I. Interest on Deposits	7950
<b>Total</b>	<b>7950</b>

**Schedule 16 - Operating Expenses**

('000₹)

<i>Particulars</i>	<i>As on 31st March, 2019</i>
I Payment to and provisions for employees	21200
II Rent, Taxes and Lighting	12000
III Depreciation on Bank's Property	5500
IV Director's fees, allowances and expenses	1000
V Auditor's fees	5000
VI Postage, Telegrams, Telephones etc.	1250
<b>Total</b>	<b>45950</b>

**Answer 1(e)**

**Retail Banking :** Retail Banking is typical mass market banking wherein individual customers use local branches of large commercial banks. In retail banking, the commercial banks offer various types of services. They accept Savings and Current Deposits, grant personal loans to the customers in the form of housing loans, education loans, consumer loans, travel loans, credit card loans, car loans etc. It is different from wholesale banking or corporate banking. Retail banking is a high volume business with many service providers competing for market share. A Company which provides a market basket of financial services is termed as a financial super market. This term became part of banking vocabulary, when non-banking financial companies began to offer financial services in competition with banks. The participants in retail banking are the commercial banks, co-operative banks, private banks, Post Office Payment Banks and Small Finance Banks. For the successful operation of retail banking, a large marketing network is essential.

The objective is to increase penetration by offering value added services. The banks get opportunity to cross sell various retail products (Credit card or housing loan or Insurance or mutual fund to Savings account holder).

**Wholesale Banking :** Wholesale banking refers to banks lending money to large entities like Corporate, Government etc. They also undertake activities like Money Markets, Foreign Exchange and Finance for Trade. Wholesale Banking is the provision of banking Services by Banks to Corporate Clients, Mid-sized Companies, Real Estate developers and investors, international trade finance, business, institutional customers, such as pension funds and government agencies and services offered to other banks, and financial institutions.

Wholesale banking is different from retail banking, in that the wholesale banking concentrates more on the Corporate entities and high-value transactions whereas retail banking is involved in providing financial services to individual customers. A Commercial bank deals with both wholesale and retail banking. Wholesale Banking requires expertise personnel.

Wholesale banking is a complete banking solution provide to large scale business organisations, the government agencies or institutions. To avail the facility of wholesale banking, the companies need to have strong financial position and operate on a large scale. Today's wholesale banks engage in finance wholesaling, underwriting, consultancy, fund management, mergers and acquisitions.

### Question 2

- (a) An export customer has a bill for £ 100,000, the bank has to purchase £ (Pound Sterling) from him and give an equivalent amount in rupees to the customer. Presuming the inter-bank market quotations for spot delivery are as follows :

$$\text{US\$ } 1 = \text{₹ } 60.8450/545$$

The London market is quoting as under :

$$\text{£ } 1 = \text{US\$ } 1.9720/40$$

Calculate the amount in ₹ to be received by the customer.

- (b) ABC bank has financed a term loan of ₹ 120 lakh to a Micro Small Enterprises unit, which was repayable in 60 monthly instalments of ₹ 2.00 lakh and Interest. The monthly instalments of ₹ 2.00 lakh plus interest from 15th December, 2017 remained unpaid though the available security is more than the outstanding balance (₹ 80 lakhs).

Explain the movement of Asset Classification of account and provision requirement (percentage and amount) as per RBI guidelines. (6 marks each)

### Answer 2(a)

There are two transactions for the Bank :

#### **Sell £ 100,000 in the London Market against US\$**

The bank has to sell £'s in the London market at US\$ 1.9720, i.e. the market's buying rate for £1.

#### **Sell US\$ in the local Interbank Market against Rupees.**

The US dollars so obtained have to be disposed-off in the local inter-bank market at US\$ 1 = Rs. 60.8450 (market's buying rate) for US\$.

**By chain rule, we get:**

$$\text{£ } 1 = 1.9720 \times 60.8450 = \text{Rs. } 119.9863$$

$$\text{Total amount in Rupees for £ } 100,000 = 100000 \times 119.9863 = \text{19,98,630}$$

### Answer 2(b)

The instalments remained overdue from 15th December, 2017. Balance outstanding

is ₹ 80 lakh as on the date of NPA. Outstanding is 100% secured by the asset charged to the bank. On the basis of record of recovery, the asset classification will be as under:

<i>Period</i>	<i>Asset Classification</i>	<i>Provision Norms as per RBI guidelines</i>	<i>Provision Requirement</i>
<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>
15th December, 2017 to 14th March, 2018	Standard (SMA-0, SMA-1, SMA-2)	0.25%	₹20000
15th March, 2018 to 14th March, 2019	Sub Standard	15%	₹12 lakh
15th March, 2019 to 14th March, 2020	Doubtful - Category - I	25%	₹20 lakh
15th March, 2020 to 14th March, 2022	Doubtful - Category - II	40%	₹32 lakh
15th March, 2022 onwards	Doubtful - Category - III	100%	₹80 lakh

### Question 3

- (a) Explain the guidelines of "Internal Ombudsman Scheme, 2018 for Scheduled Commercial Banks" issued by Reserve Bank of India. (6 marks)
- (b) Company has issued two series of bonds A and B. They have the following characteristics :

	<i>Bond A</i>	<i>Bond B</i>
<i>Face Value</i>	₹100	₹100
<i>Coupon Rate</i>	14%	14%
<i>Current market price</i>	₹100	₹100
<i>Term to maturity</i>	4 years	7 years
<i>Coupon Payment</i>	Annually	Annually

- (i) Compute the YTM of Bond A and B.
- (ii) If the interest rates fall by 1%, what would be the new market price of the bonds ?
- (iii) What is the percentage change in the price of two bonds ? What did you notice regarding the percentage price change in case of Bonds A and B identical in all respects, except term to maturity ?

Note :

- (1) Present Value (PV) interest factor of annuity (PVIFA), 13% for 4 years = 2.9745, 13% for 7 years = 4.4226.

- (2) Present value (PV) of ₹1 that is  $(1 + r)^n$  where  $r$  = interest rate,  $n$  = number of period until receipt. Present value, where  $r$  (13%) and  $n$  (period) 4 years,  $PV = 0.613$  and  $r$  (13%) and  $n$  (period) 7 years,  $PV = 0.425$ . (6 marks)

### Answer 3(a)

Reserve Bank of India (RBI) had, in May 2015, advised all public-sector and select private and foreign banks to appoint Internal Ombudsman (IO) as an independent authority to review complaints that were partially or wholly rejected by the respective banks. The IO mechanism was set up with a view to strengthen the internal grievance redressal system of banks and to ensure that the complaints of the customers are redressed at the level of the bank itself by an authority placed at the highest level of bank's grievance redressal mechanism so as to minimize the need for the customers to approach other for a for redressal.

As a part of this customer-centric approach, to enhance the independence of the IO while simultaneously strengthening the monitoring system over functioning of the IO mechanism, RBI has reviewed the arrangement and issued revised directions under Section 35A of the Banking Regulation Act, 1949 in the form of 'Internal Ombudsman Scheme, 2018'.

The Scheme covers, inter-alia, appointment / tenure, roles and responsibilities, procedural guidelines and over mechanism for the IO.

All Scheduled Commercial Banks in India having more than ten banking outlets (excluding Regional Rural Banks), are required to appoint IO in their banks. The IO shall, inter alia, examine customer complaints which are in the nature of deficiency in service on the part of the bank, (including those on the grounds of complaints listed in Clause 8 of the Banking Ombudsman Scheme, 2006) that are partly or wholly rejected by the Bank. As the banks shall internally escalate all complaints, which are not fully redressed to their respective IOs before conveying the final decision to the complainant, the customers of the banks need not approach the IO directly. The implementation of IO Scheme 2018 will be monitored by the Bank's internal audit mechanism apart from regulatory oversight by RBI.

### Answer 3(b)

- (i) Since the bonds are available at their respective face values, the YTM of the Bond A and B will be equal to their coupon rates, i.e. 14%.

- (ii) **After the interest rate fell by 1 %**

**The market price of Bond A is**

$$= 14 \times \text{PVIFA}(13\%, 4) + 100(13\%, 4)$$

$$= 14 \times 2.974 + (100 \times 0.613)$$

$$= 41.636 + 61.30 = ₹102.94$$

**The market price of Bond B is**

$$= 14 \times \text{PVIFA}(13\%, 7) + 100(13\%, 7)$$

$$= 14 \times 4.423 + (100 \times 0.425)$$

$$= 61.922 + 42.50 = ₹104.42$$

(iii) **Percentage price change in case of Bond A is**

$$= \frac{102.94 - 100}{100}$$

$$= 2.94\%$$

**Percentage price change in case of Bond B is**

$$= \frac{104.42 - 100}{100}$$

$$= 4.42\%$$

We observe that for a decrease in YTM by 1 % the bond having longer term to maturity experience a price change that is more than the price change for a bond that is having a shorter term to maturity.

#### Question 4

(a) *Reserve Bank of India issued Guidelines to Indian Commercial Banks on "Timelines for Large Accounts to be referred under IBC, 2016". Explain.*  
(6 marks)

(b) *M/s Ramesh Kumar Export Pvt. Ltd. (Customer) requested Bank to book a forward sale contract for US \$ 100000 deliver after 3 months. US \$ are quoted in the local interbank market as under :*

<i>Spot US \$ 1 =</i>	<i>₹68.7400/7500</i>
<i>One month forward premium :</i>	<i>0.0850/0.0900</i>
<i>Two months forward premium :</i>	<i>0.3650/0.3700</i>
<i>Three months forward premium :</i>	<i>0.6300/0.6350</i>

*Additional information :*

- (a) Exchange profit must be included in the rate quoted to the Customer.*
- (b) Rate quoted should be nearest to the fourth decimal in multiples of 0.0025.*
- (c) Brokerage and other charges may be ignored.*
- (d) Bank is entitled to exchange profit of 0.10% on the transaction.*

*Calculate the rate which will be quoted by you as a banker to M/s Ramesh Kumar Export Pvt. Ltd. What will be bank's profit from this transaction ?* (6 marks)

#### Answer 4(a)

In respect of accounts with aggregate exposure of the lenders at Rs.20 billion and above, on or after March 1, 2018 ('reference date'), including accounts where resolution may have been initiated under any of the existing schemes as well as accounts classified as restructured standard assets which are currently in respective specified periods (as

per the previous guidelines), Resolution Plan (RP) shall be implemented as per the following timelines:

- (i) If in default as on the reference date, then 180 days from the reference date.
- (ii) If in default after the reference date, then 180 days from the date of the first such default.
- (iii) If a RP in respect of such large accounts is not implemented as per the timelines specified in paragraphs, lenders shall file insolvency application, singly or jointly, under the Insolvency and Bankruptcy Code 2016 (IBC) within 15 days from the expiry of the said timeline.
- (iv) In respect of such large accounts, where a RP involving restructuring / change in ownership is implemented within the 180-day period, the account should not be in default at any point of time during the 'specified period', failing which the lenders shall file an insolvency application, singly or jointly, under the IBC within 15 days from the date of such default.
- (v) 'Specified Period' means the period from the date of implementation of RP up to the date by which at least 20 percent of the outstanding principal debt as per the RP and interest capitalisation sanctioned as part of the restructuring if any, is repaid.
- (vi) Provided that the specified period cannot end before one year from the commencement of the first payment of interest or principal (whichever is later) on the credit facility with longest period of moratorium under the terms of RP.
- (vii) Any default in payment after the expiry of the specified period shall be reckoned as a fresh default for the purpose of this framework.
- (viii) For other accounts with aggregate exposure of the lenders below Rs.20 billion and, at or above Rs.1 billion, the Reserve Bank intends to announce, over a two-year period, reference dates for implementing the RP to ensure calibrated, time-bound resolution of all such accounts in default.
- (ix) It is, however, clarified that the said transition arrangement shall not be available for borrower entities in respect of which specific instructions have already been issued by the Reserve Bank to the banks for reference under IBC. Lenders shall continue to pursue such cases as per the earlier instructions.

#### Answer 4(b)

##### Calculation of Bank's profit from Transaction

Interbank spot selling rate	68.7500
Add : Three month forward premium	0.6350
	69.3850
Add : Exchange profit 0.10%	0.069385
	69.454385
Rounded off to higher amount	69.4550
Profit on the transaction:	
Rate quoted to the customer	69.4550
(i) US \$ 100000 @ 69.4550	6945500
(ii) Less : US\$ 100000 @ 69.3850	6938500
<b>Profit (i) - (ii)</b>	<b>7000</b>



**Question 5**

- (a) Calculate the working capital finance (Bank Finance) for the year 2019-20 of M/s Ganga Enterprises Pvt. Ltd. as per Simplified Turnover Method of lending based on the following information :

**Balance Sheet****As on 31st March 2019**

Liabilities	₹	Assets	₹
Equity Share Capital	10,00,000	Fixed Assets	12,50,000
Long term Debt	10,00,000	Debtors	5,00,000
Creditors	5,00,000	Stock	16,00,000
Cash Credit	10,00,000	Cash	1,50,000
	35,00,000		35,00,000

Sales of the company for the year 2018-19 were ₹80,00,000. (6 marks)

- (b) Information Technology (IT) has brought a revolution in the working of banks in India, it also carries various risks. Explain the various types of IT risks and control mechanism for managing these risks. (6 marks)

**Answer 5(a)**

Turnover method of lending is suggested by Nayak committee. Under this method minimum 25% of the projected turnover (or 3 months sales) is the working capital requirement. The working capital limit given is 20% of projected sales and the borrower's contribution (margin) is 5% of projected turnover.

Particulars	Amount
Sales turnover (assuming they are projected by the borrower and accepted by the banker)	80,00,000
Minimum WC required (25% of projected sales)	20,00,000
Minimum Borrower's contribution 5 % of projected sales	4,00,000
Available margin (NWC)	
Excess of LTS over LTU 7,50,000 + Creditors 5,00,000	12,50,000
<b>Bank finance as per Turnover method</b>	<b>7,50,000</b>

**Answer 5 (b)**

IT risks can be classified according to their impact on the organisation, as listed below:

- (i) **Security Risk** : The risk that information will be altered, accessed, or used by unauthorised parties. Sources of security risk could be external attacks, malicious code, physical destruction inappropriate access, unsatisfied employees, variety

of platform and messaging types. Potential impacts associated with them are corruption of information, external fraud, identify theft, theft of financial assets, damage to reputation and damage to assets.

- (ii) **Availability Risk** : The risk that information or applications will be inaccessible due to system failure or natural disaster, including recovery period. Sources of availability risks are hardware failure, network outages, data centre failures and force majeure. Potential impacts associated with them are abandoned transactions, lost sales, reduced level of customer, or employee confidence, interruption or delay of business critical processes, reduced IT staff productivity.
- (iii) **Performance Risk** : The risk that under performance of systems, applications, or personnel, or IT as a whole will diminish business productivity or value. Sources of performance risk are poor system architectures, network congestion, inefficient code, inadequate capacity. Potential impacts associated with them are reduced customer satisfaction and loyalty, interruption or delay of business-critical process, lost IT productivity.
- (iv) **Compliance Risk** : It is a risk of information handling or processing fails to meet regulatory, IT or business policy requirements. Usually, it involves penalties, fines, or loss of reputation from failure to comply with laws or regulations, or consequences of non-compliance with IT policies. Sources of compliance risks are regulations unique to each jurisdiction, legal actions, internal IT safeguards supporting compliance, inadequate third-party compliance standards etc. Potential impacts associated with them are - damage to reputation, breach of client confidentiality, litigation etc.

**Mechanism for controlling IT risks** : An effective control mechanism is required for managing risks in IT areas. These controls are as under:

1. *Preventive Controls* : This control mechanism that stops errors and mistakes from occurring. Good layout of forms or screen to a large extent reduces the likelihood of mistakes while feeding the data.
2. *Detective Controls* : They identify the errors after they are committed. This is done through what is known as validation protocols or programmes.
3. *Corrective Controls* : These controls eliminate or reduce errors after identification of such data with errors or irregularities.

The basic purpose of these controls is to prevent the occurrence of errors or irregularities in the system. Secondly inspite of such prevention if such errors or irregularities continues to occur, they need to be detected and eliminated or corrected.

#### Question 6

- (a) *“For a successful implementation of an effective Credit Risk Management System, in banks, a sound organizational structure is a pre-requisite”. In this regard, briefly explain the recent RBI guidelines to Banks on appointing Chief Risk Officer (CRO).*
- (b) *Explain the Composition of Regulatory Capital. What is the minimum regulatory capital requirement for Banks in India as per Basel III Accord ? (6 marks each)*

**Answer 6(a)**

As part of Risk Management, banks are required, inter-alia, to have a system of separation of credit risk management function from the credit sanctioning process. As banks follow diverse practices in this regard, to bring uniformity in approach followed by banks and to align the risk management system with the best practices, banks are advised as under:

- a. Each bank to lay down a Board-approved policy clearly defining the role and responsibilities of the Chief Risk Officer (CRO).
- b. Appointment of the CRO shall be for a fixed tenure with the approval of the Board of Directors. The CRO may be transferred / removed from his post before completion of the tenure only with the approval of the Board and such premature transfer/removal shall be reported to the Department of Banking Supervision, Reserve Bank of India (RBI), Mumbai. In case of listed banks, any change in incumbency of CRO shall be reported to the stock exchanges also.
- c. CRO should be a senior official in the banks' hierarchy and shall have the necessary and adequate professional qualification / experience in the areas of risk management.
- d. The CRO shall have direct reporting lines to the Managing Director (MD) & CEO/ Risk Management Committee (RMC) of the Board. If the CRO reports to the MD & Chief Executive Officer (CEO), the RMC shall meet the CRO on one-to-one basis, without the presence of the MD & CEO, at least every quarter.
- e. The CRO not to have any reporting relationship with the business verticals of the bank and not be given any business targets.
- f. In case the CRO is associated with the credit sanction process, it has to be clearly spelt out whether the CRO's role would be that of an adviser or a decision maker. The policy to include the necessary safeguards to ensure the independence of the CRO.
- g. In banks that follow committee approach in credit sanction process for high value proposals, if the CRO is one of the decision makers in the credit sanction process, he shall have voting power and all members who are part of the credit sanction process, shall individually and severally be liable for all the aspects, including risk perspective related to the credit proposal. If the CRO is not a part of the credit sanction process, his role will be limited to that of an adviser.
- h. In banks which do not follow committee approach for sanction of high value credits, the CRO can only be an adviser in the sanction process and with no sanctioning power.
- i. The CRO in his role as an adviser shall be an invitee to the credit sanction / approval committee without any voting rights in the proceedings of the committee.
- j. There shall not be any 'dual hatting' i.e. the CRO shall not be given the responsibility of Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief of the internal audit function or any other function.

**Answer 6(b)****Composition of Regulatory Capital**

Banks are required to maintain a minimum Pillar 1 Capital to Risk-weighted Assets Ratio (CRAR) of 9% on an on-going basis (other than capital conservation buffer and countercyclical capital buffer etc.). The Reserve Bank will take into account the relevant risk factors and the internal capital adequacy assessments of each bank to ensure that the capital held by a bank is commensurate with the bank's overall risk profile. This would include, among others, the effectiveness of the bank's risk management systems in identifying, assessing / measuring, monitoring and managing various risks including interest rate risk in the banking book, liquidity risk, concentration risk and residual risk. Accordingly, the Reserve Bank will consider prescribing a higher level of minimum capital ratio for each bank under the Pillar 2 framework on the basis of their respective risk profiles and their risk management systems. Further, in terms of the Pillar 2 requirements, banks are expected to operate at a level well above the minimum requirement.

Common Equity Tier 1 Capital Ratio =

$$\frac{\text{Common Equity Tier 1 Capital}}{\text{Credit Risk RWA} + \text{Market Risk RWA} + \text{Operational Risk RWA}}$$

Tier 1 Capital Ratio =

$$\frac{\text{Eligible Tier 1 Capital}}{\text{Credit Risk RWA} + \text{Market Risk RWA} + \text{Operational Risk RWA}}$$

Total Capital (CRAR#) =

$$\frac{\text{Total Capital (Tier 1 Capital + Tier 2 Capital)}}{\text{Credit Risk RWA} + \text{Market Risk RWA} + \text{Operational Risk RWA}}$$

\*RWA = Risk Weighted Assets

#CRAR = Capital to Risk Weighted Asset Ratio

**Components of Capital**

Total regulatory capital consists of the sum of the following categories:

- (i) Tier 1 Capital (going-concern capital)
  - (a) Common Equity Tier-1
  - (b) Additional Tier
- (ii) Tier 2 Capital (gone-concern capital)

**Minimum regulatory capital requirement for Banks in India as per Basel III Accord:**

With full implementation of capital ratios and Capital Conservation Buffer (CCB) the capital requirements are summarised as follows:

<i>Regulatory Capital</i>	<i>As % to RWAs</i>
(i) Minimum Common Equity Tier 1 Ratio	5.5
(ii) Capital Conservation Buffer (comprised of Common Equity)	2.5
(iii) Minimum Common Equity Tier 1 Ratio plus Capital Conservation Buffer [(i)+(ii)]	8.0
(iv) Additional Tier 1 Capital	1.5
(v) Minimum Tier 1 Capital Ratio [(i) +(iv)]	7.0
(vi) Tier 2 Capital	2.0
(vii) Minimum Total Capital Ratio (MTC) [(v)+(vi)]	9.0
(viii) Minimum Total Capital Ratio plus Capital Conservation Buffer [(vii)+(ii)]	11.5

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## **INSURANCE – LAW & PRACTICE** (Elective Paper 9.2)

Time allowed : 3 hours

Maximum marks : 100

- NOTE:** 1. Answer ALL Questions.
2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.

### **Question 1**

The following policyholders have taken medical insurance from different Public Sector insurance companies as per details given below :

- Bhima Singh obtained the mediclaim policy from the XXX General Insurance Co. Ltd. in April, 1995 and renewed annually upon payment of the requisite amount of premium. After over three years namely, in July, 1998, Bhima Singh suffered a coronary disease and was admitted in the Escorts Heart Institute and Research Centre where he underwent 'Angioplasty'. A claim made by him was paid by the Insurance Company. In January, 2001 he was once again admitted to the Escorts Heart Institute and Research Centre and once again underwent 'Angioplasty'. The amount claimed was duly reimbursed by the Insurer. In May, 2002 he was hospitalized in Holy Family Hospital for a minor operation and the medical expenses claimed to that effect were reimbursed by the Insurer. In April, 2002 he underwent a bye-pass surgery. Bhima Singh submitted his claim which, however, was not paid. On 3rd April, 2003, Bhima Singh approached the Insurance Company for renewal of the policy and issued a cheque towards payment of the premium for the purpose of renewal of the policy w.e.f. 6th April, 2003, which was refused on the purported ground of 'high claim ratio'.
- Rajesh entered into a contract of mediclaim insurance in 1990 for a sum of ₹90,000 from 1992 to 2002. He had been making payments of the premiums regularly. His policy had been renewed every year. It was also renewed for the period 4-10-2001 to 3-10-2002. The insured's wife, son and daughter-in-law have also entered into such policy since 1992. Their policies had also been renewed from time to time without any change in terms. On 9-9-2002, Rajesh handed over a cheque for a sum of ₹6,377 by way of renewal of insurance policy. As no action thereon was taken, a reminder was sent. A legal notice was also issued. The legal notice was refused to be accepted by the Divisional Manager. In response thereto, only on 30-9-2002, the appellant stated that the policy would be renewed by loading of 300% premium. A sum of ₹18,982 was deposited. A receipt acknowledging the sum of ₹6,377 was also issued. Despite issuance of the said sum, the policy was not renewed. Strangely enough, only on October 3, 2002, the Insurer stated that the said policy could be renewed subject to exclusion of the diseases specified therein.
- Mahesh who is a practicing consultant neurologist and physician since 1961,

had taken mediclaim insurance for himself, his wife and his family members since 1992-1993. He was diagnosed with Hypogamglobulinemias in August-September 1999. Despite the same, the policy was renewed. By a letter dated 26-7-2002, the Insurer informed him that his mediclaim policy which was to expire on 13-8-2002 would be renewed subject to the exclusion of the disease Septioemia with Hypogamglobulinemias and was advised that the next premium will be accepted after loading of 100% with 5% excess for each and every claim.

- Suresh had taken a mediclaim policy and accident insurance policy in 1988. By a letter dated 15-1-2002, the mediclaim policy for the year 2002-2003 was refused to be renewed and he was asked to renew his policy in another company. The policy was cancelled.

Answer the following keeping in view the details above :

- (i) In all these cited cases, justify or reject the stand taken by insurance companies.  
Are the renewals of the mediclaim policies not automatic ?
- (ii) How is a Personal accident insurance policy different from a mediclaim insurance policy ?
- (iii) Discuss the provisions and grounds on which companies can cancel the mediclaim insurance policy ?
- (iv) Do you agree that the policyholders should be informed about all the provisions through a prospectus ?
- (v) What are the guidelines issued by IRDAI regarding prospectus ? (8 marks each)

### **Answer 1(i)**

In all these cited cases, the insurance companies are not justified in refusing to renew the insurance policies. The insurance companies have their obligations not only in terms of the constitutional provisions but also the provisions of the Insurance Regulation Act, 1938, the Indian Contract Act, 1972, and the Insurance Regulatory and Development Authority Act, 1999. As per these Regulations framed thereunder and the guidelines issued, the companies are bound to renew mediclaim policies from time to time on the same terms and conditions. The right to cancel the policy and refusal to renew the same must be held to be confined only to the exclusionary clauses contained in the policy. The functions of the appellant i.e. the insurance companies are regulated by statutory guidelines and circulars issued from time to time, any departure therefrom must be held to be wholly unfair and mala fide.

A renewal of Health insurance policy cannot be denied by an insurer on the following grounds:

- (a) High incidence of claims by the customer, except in the case of benefit-based health insurance policies issued by Life insurance companies, where the Policy itself comes to an end upon payment of say, a Critical illness claim, as per terms and conditions of the Policy.
- (b) On the grounds of age, if the Customer has renewed the Policy without any break.

However, renewal of Health insurance policy can be denied by the insurer, if fraud or misrepresentation on the part of the Customer during the previous Policy period or non-cooperation by the customer.

Under individual policies, where the Policy is renewed by the Customer, extra premiums cannot be charged only based on the unfavourable claims experience in the said Policy and, instead, shall be based on increase or decrease in premium for the entire portfolio.

No fresh medical examination can be called by the Insurer at the time of renewals, provided the Customer has renewed the Policy without any break. However, if there is any favourable factor for the Customer, viz., reduction in the risk profile of the Customer, loadings in premiums shall be considered for reduction by the Insurer.

As per the provisions of the Act, the policyholders have these options under the existing mediclaim insurance policy to continue the cover by payment of renewal premium in time in respect of the sum insured:

In case of Bhima Singh, there was a renewal without break in the period. Hence the mediclaim insurance policy will be renewed without excluding any disease already covered under the existing policy which may have been contracted during the period of the expiring policy. Renewal of mediclaim insurance policy cannot be refused on the ground of high claim ratio or that the insured had contracted disease during the period of the expiring policy so far as the basic sum insured under the existing policy is concerned. Also, the insurance company cannot charge loading on the basis of past history of claim at the time of renewal.

- In case of Rajesh where the insured seeks an enhancement of the amount of sum insured at the time of renewal, the option to renew will not extend to the amount of such enhancement and renewal in respect thereof will depend upon the mutual consent of the contracting parties.

### **Alternative Answer**

In case of Rajesh, the conduct of insurance company is not justified. The insured within the validity of policy handed over the cheque for renewal but the policy is not renewed within time. The insurance company is also not justified for seeking 300% loading on premium as extra premiums cannot be charged only based on the unfavourable claims experience in the said Policy. The insured and insurer has entered into a contract at the time of first year of policy and all the terms and conditions has been decided at that time only. The contention of insurer for seeking extra premium without increase or decrease in premium for the entire portfolio and excluding diseases which was originally included is not justified.

- In case of Mahesh, Renewal of a medical claim insurance policy cannot be refused, despite timely payment of the renewal premium, on the ground that continuance of the cover would become more onerous or burdensome for the insurer due to the insured contracting a covered disease during the period of the existing policy.
- In case of Suresh, the insurer may refuse renewal, even in cases where the insured has an option to renew the policy on payment of the renewal premium in



time, on the grounds, such as, misrepresentation, fraud or non-disclosure of material facts that existed at the inception of the contract and would have vitiated the insurance of the cover at its inception or non-fulfillment of obligations on the part of the insured or any other ground on which the performance of the promise under the contract is dispensed with or excused under the provisions of the Indian Contract Act or any other law or when the insurer has stopped doing business. But in the given case of Mr. Suresh, there was no mention of misrepresentation.

### **Answer 1(ii)**

Personal Accident is an insurance cover wherein, in the event of the person sustaining bodily injuries resulting solely and directly from an accident caused by EXTERNAL, VIOLENT & VISIBLE means, resulting into death or disablement Events covered under Personal Accident Insurance.

Personal Accident insurance covers but not limited to an accident may include events like:

- Rail/Road/Air Accident.
- Injury due to any collision/fall.
- Injury due to bursting of gas cylinder.
- Snake-bite, Frost bite/Dog bite.
- Burn Injury, Drowning, Poisoning etc.

### **Scope of Cover & Benefits available under Personal Accidental Cover**

Personal Accidental policy covers accidental death, loss of limbs, permanent total and partial disablement as selected and granted by the insurance companies based on the underwriting norms. On payment of additional premium, medical expenses reimbursement can also be covered under personal accident insurance. These expenses are payable, in case, if the claim is admitted under the basic policy cover Age Limits under Personal Accident Cover.

This Policy is available to persons between the age of 5 and 70 years (Male & Female). In case of Family Package covers, the age of children should be between 5 to 19 years.

Factors affecting Sum Insured under Personal Accident Insurance Sum insured is based on various factors namely:

- (a) Income from gainful employment
- (b) Type of occupation
- (c) Age as on date of proposal
- (d) Period of insurance
- (e) Conditions prevailing at the place from where the proposal is made etc.

Health insurance covers offered by non-life insurers are mainly hospitalization covers either on reimbursement or cashless basis. The cashless service is offered through

Third Party Administrators who have arrangements with various service providers, i.e., hospitals. The Third Party Administrators also provide service for reimbursement claims. Sometimes the insurers themselves process reimbursement claims. Accident and health insurance policies are available for individuals as well as groups. A group could be a group of employees of an organization or holders of credit cards or deposit holders in a bank etc. Normally when a group is covered, insurers offer group discounts.

While a health insurance plan provides a pure risk cover where the sum assured becomes payable upon the life assured being diagnosed of certain identified illness during the term of the policy. Health insurance is also popularly known as Medical Insurance or Mediclaim that covers medical expenses including hospitalization expenses. The type and amount of health insurance depends upon the scope of illnesses covered and the extent of expenses required to be covered. Health insurance benefits are also available as riders in group insurance plans. While life is very uncertain, a person may not stay healthy & fit throughout their life. Therefore it is prudent to have health cover at every stage of life. If a major illness like heart failure is diagnosed & the funds for treatment cannot be immediately arranged. It may lead to loss of life. If the family resorts to costly personal loans for treatment & the life of the person cannot be saved then the family could incur huge debts. Having health insurance cover can help to overcome this problem.

#### **Answer 1(iii)**

The provisions and grounds when companies can cancel the mediclaim insurance policy as per cancellation Clause is mentioned below:

- The policy may be cancelled or renewed by mutual consent.
- The Company shall not however be bound to give notice that it is due for renewal and the Company may at any time cancel this policy by sending the Insured 30 day's notice by registered letter at the insureds' last known address and in such event the Company shall refund to the Insured a pro-rata premium for unexpired Period of Insurance.
- The Company shall, however, remain liable for any claim, which arose prior to the date of cancellation.
- The Insured may at any time cancel this Policy and in such event the Company shall allow refund of premium at Company's short period rate only.
- The Company shall not be liable to make any payment under this policy in respect of any expenses whatsoever incurred by any Insured Person in connection with or in respect of events not agreed at the time of insurance.
- All diseases/injuries which are pre-existing when the cover incepts for the first time.
- Renewal of Health insurance policy can be denied by the insurer, if fraud or misrepresentation on the part of the Customer during the previous Policy period or non-cooperation by the Customer

**Answer 1(iv)**

Yes, policyholders / prospects should be informed about all the provisions of proposed policy through prospectus. The basic contents of the prospectus should be as under:

1. the scope of benefits
2. the extent of insurance cover
3. warranties, exclusions/exceptions and conditions of the insurance cover along with explanations
4. a description of the contingency or contingencies to be covered by insurance
5. the class or classes of lives or property eligible for insurance under the terms of such prospectus
6. a full statement of the circumstances, if any, in which rebates of the premiums quoted in the prospectus or table shall be allowed on the effecting or renewal of a policy, together with the rates of rebate applicable to each case
7. the allowable riders or add-on covers on the insurance products shall be clearly spelt out with regard to their scope of benefits
8. in case of life insurance, whether the product is participating (with-profits) or nonparticipating (without-profits).

**Answer 1(v)**

'Prospectus' has been defined in the Regulation 2(1) (e) of the IRDA (Protection of Policyholders' Interest) Regulations, 2002 to mean a document issued by the insurer or in its behalf to the prospective buyers of insurance, and should contain such particulars as are mentioned in Rule 11 of Insurance Rules, 1939 and includes a brochure or leaflet serving the purpose. Such a document should also specify the type and character of riders on the main product indicating the nature of benefits flowing thereupon.

Regulation 6 provides for the matters to be stated in the insurance policy.

The Regulation 7(1) (n) of 2002 Regulations read thus a general insurance policy shall clearly state:

- Provision for cancellation of the policy on grounds of misrepresentation, fraud, non-disclosure of material facts or non-cooperation of the insured.
- All literature relating to the product should be in simple language and easily understandable to the public at large. As far as possible, a similar sequence of presentation may be followed. All technical terms should be clarified in simple language for the benefit of the insured.
- The product should be a genuine insurance product of an insurable risk with a real risk transfer. "Alternate risk transfer" or "financial guarantee" business in any form will not be accepted.
- Insurers should use as far as possible, similar wordings for describing the same cover or the same requirement across all their products. For example clauses

on renewal of insurance, basis of insurance, due diligence, cancellation, arbitration etc., should have similar wordings across all products.

- The pricing of products should be based on appropriate data and with technical justification.

### Question 2

- (a) *“Insurance too is a contract but with a difference”. Explain. (6 marks)*
- (b) *The complainant Sneha the proprietress of M/s Tungabhadra Agro Industries, purchased a burglary policy and cash insurance policy for the period 14-04-2004 to 13-04-2005 to cover money in a locked safe in her premises for a sum insured of ₹2,50,000 and stock-in-trade of ₹7,50,000. There was an alleged burglary in the premises on 19-04-2004. 22 to 24 bags of Bengal gram; 2 to 4 bags of fried gram; cash amounting to ₹73,000 were alleged to have been stolen. The theft was informed to the insurers. Surveyor was deputed and the claim was closed, as requirements as demanded by the insurer/surveyor were not furnished. The complainant contended that the police authorities seized the account books etc. The insurer was directed to send the surveyor to police authorities and peruse the said documents and give his report within one month from the date of hearing. The police categorically denied having taken the account books etc. The Final Investigation Report highlighted the fact that the complaint was intentionally registered on account of financial burden on the complainant as she had taken a loan to start the factory and could not make payment regularly. Based on the facts of the case, identify the category of hazard. Differentiate between risk, peril and hazard. (6 marks)*

### Answer 2(a)

A contract of insurance is an agreement whereby one party, called the insurer, undertakes, in return for an agreed consideration, called the premium, to pay the other party, namely the insured, a sum of money or its equivalent in kind, upon the occurrence of a specified event resulting in a loss to him. The policy is a document which is an evidence of the contract of insurance.

Though all contracts share fundamental concepts and basic elements, insurance contracts typically possess a number of characteristics not widely found in other types of contractual agreements. The most common of these features are listed here:

#### (a) Aleatory

If one party to a contract might receive considerably more in value than he or she gives up under the terms of the agreement, the contract is said to be aleatory. Insurance contracts are of this type because, depending upon chance or any number of uncertain outcomes, the insured (or his or her beneficiaries) may receive substantially more in claim proceeds than was paid to the insurance company in premium dollars. On the other hand, the insurer could ultimately receive significantly more money than the insured party if a claim is never filed.

#### (b) Adhesion

In a contract of adhesion, one party draws up the contract in its entirety and

presents it to the other party on a 'take it or leave it' basis; the receiving party does not have the option of negotiating, revising, or deleting any part or provision of the document. Insurance contracts are of this type, because the insurer writes the contract and the insured either 'adheres' to it or is denied coverage. In a court of law, when legal determinations must be made because of ambiguity in a contract of adhesion, the court will render its interpretation against the party that wrote the contract. Typically, the court will grant any reasonable expectation on the part of the insured (or his or her beneficiaries) arising from an insurer-prepared contract.

**(c) Utmost Good Faith**

Although all contracts ideally should be executed in good faith, insurance contracts are held to an even higher standard, requiring the utmost of this quality between the parties. Due to the nature of an insurance agreement, each party needs – and is legally entitled – to rely upon the representations and declarations of the other. Each party must have a reasonable expectation that the other party is not attempting to defraud, mislead, or conceal information and is indeed conducting themselves in good faith. In a contract of utmost good faith, each party has a duty to reveal all material information (that is, information that would likely influence a party's decision to either enter into or decline the contract), and if any such data is not disclosed, the other party will usually have the right to void the agreement.

**(d) Executory**

An executory contract is one in which the covenants of one or more parties to the contract remain partially or completely unfulfilled. Insurance contracts necessarily fall under this strict definition; of course, it's stated in the insurance and agreement that the insurer will only perform its obligation after certain events take place (in other words, losses occur).

**(e) Unilateral**

A contract may either be bilateral or unilateral. In a bilateral contract, each party exchanges a promise for a promise. However, in a unilateral contract, the promise of one party is exchanged for a specific act of the other party. Insurance contracts are unilateral; the insured performs the act of paying the policy premium, and the insurer promises to reimburse the insured for any covered losses that may occur. It must be noted that once the insured has paid the policy premium, nothing else is required on his or her part; no other promises of performance were made. Only the insurer has covenanted any further action, and only the insurer can be held liable for breach of contract.

**(f) Conditional**

A condition is a provision of a contract which limits the rights provided by the contract. In addition to being executory, aleatory, adhesive, and of the utmost good faith, insurance contracts are also conditional. Even when a loss is suffered, certain conditions must be met before the contract can be legally enforced. For example, the insured individual or beneficiary must satisfy the condition of submitting to the insurance company sufficient proof of loss, or prove that he or she has an insurable interest in the person insured.

**(g) Personal contract**

Insurance contracts are usually personal agreements between the insurance company and the insured individual, and are not transferable to another person without the insurer's consent. (Life insurance and some maritime insurance policies are notable exceptions to this standard.) As an illustration, if the owner of a car sells the vehicle and no provision is made for the buyer to continue the existing car insurance (which, in actuality, would simply be the writing of the new policy), then coverage will cease with the transfer of title to the new owner.

**Answer 2(b)**

Risk is the potential of loss (an undesirable outcome, however not necessarily so) resulting from a given action, activity and/or inaction. The notion implies that a choice having an influence on the outcome sometimes exists (or existed). Potential losses themselves may also be called "risks". Any human endeavour carries some risk, but some are much riskier than others.

Risk can be defined in seven different ways

- The probability of something happening multiplied by the resulting cost or benefit if it does.
- The probability or threat of quantifiable damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through pre-emptive action.

Hazard is important when an insurance company is deciding whether or not it should insure some risk and what premium to charge. So a hazard is a condition that creates or increases the chance of loss. There are three major types of hazards: Hazard can be physical or moral or Morale. Moral hazard concerns the human aspects which may influence the outcome. Moral hazard is dishonesty or character defects in an individual that increase the chance of loss. For example, a business firm may be overstocked with inventories because of a severe business recession. If the inventory is insured, the owner of the firm may deliberately burn the warehouse to collect money from the insurer. In effect, the unsold inventory has been sold to the insurer by the deliberate loss. A large number of fires are due to arson, which is a clear example of moral hazard. Moral hazard is present in all forms of insurance, and it is difficult to control. Dishonest insured persons often rationalise their actions on the grounds that "the insurer has plenty of money". This is incorrect since the company can pay claims only by collecting premiums from other policy owners.

In the given case, the case, the hazard present is an example of Moral hazard.

**Question 3**

*Rajeshwar Nath Gupta filed an appeal against the decision of ABC Life Insurance Company relating to non-settlement of death claim of his sister's pension policy. The claimant stated that his sister had purchased a Deferred Annuity policy from the insurance company on 24-2-2005 which matured on 24-2-2011 and he was the nominee in her policy. His claim was rejected by Divisional Office Agra on the ground that his sister had not given the name of her "spouse" at the time of annuity. The complainant stated that since his sister was unmarried, hence, the question of*

spouse as nominee does not arise. It is possible that the time of maturity, wrong annuity option was ticked by his sister. His claim was genuine and should be paid by the Insurance Company in the shape of annuity or sum assured. The Insurance Company submitted that the policy matured on 24-2-2011 and annuity started @ 5949 on yearly basis. The total Notional cash option under the policy was ₹66023. After receipt of five annuity installments, the assured died on 10-6-2016. Since it was an annuity plan, the deceased had opted for option "I" which means Annuity for life with provision of 100% annuity to Spouse for life on death of Annuitant. Since the annuitant did not provide the name of her spouse, the claim was rejected by the insurance company. However, later on it was observed that the annuitant was unmarried and had nominated her brother in her policy. The matter of fact is that the deceased had wrongly ticked option 'I' (Annuity for life with a provision for 100% of annuity to the spouse of the annuitant for life on death of annuitant) instead of option 'F' (annuity for life with return of purchase price).

Based on above facts, answer the following :

- (a) What is an annuity ? Explain the various types of annuity policies. Explain how, in Life Insurance Policies unlike General Insurance Policies insurable interest is not necessary after the Policy is issued. Discuss the provisions of the Insurance Act, with regard to nomination of Life Insurance Policies.
- (b) Is the insurance company justified in denial of the claim in the given case.  
(6 marks each)

### Answer 3(a)

Annuity is a Life insurance Policy which covers the risk of living longer as against a Pure Term Policy which covers the risk of dying early.

Like Term Policy, mortality tables (which include survival rates for each age) is utilised to calculate the premiums payable under an Annuity Policy.

Further, Annuity Policy also takes care of investment risk by guaranteeing monthly annuity amounts for longer periods.

Thus Annuity Policy takes care of 2 risks: (a) Risk of living longer (Longevity risk) and (b) Risk of fall in interest rates (Investment risk)

Thus under an Annuity Policy, in consideration of a lump sum, the Life insurer undertakes to pay a periodic usually fixed and monthly amounts, to the Annuitant till he/she is alive.

### **Types of Annuity**

#### **Fixed Rate Annuity**

A fixed rate annuity is an annuity in which the insurance company agrees to pay a guaranteed amount of annuity based on the investment for life.

A Variable Annuity means that the monthly income provided by the Policy may vary according to the actual investment experience of the insurer. Variable annuities are much like an investment in mutual funds because the variable annuities offer a collection of securities. The customer can decide how the investment will be allocated among the various choices.

Equity indexed Annuity is an annuity that earns interest that is linked to a stock or other equity index. An equity-indexed annuity is different from other fixed annuities because of the way it credits interest. Equity-linked annuities credit interest using a formula based on changes in the index to which the annuity is linked. The formula decides who the additional interest, if any, is calculated and credited.

### ***Settlement options (Payment terms) under an Annuity Policy***

#### **Life Annuity**

This is the most popular form of Annuity and under this option, the Annuitant receives a specified amount of income for his or her life, whether the period of the annuitant's life is 1 year or many years. Once the annuitant dies, there are no more payments to the state or family

#### **Annuity Certain**

Annuity Certain provides a specified amount of monthly income for a specified period of years, without consideration of any life contingency. IF an individual buys an annuity certain for 10 years, he is sure to get the annuity payments for 10 years if he is alive or if he dies during the period of 10 years, his beneficiary will receive the annuity for the residual period.

#### **Joint Life Annuity**

Joint Life Annuity is issued on 2 individuals under which payments continue in whole or in part until both individuals die. It is also called Joint Life Last Survivor Annuity.

#### **Annuity with Return of Purchase Price**

These are annuities which pay back the purchase price of the annuity after a certain period or on death as per the terms of the Policy

#### **Increasing Annuity**

Annuity increases at the rate of 1% or 2% or 3% per annum as the case may be and payable during the life of the annuitant. This is intended to take care of the increased cost of living.

#### **Answer 3(b)**

In Life insurance Policies, unlike general insurance policies, continuance of insurable interest is not necessary after the policy is issued and hence freely assignable. The principal of insurable states that the person getting insured must have insurable interest in the object of insurance. A person has an insurable interest when the physical existence of the insured object gives him some gain but its non-existence will give him a loss. In simple words, the insured person must suffer some financial loss by the damage of the insured object.

#### **Assignments and nomination under Insurance policies (Section 38 & 39 of Insurance Act, 1938)**

Assignments are transfers of Insurance policies from Policy holder to another with or without a valid consideration.



Nomination is effected by the person taking the policy on his own life, to decide the person who will receive the benefits upon the death of the policyholder (since the policyholder will not be alive at that time). For minor nominees, a Guardian (called "appointee"), other than the policyholder himself, needs to be appointed. In order to be effective, the name of the nominee must be incorporated in the policy document itself, based on the name of the nominee mentioned in the Proposal form (application for life insurance). However, a nomination, if not made at the proposal stage, can be made by way of an endorsement in the policy by the Insurer subsequently, for which a notice has to be given by the Policyholder to the insurer. Upon receipt of such notice, the insurer shall register the nomination and make an endorsement on the Policy document. Similar process is adopted for change of nominations as well. An assignment under a policy shall automatically cancel a nomination subsisting on the date of assignment. This is because nomination is valid only for policies taken on one's own life. Upon assignment, the policyholder becomes a person different from life assured and assignee is the only person entitled to receive any benefit upon death of the life assured (assignor).

In the given case, Rajeshwar Nath Gupta is entitled to the death claim of his sister's pension policy. Based on the facts of the case, the insurance company is not justified in denial of the claim in the given case. The matter of fact is that the deceased had wrongly ticked option T (Annuity for life with a provision for 100% of annuity to the spouse of the annuitant for life on death of annuitant) instead of option 'F' (annuity for life with return of purchase price). And they simply denied the claim stating that the assured had ticked the option T Hence, considering it an unintentional human error, the Insurance Company should not have denied the claim on such a flimsy ground. The claim thus stands payable.

#### **Question 4**

*Jagveer Singh filed a complaint against the decision of BB Life Insurance Corporation of India relating to rejection of death claim in respect of his wife on the ground of Suicide clause. The complainant stated that his wife had taken the said policy from BB Life Insurance Co. Aligarh Division. She died on 27-3-2016 due to burn injury during the treatment at J.N. Medical College, Bulandshahr. The Complainant submitted the claim with all documents before the Insurance Company but his claim was rejected by the Company on the ground of suicide clause of the policy. The complainant stated that it was a case of accident and not of suicide and his claim was genuine and should be paid by Company. The Insurance Company stated that the deceased falls under category III female live as per underwriting norms of Insurance Company. The insured expired due to 90% thermal burn during treatment at J.N. Medical Hospital Aligarh on 27-3-2016 i.e. only after 8 months 28 days from the date of proposal and the claim was under the category of very early claim. Hence the matter was investigated by Insurance officer, during investigation the statements of two neighbors were taken into consideration and in their written statement, ex-pradhan informed that the deceased had committed suicide. Insurance company could not produce any other proofs as the FIR was lodged but no action/enquiry was made by the police as both the parties had reconciled the matter between themselves. Police Report mentioned that death is due to burn injuries, because of bursting of stove while cooking. The Reports of Postmortem also endorsed the Police Report. But the insurance company repudiated the claim on the ground of*

*suicide clause under policy condition, which states “if the life assured (whether sane or insane) commits suicide at any time within 12 months from the date of commencement of risk, the corporation will not entertain any claim under this policy except to the extent of 80% of the premium paid excluding any taxes, extra premium and rider premiums, if any, provided the policy is.”*

*Based on above answer the following :*

- (i) Is the repudiation of the claim by the insurance company is justified in this case?*
- (ii) Discuss the provisions for suicide condition under a life insurance policy.*  
*(6 marks each)*

#### **Answer 4(i)**

The repudiation of the claim is not justified by the insurance company, in the given case, although the Insurance Company submitted the statements of two neighbours of the deceased in support of repudiation of the claim, which were not found actionable evidence. But, still not convinced with the proof, the Insurance Company was therefore asked to submit some other proof to establish that the insured had committed suicide, which they could not submit. Secondly, the police report clearly speaks of burn injury due to bursting of stove while cooking. Similarly, the post mortem and other reports also speak of death due to burn only. Hence, the allegation of suicide by the insurer finds no documentary support. Hence, in the absence of any hard evidence, benefit of doubt should go in favour of complainant. Hence the claim is payable.

#### **Answer 4(ii)**

The provisions for suicide condition under a life insurance policy is governed by a condition subsequent to the formation of the contract. A condition precedent is any event or act that must take place or be performed before the contractual right will be granted. For instance, before an insured individual can collect medical benefits, he or she must become sick or injured. Further, before a beneficiary will be paid a death benefit, the insured must actually become deceased. A condition subsequent is an event or act that serves to cancel a contractual right. A suicide clause is an example of such a condition. Typical suicide clauses cancel the right of payment of the death benefit if the insured individual takes his or her own life within two years of a life insurance policy's effective date.

#### **Question 5**

*On 11-4-2016 Avtar Singh the grandson of the Life Assured had lodged a complaint against SBI Life Insurance Co. for payment of repudiated death claim for ₹9,99,000. The complainant had stated in his complaint that his grandfather (father's Uncle) Bhura Singh died on 9-6-2015. He submitted all the required documents with the insurance company for payment of death claim but insurance company had repudiated the claim on the ground that the life assured had understated his age at the time of taking policy from the insurer. He was 73 years of age and not 57 years of age as declared at the time of taking policy and he had concealed material fact of age.*

*Actually, the policy was issued on 29-10-2013, with initial yearly deposit of 99,900*

for 10 years term policy. The date of birth of insured was taken as 2-5-1956 and age 57 years, on the basis of PAN card mentioned in the proposal form. Bhura Singh died on 9-6-2015. The policy was in force on date of death and life assured died within 1 year 7 month time from date of commencement (DOC) of the policy. After investigation it was found that the life assured was much older than what was declared in the proposal form. In view of the understatement of age by the insured the death claim was repudiated.

Answer the following on the basis of facts given above :

- (a) "Proposal is the basis of insurance". Explain. What are the facts from the proposal form that are considered for underwriting a life insurance policy ? When the insurance company has issued the policy based on the proposal and PAN-card as proof, is the repudiation justified ?
- (b) Is this a case of misrepresentation or concealment ? Discuss the governing principle which requires full declaration of material facts. (6 marks each)

#### Answer 5(a)

**"Proposal is the basis of insurance"**. The Insurance policy is a legal contract between the Insurer and the Policyholder. As is required for any contract there is a proposal and an acceptance. The application document that is used for making the proposal is commonly known as the 'Proposal Form'. All the facts stated in the Proposal form becomes binding on both the parties and failure to appreciate its contents can lead to adverse consequences in the event of claim settlement. The Proposal form has been defined under IRDA (Protection of Policyholders' Interests) Regulations, 2002 as "it means a form to be filled in by the proposer for insurance for furnishing all material information required by the insurer in respect of a risk, in order to enable the insurer to decide whether to accept or decline, to undertake the risk, and in the event of acceptance of the risk, to determine the rates, terms and conditions of a cover to be granted.

*Explanation* : "Material" for the purpose of these regulations shall mean and include all important, essential and relevant information in the context of underwriting the risk to be covered by the insurer." While the IRDAI had defined the Proposal form, the design and content was left open to the discretion of the Insurance company. The Proposal form carries detailed instructions not only for the Proposer and the Proposed Life Insured but also to the Intermediary who solicits the policy and assists in filling up the form.

It also requires the Proposer and the Proposed Insured to declare the correctness and authenticity of the information provided in the form. In addition, the Intermediary is required to certify that he has explained the features of the policy, including terms and conditions, premium requirements, exclusions and applicable charges to the Proposer. It is pertinent to mention here that the Proposal form gains utmost importance in any insurance contract, as the insurance company offers a cover on the basis of information provided in the Proposal form.

The Proposal form, the Insurer seeks to elicit all material information of the Proposer and the Proposed Insured, which includes name, age, address, education, income and employment details of the Proposer, medical history of the Proposed Insured and his family members, income details, any existing life insurance cover on the Proposer as well as Proposed Insured. The Information sought in the Proposal form is important for

an insurance company to assess the risk that can be underwritten and also to comply with other regulatory requirements such as the 'Know Your Customer' norms.

When the insurance company has issued the policy based on the proposal and pan-card as proof, the repudiation is not justified. It is because, it was observed that the company had admitted the age on the basis of pan card at the time of proposal where the date of birth was mentioned as 02.05.1956. The Pan card is a *standard age proof* which was duly admitted and accepted by the insurer at the time of proposal which cannot be nullified by ration card, which is substandard age proof. On the other hand voter card is considered a nonstandard age proof and this cannot be over ride standard age proof only for the purpose of repudiating the claim unless the insurer proves that the Pan card is fake. The insurer admitted that they were not questioning the authenticity of the Pan card, hence denial of claim on this ground is not valid and justified. In view of these facts, the insurance company is to be directed to pay death claim of full sum assured Rs. 9,99,000/- and accrued bonus up to the date of death.

#### **Answer 5(b)**

A misrepresentation is a statement, whether written or oral, that is false. Generally speaking, in order for an insurance company declare a contract as void due to misrepresented information, the information in question must be material to the decision in order to extend coverage. Concealment, on the other hand, is the failure to disclose information that one clearly knows about. To void a contract on the grounds of concealment, the insurer typically must prove that the applicant willfully and intentionally concealed information that was of a material nature. While Fraud is the intentional attempt to persuade, deceive, or trick someone in an effort to gain something of value. Although misrepresentations or concealments may be used to perpetrate fraud, by no means are all misrepresentations and concealments acts of fraud. For instance, if an insurance applicant intentionally lies in order to obtain coverage or make a false claim, it could very well be grounds for the charge of fraud. However, if an applicant misrepresents some piece of information with no intent for gain (such as, for example, failing to disclose a medical treatment that the applicant is personally embarrassed to discuss), then no fraud has occurred. In the given case, there is no misrepresentation or concealment. There was oversight on the part of the Insurance Company. Hence the claim is payable.

The governing principle which requires full declaration of material facts is the principle of Utmost Good Faith. Although all contracts ideally should be executed in good faith, insurance contracts are held to an even higher standard, requiring the utmost of this quality between the parties. Due to the nature of an insurance agreement, each party needs - and is legally entitled - to rely upon the representations and declarations of the other. Each party must have a reasonable expectation that the other party is not attempting to defraud, mislead, or conceal information and is indeed conducting themselves in good faith. In a contract of utmost good faith, each party has a duty to reveal all material information (that is, information that would likely influence a party's decision to either enter into or decline the contract), and if any such data is not disclosed, the other party will usually have the right to void the agreement. The Principle of Uberrimaefidei (a Latin phrase), or in simple English words, the Principle of Utmost Good Faith, is a very basic and first primary principle of insurance. According to this principle, the insurance contract must be signed by both parties (i.e. insurer and insured) in an absolute good faith or belief or trust. The person getting insured must willingly

disclose and surrender to the insurer his complete true information regarding the subject matter of insurance. The insurer's liability gets void (i.e. legally revoked or cancelled) if any facts, about the subject matter of insurance are either omitted, hidden, falsified or presented in a wrong manner by the insured. The principle of *Uberrimaefidei* applies to all types of insurance contracts.

### Question 6

- (a) *Rajesh alleged that he purchased Home contents insurance covering household goods from the DIY insurance company w.e.f. 16-02-2017 to 15-02-2018. He got his jewellery covered along with other household goods for SI of ₹10 lacs. An incidence of theft took place on 10-03-2017 at his house and thieves broke wooden gates and stole two silver idols from the place of worship along with two silver coins. The matter was reported to the police and he raised a claim bill for ₹21750 but the insurance company denied the claim. During the course of hearing, the insurance company stated that Idols in question were not covered as per policy schedule stating that Section III of the policy covers only Jewellery and not other valuables like Silver statues and silver coins as these do not fall under the definition of jewellery.*

*Discuss the coverage available under a Householder's policy. Justify the denial of claim in the given case with supportive provisions.*

- (b) *Discuss the regulatory provisions framed by IRDAI with special focus on "Protection of Policyholders interests" in respect of claims under life insurance. (6 marks each)*

### Answer 6(a)

Home insurance, also commonly called hazard insurance or homeowner's insurance (often abbreviated in the real estate industry as HOI), is a type of property insurance that covers a private residence, such as a condominium or renters' insurance or home or multiple unit buildings (duplex, triplex or quadplex so long as the owner lives in one of the units). It is an insurance policy that combines various personal insurance protections, which can include losses occurring to one's home, its contents, loss of use (additional living expenses), or loss of other personal possessions of the homeowner, as well as liability insurance for accidents that may happen at the home or at the hands of the homeowner within the policy territory. If a home does not meet the underwriting guidelines of a standard homeowners policy (such as more than 15-20 year old shingled roof, 20-30 year old heating system, no central heating, etc.) the residence could qualify for a limited coverage dwelling policy (DP).

Homeowner's policy is referred to as a multiple-line insurance policy, meaning that it includes both property insurance and liability coverage, with an indivisible premium, meaning that a single premium is paid for all risks. Standard forms divide coverage into several categories, and the coverage provided is typically a percentage of Coverage A, which is coverage for the main dwelling. The cost of homeowner's insurance often depends on what it would cost to replace the house and which additional endorsements or riders are attached to the policy. The insurance policy is a legal contract between the insurance carrier (insurance company) and the named insured(s). It is a contract of indemnity and will put the insured back to the state he/she was in prior to the loss. Typically, claims

due to floods or war (whose definition typically includes a nuclear explosion from any source), amongst other standard exclusions (like termites), are excluded. Special insurance can be purchased for these possibilities, including flood insurance. Insurance should be adjusted to reflect replacement cost, usually upon application of an inflation factor or a cost index.

The home insurance policy is usually a term contract—a contract that is in effect for a fixed period of time. The payment the insured makes to the insurer is called the premium. The insured must pay the insurer the premium each term. Most insurers charge a lower premium if it appears less likely the home will be damaged or destroyed. For example, if the house is situated next to a fire station or is equipped with fire sprinklers and fire alarms; if the house exhibits wind mitigation measures, such as hurricane shutters; or if the house has a security system and has insurer-approved locks installed. Perpetual insurance, a type of home insurance without a fixed term, can also be obtained in certain areas.

In the given case, Rajesh alleged that he purchased Home contents insurance covering household goods from the DIY insurance company w.e.f. 16.02.2017 to 15.02.2018. He got his jewellery covered alongwith other household goods for SI of Rs. 10 lacs. During the course of hearing, the insurance company stated that Idols in question were not covered as per policy schedule stating that Section III of the policy covers only Jewellery and not other valuables like Silver statues and silver coins as these do not fall under the definition of jewellery. The claim raised was not justified and the complaint was dismissed. The claim denial is justified. The Insurance company is not liable to pay the claim.

**Answer 6(b)**

The regulatory provisions framed by IRDAI with special focus on "Protection of Policyholders interests" in respect of life and—general insurance claims is as under:

The IRDA (Protection of policy holder Interest) Regulations, 2002, under clause 6 stipulates the matters to be included in a Life Insurance Policy Contract.

As per Regulation 6 of Protection of Policyholders' Interests) Regulations, 2017, A Life insurance policy shall clearly state:

- (a) the name of the plan governing the policy, its terms and conditions;
- (b) whether it is participating in profits or not;
- (c) the basis of participation in profits such as cash bonus, deferred bonus, simple or compound reversionary bonus;
- (d) the benefits payable and the contingencies upon which these are payable and the other terms and conditions of the insurance contract;
- (e) the details of the riders attaching to the main policy;
- (f) the date of commencement of risk and the date of maturity or date(s) on which the benefits are payable;
- (g) the premiums payable, periodicity of payment, grace period allowed for payment of the premium, the date the last instalment of premium, the implication of

discontinuing the payment of an instalment(s) of premium and also the provisions of a guaranteed surrender value.

- (h) the age at entry and whether the same has been admitted;
- (i) the policy requirements for (a) conversion of the policy into paid-up policy, (b) surrender, (c) non forfeiture and (d) revival of lapsed policies;
- (j) contingencies excluded from the scope of the cover, both in respect of the main policy and the riders;
- (k) the provisions for nomination, assignment, and loans on security of the policy and a statement that the rate of interest payable on such loan amount shall be as prescribed by the insurer at the time of taking the loan;
- (l) any special clauses or conditions, such as, first pregnancy clause, suicide clause etc.; and
- (m) the address of the insurer to which all communications in respect of the policy shall be sent;
- (n) the documents that are normally required to be submitted by a claimant in support of a claim under the policy. The Policy contract is approved by IRDAI. The IRDAI has advised that the language of the policy contract should be simple, unambiguous, clear and consistent for better understanding of common man.

## **OTHER AREAS OF PROTECTION OF POLICYHOLDERS INTERESTS**

### **Claims under Life insurance policies**

Upon death of the Life assured, the Nominee shall prefer a claim with the insurance company submitting certain claim documents. A life insurance company may investigate a claim to rule the possibility of any frauds, especially for early claims. Any claim occurring within 2 years of taking a Life insurance policy is categorised as 'Early claims'. This raises a suspicion of breach of the condition of 'utmost good faith', the obligation on the part of the Life assured to disclose the status of his/her health in the Proposal form correctly and without hiding any material information. Therefore, an investigation is undertaken by Life insurance companies with the probable Hospitals, Clinics, Diagnostic Centres, Treating Doctors etc., to verify the status of health of the Life assured at the time of taking the Policy. If the investigation reveal any adverse findings which were not disclosed in the Proposal form for Life insurance, the claim may be repudiated in terms of Section 45 of the Insurance Act, 1938.

Following are the procedural compliance requirements under the IRDAI (Protection of Policyholders' Interests) Regulations, 2017:

- Customer requirements must be raised by Life insurance companies within 15 days of receipt of intimation.
- Non-investigation Claims shall be paid or rejected or repudiated within 30 days of receipt of receipt of all papers & clarifications.
- Time limit for completion of investigation – 90 days – claim to be decided within 30 days of receipt of investigation report.

- For delays in settlement of claims, interest @ 2% above bank rate shall be payable from the date of receipt of last necessary document.
- For disputes in title, payment can be made to Court (Section 47 of Insurance Act, 1938).
- Except claims under Section 47, where claim cannot be paid for want of identification of payee, interest at bank rate payable from the date when claim is ready for payment.
- Where nominee not traceable, claim cannot be written back.
- For deaths due to suicide, 80% of the premiums paid payable (for reinstated cases, higher of 80% or surrender value whichever is higher; for ULIPs fund value).
- Where fraud or misrepresentation is established, surrender value shall be paid.
- For maturity/survival benefit settlement to be made on or before due date. For delays interest at Bankrate+2% from due date or date of receipt of last necessary document from insured/claimant, whichever is later.

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

Time allowed : 3 hours

Maximum marks : 100

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

### Question 1

*Case Study :*

*Comfort Travel is a brand name for the manufacturer of luxury cars by ComfoCar Ltd. The company is based in Japan. It has earned world-wide reputation of producing varieties of luxury cars. It has presence in many countries across the world. In India it has acquired registration in different classes of luxury cars for its trade mark "Comfo", "ComfoTrvl" and "Comfo Device" during the years 1989-2003. It launched the world-wide world's first commercial hybrid car called "Deception" in Japan in the year 1997 and in other countries like UK, Australia, the USA etc. during the year 2000-01. The company claims to have registered the trade mark 'Deception' in different countries as early as the year 1990 (in Japan) and in other jurisdictions around the world. In India the car was released in the year 2009 and till then the company had not registered the mark in India.*

*It plans to enter in the Indian market in the year 2008 with new luxury car. The Company discover that the Company ZZZ had not only got the "deception" registered in India way back in the year 2002-03 for all types of auto parts and accessories but they had also been using the said trade mark in carrying out trade in such auto parts and accessories. The first party or plaintiff therefore approached the trade mark registry for cancellation of the registered trade mark of the defendant and also filed the suit in the court questioning the other party's using the well-known trade mark of the first party without their authorisation and taking unfair advantage of the reputation and goodwill of the first party earned over a period of time across the globe. Plaintiff prayed for permanent injunction restraining the defendant from using the plaintiff's registered trade mark and permanent injunction restraining the defendant from using the well known unregistered marks "deception".*

*The defendant replied that they are using the mark 'Comfo', 'Comfo India' and 'Comfo device' on the packaging materials in which the auto parts manufactured by them are packed for the purpose of item identification and nothing more. Since operating in the same area of industry they are supposed to indicate the cars for which the spare parts have been manufactured by displaying the name on the packaging of the products. Therefore, it is honest use under section 30 and therefore protected under the Act.*

*With regards to the 'Deception' they had registered the mark in year 2002 and continuously using same since the year 2001. They have been regularly supplying the auto accessories to various automobiles giants. By the time they have acquired market reputation for the mark and their services. Since they are operating in India*

*from a time when the plaintiff has not established the product, therefore they are entitled to have the trade mark in their favour. In the background of the above facts, analyse the following issues :*

*Questions :*

- (a) What is the nature of Intellectual Property Rights in general and trade mark in particular the territorial or international or both ?*
- (b) What are the essentials for a mark to be a well-known trade mark ?*
- (c) Can a trade mark which has acquired reputation in foreign State is entitled to acquire trade mark in India ?*
- (d) What are the grounds of passing off and infringements ? (10 marks each)*

**Answer 1(a)**

Intellectual property rights are like any other property right. They allow the creators or owners of patents, trademarks or copyright to get benefited from their own work or investment in a creation. An efficient and equitable intellectual property system can help all countries to realize intellectual property's potential as a catalyst for economic development and social and cultural well-being. The intellectual property system helps strike a balance between the interests of innovators and the public interest, providing an environment in which creativity and invention can flourish, for the benefit of all. Countries have laws to protect intellectual property for two main reasons. One is to give statutory expression to the moral and economic rights of creators in their creations and such rights of the public in access to those creations. The second is to promote creativity, dissemination and application of its results and to encourage fair trading thereby leading to economic and social development.

A trade mark provides protection to the owner of the mark by ensuring the exclusive right to use it, or to authorize another to use the same in return for payment. The period of protection varies, but a trademark can be renewed indefinitely beyond the time limit on payment of additional fees.

In a larger sense, trade marks promote enterprise approach worldwide by rewarding the owners of trademarks with recognition and financial profits. Trade mark protection also prevents the unfair competitors, such as counterfeiters from using similar distinctive signs to market inferior or different products or services. The system enables people with skill and enterprise to produce and market goods and services in the fairest possible conditions, thereby facilitating international trade.

With the advent of WTO, the law of trade marks is now modernized under the Trade Marks Act of 1999 and is in harmony with two major international treaties on the subject, namely, The Paris Convention for Protection of Industrial Property and TRIPS Agreement.

Intellectual Property is developed under the territorial concept of Intellectual Property Rights. The State defined and recognised the rights of the stakeholder. The rights were applied and enforced within the jurisdiction of State. Therefore, it is known as territorial right. However, with the development of international conventions new intellectual property rights were recognised. It provided unification to the concept and principles relating to intellectual property rights. However, it did not change the nature of intellectual property

rights. The rights are legislated by the State to be enforced within the boundaries of the State. Therefore the nature of Intellectual Property Rights irrespective of international development remains territorial in nature.

### **Answer 1(b)**

Being the signatory of the Paris Convention and TRIPs Agreement, India recognises the concept of a well known trademarks. Under section 2(l)(zg) of the Trade Marks Act, 1999, "well known trade mark", in relation to any goods or services, mean a mark which has become so to the substantial segment of the public which uses such goods or receives such services that the use of such mark in relation to other goods or services would be likely to be taken as indicating a connection in the course of trade or rendering of services between those goods or services and a person using the mark in relation to the first mentioned goods and services.

A mark, which has been designated as a well- known mark, is accorded stronger protection. The Trade Marks Act, 1999 casts an obligation on the registrar to protect a well-known mark against an identical or similar trade mark. While determining whether a trademark is a well-known trade mark, takes into account all the facts which considers relevant for determining a trade mark as a well-known trade mark including the following factors:

- That the trade mark is well known to the public at large in India;
- The number of persons involved in the channels of distribution of the goods or services;
- The number of actual or potential consumers of the goods or services;
- The duration, extent and geographical area of any use of such trade mark;
- The business circle dealing with those goods or services.

Many countries protect unregistered well-known marks in accordance with their international obligations under the Paris Convention for the Protection of Industrial Property and the Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement).

### **Answer 1(c)**

The object of Trade Mark law has been explained by the Supreme Court in *Dau Dayal v. State of Uttar Pradesh*, AIR 1959 SC 433, in the following words:

“The object of trade mark law is to protect the rights of persons who manufacture and sell goods with distinct trade marks against invasion by other persons passing off their goods fraudulently and with counterfeit trade marks as those of the manufacturers. Normally, the remedy for such infringement will be by action in Civil Courts. But in view of the delay which is incidental to civil proceedings and the great injustice which might result if the rights of manufacturers are not promptly protected, the law gives them the right to take the matter before the Criminal Courts, and prosecute the offenders, so as to enable them to effectively and speedily vindicate their rights”.

The trade mark law in India is a ‘first-to-file’ system that requires no evidence of prior use of the mark. A trade mark application can be filed on a ‘proposed to be used or intent-

to-use' basis or based on use of the mark. The term 'use' under the Trade Marks Act, 1999 has acquired a broad meaning and does not necessarily mean the physical presence of the goods in India. Presence of the trade mark on the Internet and publication in international magazines and journals having circulation in India are also considered as use in India. One of the first landmark judgments in this regard is the "Whirlpool case" [*N. R. Dongre v. Whirlpool Corporation*, 1996 (16) PTC 583] in which the Court held that a rights holder can maintain a passing off action against an infringer on the basis of the trans-border reputation of its trade marks and that the actual presence of the goods or the actual use of the mark in India is not mandatory. It would suffice if the rights holder has attained reputation and goodwill in respect of the mark in India through advertisements or other means.

In the case of *Daimler Benz v. Hybo Hindustan* [AIR 1994 Del 2369], the defendant had been using the plaintiff's logo and the word 'Benz' for which the plaintiff sought injunction against such use of his logo. The court while recognizing plaintiff's logo as a well-known trademark on the ground of trans-border reputation and goodwill granted injunction against the impugned use of logo by the defendant.

In another case of *Rolex Sa v. Alex Jewellery Pvt. Ltd. & Ors.* [2009 (41) PTC 284 (Del.)], the defendants were using the trade name "Rolex" of the plaintiff while dealing in artificial jewellery for which the plaintiff brought an action against the defendant in order to prevent him from using his trade name further. The court held that the plaintiff's business dealt with watches, and the section of public using watches recognizes the trade name Rolex, for which it is a well-known trademark. The same segment of people if finds artificial jewellery with the same trade name might assume the artificial jewellery to be from plaintiff's business. For the same reasons, the court considering Rolex to be a well-known trademark granted injunction against the acts of defendants. In the present case the respondents are the original and earlier users of the trademark.

Being a signatory to the Paris Convention and TRIPs Agreement, India recognizes the concept of a well-known trade marks. A mark, which has been designated as a well-known mark, is accorded stronger protection. The Trade Marks Act, 1999 casts an obligation on the Registrar to protect a well-known mark against an identical or similar trade mark. Accordingly, the Registrar should allow the Japanese Company to use the Trade Mark.

#### **Answer 1(d)**

Infringement, very broadly means taking unfair advantage or being detrimental to the distinctive character or reputation of a trade mark. Under the Trade Marks Act, 1999 the meaning of infringement has been enlarged as more actions shall be taken as constituting infringement which are listed in Section 29.

Section 29 of the Trade Marks Act dealing with infringement of trade marks explicitly enumerates the grounds which constitute infringement of a registered trade mark. This section lays down that when a registered trade mark is used by a person who is not entitled to use such a trade mark under the law, it constitutes infringement. This section clearly states that a registered trade mark is infringed, if the mark is identical and is used in respect of similar goods or services; or the mark is deceptively similar to the registered trade mark and there is an identity or similarity of the goods or services covered by the trade mark; or the trade mark is identical and is used in relation to identical goods or

services; and that such use is likely to cause confusion on the part of the public or is likely to be taken to have an association with the registered trade mark.

The infringement action is a statutory remedy available to the registered proprietor or to the registered user, based on statutory rights conferred by registration of a trade mark, subject to other restrictions laid down in Sections 30, 34, 35 of the Trade Marks Act, 1999.

An infringement action is available to the registered proprietor or registered user to enforce his exclusive right over the trade mark in relation to the goods in respect of which it is registered. If at the time of registration of trade mark, certain limitations or conditions have been imposed, then, the exclusive right has to be evaluated within the terms of such registration.

Further, in the case of *Mahendra and Mahendra Paper Mills Ltd. Vs. Mahindra and Mahindra Ltd.* [AIR 2002 SC117] Supreme Court broadly stated, in an action for passing – off on the basis of unregistered trade mark generally for deciding the question of deceptive similarity the following factors are to be considered—

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

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

### **Relief in Suits for Infringement/Passing Off**

*Civil Litigation* : A suit can be initiated either under the law of passing off or for infringement under the Trade Marks Act, 1999 depending on whether the trade mark is unregistered, pending registration or registered respectively.

*Jurisdiction and Venue* : The suit for passing off and/or infringement can be initiated either in the District Court or in the High Court depending on the valuation of the suit. The suit can be at the place where the rights holder or one of the rights holders actually and voluntarily reside or work for gain or carries on business.

*Elements of the Complaint* : In the complaint, the rights holder is required to

demonstrate that (a) the alleged infringing act involves a mark that is identical or similar to a trade mark of the rights holder; (b) the infringing representation of a trade mark is being used in connection with goods or services and might lead to confusion in public regarding the origin of the infringing goods/services; (c) the unlawful act interfered with the trade mark holder's rights of exclusive use or caused the rights holder economic loss.

### Question 2

- (a) *Dr. Albert Costa is Professor and Scientist with TATA Institute of Medical Science, working in the area of molecular biology. During the process of his research with regards to the environmental impact in his lab, he accidentally invents a new microorganism which eats up the plastic content and converts it to bio product. Hoping that his invention will eradicate the plastic related environmental pollution worldwide, he wants to take the credit for his invention. What kind of Intellectual Property Rights protection he is entitle to ? Give justification if any. (6 marks)*
- (b) *Regenerate Inc. is a Multinational Company operating around the world over and specialises in genetic mutation of the plants and seeds. In India, it has opened its subsidiaries in Ahmedabad. It collects the seeds of tomato plant from traditional farmers from Punjab region and successfully genetically modified it to grow up/cultivate in arid tropical areas of Indian subcontinental. The experiments is a huge successful one. The genetic manipulation of seeds not only makes it suitable for other ecological environment, but also enhances the quality and size of the tomato. Advise them as to how their interest as inventor will be protected under current Intellectual Property Rights regime in India. (6 marks)*

### Answer 2(a)

As per the Patents Act, 1970, Patent of life forms are not allowed. Section 3 of the Patents Act deals with invention which are not patentable.

Section 3 (j) of the Patents Act, 1970 deals with the plants and animals in whole of any parts thereof other than microorganisms but including seeds varieties and species and essentially biological processes for production or propagation of plants and animals are not inventions. As per this provision the plants in whole or in part, animal in whole or in part, seeds, varieties and species of plant and animals, essentially biological processes for production or propagation of plant and animal are not patentable. However, Section 3 (j) makes an exception with regards to the microorganism, other than the ones discovered from the nature, may be patentable. For instance, genetically modified microorganism may be patentable subject to other requirements of patentability.

### Answer 2(b)

The genetically manipulated seeds in this case can be protected under the Protection of Plant Varieties and Farmers Rights Act, 2001 as the subject is outside the purview of Indian Patent Act, 1970. The Act recognizes the breeders right with regards to the scientific modification of the seeds and therefore for its protection the eligibility criteria of the Plant Variety has to be fulfilled i.e., section 15 of the Act defines the criteria of (1) novelty, (2) distinctiveness, (3) uniformity, (4) stability. The criteria of novelty is not as tough as in the

case of Indian Patent Act, 1970. The new variety needs to be registered under the Protection of Plant Varieties and Farmers Rights Act, 2001 for the Intellectual Property Right protection.

For registration of plant variety the following pre-requisites are essential :

- 1) Denomination assigned to such variety.
- 2) Every application shall be accompanied by an affidavit by showing that such variety does not contain any gene or gene sequences involving terminator technology.
- 3) Complete passport data of parental lines with its geographical location in India and all information relating to the contribution if any, of any farmer(s), village, community, institution or organization etc., in breeding, evolving or developing the variety.
- 4) Characteristics of variety with description for novelty, distinctiveness, uniformity and stability.
- 5) A declaration that the genetic material used for breeding of such variety has been lawfully acquired.
- 6) A breeder or other person making application for registration shall disclose the use of genetic material conserved by any tribal or rural families for improvement of such variety

### Question 3

- (a) *Mr. XYZ is a professional photographer hired by the tv channel Nature & Discovery to capture the movement of various animals in the jungle and create documentary. Mr. XYZ fixed his camera in different parts of the jungle for 24 × 7 hours. On the fourth day when he returns back to the place of camera, he discovers that his cameras are uprooted from their places. On search he discovers various selfies of the monkeys on his camera. He takes the credit for the monkey selfie and publishes it across the globe. He is highly appreciated for the photo. PETA, an NGO files case against him alleging that it is not his copyright work, but of the monkeys, as they clicked the photos by themselves. Decide the fate of copyright authorship and ownership in the given case with proper justifications. (6 marks)*
- (b) *During his stay for sociological research at tribal populated area of State A among tribal people, Mr. X discover that the indigenous community are immune from mosquito related infections and diseases. On testing the blood samples, he discovered that their immunity power is comparatively more in comparison to the urban people of the same age in neighbouring areas. Upon further research, he discovered that they consume daily certain herbal leaves of specific plant only found in their region. He shares this knowledge in the article published in the international journal Nature and Medicine. Company ABC impressed by the research article investigated and did the research from their end to verify the fact and on confirming the medicinal properties in the plant they started manufacturing medicines with the ingredients of the specific plant and its leaf to enhance the immunity power. Advise them if they can seek patent rights on medicine. (6 marks)*

**Answer 3(a)**

Copyright authorship and ownership is dependent on the fact and circumstance of the situation. The major issue in the given case is whether the animal's intellectual creativity can be a matter of copyright protection. The Intellectual Protection Rights jurisprudence right from the inception takes into consideration the intelligence of human beings only and therefore all Intellectual Protection Rights concepts are built and explored for the enjoyment of human beings. From the national and international perspective, the concept has been discussed from human angle only. Therefore, animal can't claim the copyright protection over the creative work.

Further, in the case of *Naruto v. Slater*, No. 16-15469 (9th Cir. 2018), the Ninth Circuit affirmed that the monkey lacked statutory standing because the Copyright Act does not expressly authorize animals to file copyright infringement suits.

**Answer 3(b)**

Section 3(p) of the Patents Act, 1970 provides that an invention which effect, is traditional knowledge or which is an aggregation or duplication of known properties of traditionally known component or compounds is not an invention. Traditional knowledge being knowledge already existing is not patentable. An example is the antiseptic properties of turmeric for wound healing. Another example is the pesticidal and insecticidal properties of neem. The examiner conducts an investigation by using the Traditional Knowledge Digital Library (TKDL) and other resources to decide as to whether the claimed subject matter falls within the purview of the above provision.

However, if there is a substantial improvement in the existing Traditional Knowledge (TK) which enables the invention to fulfil the criteria under the Indian Intellectual Property (IP) Law, Intellectual Property protection can be sought. The key issue in protecting Traditional Knowledge is prior knowledge of the innovation as much of Traditional Knowledge is already in public domain being passed on orally or through documentation through generations. This makes most Traditional Knowledge ineligible for IP protection as majority of information is already part of "prior art" and therefore there is very little in terms of novelty which can be established for patent protection.

Traditional Knowledge is an integral part of strength of local community knowledge. Attempts to exploit TK owned by local communities, for industrial or commercial benefit is a major issue as it is unfair exploitation of knowledge owned by local communities, as IP protection creates monopoly of patent owners. Governments the world-over including India have enacted laws to prevent such unfair exploitation of TK. Indian law has adequate provisions for the protection of TK. Traditional knowledge, by its very definition, is in the public domain and hence, any application for patent relating to TK does not qualify as an invention under section 2 (1) (j) of the Patents Act, 1970, which defines that "invention means a new product or process involving an inventive step and capable of industrial application".

**Question 4**

- (a) *XYZ company has ventured into design work. It provides logistic as well as creates architecture design for their clients. They made a three-dimensional diagram for the new corporate office for ABC Company Pvt. Ltd. in Delhi in 2006, and paid the consideration of ` 10 lakh for that. However, it planned in 2016 to*



*work on it and create infrastructure according to the design. To their surprise, they discovered the same architecture design as created by the other builder in making commercial complex. What kind of rights are violated and what is the remedy ?*

*(b) Discuss how labour theory is different from the functional theory in justifying the intellectual property. (6 marks each)*

#### **Answer 4(a)**

Design as per Section 2(d) of the Designs Act, 2000 means only the features of shape, configuration, pattern or ornament or composition of lines or colour or combination thereof applied to any article whether two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual, mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye, but does not include any mode or principle or construction or anything which is in substance a mere mechanical device, and does not include any trade mark, as define in clause (v) of sub-section of Section 2 of the Trade and Merchandise Marks Act, 1958, property mark or artistic works as defined under Section 2(c) of the Copyright Act, 1957.

Section 30 of the Design Act, 2000 read with Rules 32, 33, 34 and 35 of the Design Rules, 2001, recognizes the contracts relating to assignment of designs and provides procedure thereof. The Copyright in the design is only protected if the same is statutorily recognized under the provisions of the Designs Act, 2000. Similarly, the rights acquired by third parties by way of assignments or licenses are only made effective if the same is duly registered in accordance with the provisions of the Act and the Rules framed there-under. There is no concept of common law license under design law.

A registered proprietor can institute a suit for injunction as well as recovery of damages against any person engaged in piracy of the registered design. Such legal proceedings can be instituted from the date of registration and till the expiry of copyright. However, in case of reciprocity application, the registered proprietor can claim damages only from the actual date on which the design is registered in India.

If any person commits piracy of a registered design, as defined in Section 22, he shall be liable to pay for a payment of a sum not exceeding Rs. 25,000/- recoverable as contract debt. However, the total sum recoverable in respect of any one design shall not exceed Rs. 50,000/-.

The suit for injunction/damages shall not be instituted in any Court below the Court of District Judge.

In a case between Ampro Food Products v. Ashok Biscuit Works, AIR 1973 AP 17, the appellant manufactured biscuits with AP embossed on them. The respondent also manufactured biscuits with identical design except that letters AB were embossed on them, in place of AP. The suit claimed injunction bringing a charge of piracy of design. Issuing a temporary injunction, the Court held that in such cases the defence cannot argue that the appellant's registered design was not new or original if no steps had been taken earlier seeking cancellation of the registration of the design.

#### **Answer 4(b)**

Labour theory is also known as positive theory. The underlying principle of the theory is that labour of the individual is the foundation of the property. As per the theory A

product is a property of a person who produces it or bring it into existence. Property is the result of individual labour and therefore no person has a moral right to the property which has not been acquired by his personal efforts. The theory is individualistic in approach in relating to property rights.

Functional theory is also known as sociological theory of property. According to the theory no one can be allowed to have an unrestricted use of the property to the detriment of others, the use of the property should conform to the rules of the reason and welfare of the community. The theory takes into concern the society as a whole and therefore maintains a welfare approach towards the creation of the property.

### Question 5

- (a) *Geographical indications serve to recognize the essential role geographic and climatic factors and/or human know-how can play in the end quality of a product. Discuss.*
- (b) *What are the cases and the legislations you can quote that will justify that trade secrets are protected in India ? Elucidate. (6 marks each)*

### Answer 5(a)

Geographical Indications (GIs) serve to recognize the essential role geographic and climatic factors and/or human know-how can play in the end quality of a product. Like trademarks or commercial names GIs are also Intellectual Property Rights (IPRs), which are used to identify products and to develop their reputation and goodwill in the market. The Agreement on Trade Related Aspects of Intellectual Property (TRIPS), prescribes minimum standards of protection of GIs and additional protection for wines and spirits. Articles 22 to 24 of Part II Section III of the TRIPS prescribe minimum standards of protection to the geographical indications that WTO members must provide. Moreover, TRIPS leaves it up to the Member countries to determine the appropriate method of implementing the provisions of the Agreement (including the provisions on GIs) within their own legal framework (Article 1.1).

Notably, under the Agreement on Trade Related Aspects of Intellectual Property (TRIPS), countries are under no obligation to extend protection to a particular geographical indication unless that geographical indication is protected in the country of its origin. India did not have such a specific law governing geographical indications of goods which could adequately protect the interest of producers of such goods. This resulted in controversial cases like turmeric, neem and basmati. In the case of turmeric, in March 1995, a US Patent was granted to two NRIs at the University of Mississippi Medical Centre Jackson, for turmeric to be used as wound healing agent. This patent was challenged by CSIR at the USPTO on the ground of "Prior Art" claiming that turmeric has been used for thousand years for healing wounds and rashes and hence this was not a new invention. Even CSIR presented an ancient Sanskrit text and a paper published in 1953 in the Journal of the Indian Medical Association as documentary evidence. Upholding the objections, the US patent office cancelled the Patent.

Agricultural products typically have qualities that derive from their place of production and are influenced by specific local, geographical factors such as climate and soil. It is therefore not surprising that a majority of GIs throughout the world are applied to agricultural products, foodstuffs, wine and spirit drinks. However, the use of GIs is not limited to

agricultural products. A GI may also highlight specific qualities of a product that are due to human factors found in the product's place of origin, such as specific manufacturing skills and traditions. That is the case, for instance, for handicrafts, which are generally handmade using local natural resources and usually embedded in the traditions of local communities. For want of adequate legal protection, the legitimate right holders of various GIs of Indian origin, for instance, have long since been adversely affected by such unscrupulous business practices. Innumerable companies and traders have been found to be free-riding on the goodwill and reputation associated with various renowned geographical names of Indian origin, for years. For instance, tea produced in countries like Kenya, Sri Lanka, have often been passed off around the world as 'Darjeeling tea', which originally denotes the fine aromatic produce of the high-altitude areas of North-Bengal, from where it received the name.

### **Answer 5(b)**

Trade secrets, just as other intellectual property rights, can be extremely valuable to a company's growth and sometimes even critical for its survival. Businesses must ensure that they adequately protect their business processes, technical know-how and confidential information from competitors. A trade secret may refer to a practice, process, design, instrument or a compilation of data or information relating to the business which is not generally known to the public and which the owner reasonably attempts to keep secret and confidential. Such data or information may also involve an economic interest of the owner in obtaining an economic advantage over competitors.

The precise language by which a trade secret is defined may differ, however there are three factors, which can be said to be common to all such definitions. They are -

- It must not be generally known or readily accessible by people who normally deal with such type of information.
- It must have commercial value as a secret.
- The lawful owner must take reasonable efforts to maintain its secrecy.

But the Indian Courts have tried putting the trade secrets of various businesses under the purview of various other legislations in order to protect them and also they have tried to define what a trade secret is in various cases, some of them are as follows:-

1. *American Express Bank Ltd. v. Ms. Priya Puri* (2006) III LLJ 540(Del) Delhi High Court, in this case defined trade secrets as "... formulae, technical know-how or a peculiar mode or method of business adopted by an employer which is unknown to others."
2. *Michael Heath Nathan Johnson v. Subhash Chandra And Ors* (60(1995) DLT 757) and *John Richard Brady And Ors v. Chemical Process Equipments P. Ltd. And Anr* (AIR 1987 Delhi 372) took note of the contentions of the counsels who referred to English decisions to define trade secrets
3. *Mr. Anil Gupta and Anr. v. Mr. Kunal Dasgupta and Ors* [97 (2002) DLT 257] the Delhi High Court held that the concept developed and evolved by the plaintiff is the result of the work done by the plaintiff upon material which may be available for the use of anybody, but what makes it confidential is the fact that the plaintiff has used his brain and thus produced a result in the shape of a concept.

The legislations which are having a connection with the trade secrets can be summed up as

1. Copyright Act, 1957[Section 51,55 and 63]
2. Designs Act, 2000
3. The Information Technology Act, 2000[Section 65, 72]
4. Indian Penal Code [Section 408, 415]
5. The Indian Contract Act [Section 27]
6. The Competition Act, 2002 [Section 3]
7. Civil Procedure Code
8. Criminal Procedure Code.

#### Question 6

*Mr. Zubair claimed that around 2006 he wrote the script of the film "Once upon a time" and had it registered with the Film Writer's Association in Mumbai. He asserted that upon registration, he was accorded a registration number : No.RNA-1856743. He claimed that he was looking out for producers, for conversion of the script into a film when he met Mr. Subhash Kapoor. As per him the meeting took place in and around May-June 2007 and agreed to convert it to movie. The pre-production work for making of the hindi version of "once upon a time", according to the him, commenced in and about July, 2007. Between July-January, 2008, several other producers had expressed interest in producing a hindi film, based on the script. However nothing happened as all such producers/production houses demanded transfer of entirety of rights in the script, which included derivative works, remakes and versions of films produced by them. Zubair was interested to grant a license to the producer to use his script for the limited purpose of making a cinematograph film in hindi language alone. The shooting of the film "once upon a time" commenced in December, 2008. The film finally completed on August, 2010.*

*The film received excellent reviews from the critics and also won the Grand Jury Prize at the New York Film Festival, the film, did not do well commercially. As per Zubair the commercial failure of the film was on account of the producers not being able to provide wide publicity to the film. He claimed that since he got to know in March, 2013, that the producers are attempting to dub the film in Telugu, Punjabi, Bangla language and also, perhaps, were wanting to remake and/or adapt the said film, albeit, without his prior consent. Zubair feel betrayal and plan to take action against producer.*

*Advise him on the following issues :*

*(a) Who has the rights with regarding dubbing of the movie ?*

*(b) What are the derivative rights ?*

*(6 marks each)*

#### Answer 6(a)

As per the Copyright Act, 1957, the author has he right with regards to various

economic rights. Since there is no assignment of his rights partial or fully, the right with regards to script sold to producer is with regards to the production of film. Section 14 of the Act defines the right of author and assign him reproduction, publication, performance of work, make cinematograph work rights. The same section provide the rights to the producer in case of cinematograph work the right to “communicate the film to the public” The Madras High Court in the case of *Mr. Thiagarajan Kumararaja v. M/s Capital Film Works (India) Pvt Ltd.*, decided on 20.11 2017 held that right to remake or make different version of film does not fall within the expression “communicating the film to the public” as this would entail change being made in the original script without the consent of author. The producer can't remake the subject film or make other version of the same film.

#### **Answer 6(b)**

Copyright also protects 'derivative works' that includes translation, adaptation, arrangement of music and other alteration and modification of literary and artistic work-all receive the same protection as original works. Adaptation is generally perceived as a modification of original work to create another work. For example-adapting a novel to make a film or adapting a textbook that is originally written universities, to make it suitable for a lower level. Section 2(a) of the Copyright Ac, 1957 defines the word adaptation. An adaptation under Indian law is basically a change of format i.e. a copyrighted work is converted from one format to another. If an adaptation is created by adding a significant amount of new material, then such work would not be considered as adaptation under Copyright Act, 1957. The copyright in a derivative work will only extend to the material contributed by the adapter and does not affect the copyright protection given to the original material. According to copyright theory, adaptation is a work which is essentially the same as the original work although there may be a change in the format. If we refer to copyright theory and read it in conjunction with copyright law, it might be possible to argue that adaptations derivations, and transformations, are distinct species although they belong to the same family. Adaptation and derivation both belong to one genus and transformation belongs to another genus.

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## **FORENSIC AUDIT** (Elective Paper 9.4)

Time allowed : 3 hours

Maximum marks : 100

- NOTE:** 1. Answer ALL Questions.
2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.

### **Question 1**

*Case Study :*

*PD Limited which is a public limited Company incorporated on 1st January, 2000 under the provisions of Companies Act, 1956. The main object of the company is to promote the formation and mobilisation of capital and to promote industrial finance by way of advance, deposits, lending money, to manage the capital, saving and investment, to act as a discount and acceptance.*

*Further, it is also stated that the company can carry on and undertake business of finance and trading, refinance, to act as or carry on the business of consultants, advisors, experts and technical collaborators in matters pertaining, without prejudice to the generality of the foregoing, portfolio management services, syndication of loans, counselling and tie-up of project and working capital, infrastructure of finance, corporate restructuring, corporate planning and strategic planning, foreign currency lending or borrowing, project planning and feasibility, investment counselling, setting up of joint ventures and further perform any other kind of role as an Intermediary or Advisor in the security market.*

*The PD Limited has a wholly owned subsidiary company and that subsidiary company has subsidiary company. These companies are formed for the same objects as of the main company. The company launched various public deposit schemes such as saving deposits, fixed deposits and recurring deposits. The total amount of public deposits collected by the Company amounts to ₹1400.00 crores. However only 19% of the above amount has been invested by the company in statutory liquidity ratio. In the year 2019, it is observed that various complaints came to be lodged by the depositors and creditors before statutory agencies like RBI on non-payment of interest and non-return of deposits. It appears that the company has failed to comply with almost all the norms prescribed for a non-banking financial company.*

*The unpaid depositors and creditors filed a petition for the winding-up of the company. Further complaints have been lodged against the directors/promoters alleging fraudulent diversion of money and dishonest misappropriation of funds. The company apparently in financial troubles and is found struggling to pay interest and principal to the depositors. Based on the allegations, Government conducted a preliminary investigation which reveals a misappropriation of nearly ₹1000.00 crores.*

*The Government has approached your firm to conduct a Forensic Audit of the PD Limited and its subsidiaries. The scope of the audit has to be formulated on the following allegations made :*

- (1) Non-maintenance of books of accounts and proper records;*
- (2) Diversion and misappropriation of funds, including acquisition of immovable properties at Mumbai and Chennai;*
- (3) Failure on part of the company in non-payment of invest and in repaying the deposits accepted.*

*On the basis of the above, draw up a plan of action which you will adopt to fulfill your work to (suitable assumption may be made by you) indicate your approach in the following areas :*

- (a) Detailed Methodology.*
  - (b) Findings of the case based on your methodology.*
  - (c) Limitation to a forensic report.*
  - (d) Legal steps that could be taken against company, its subsidiaries and their directors.*
- (10 marks each)*

### **Answer 1(a)**

#### **Detailed Methodology**

A study of the basic documents of the company and its subsidiaries like the Memorandum of Association, Articles of Association, Minutes books etc. to ascertain whether the organisation have been running the business properly or not.

The following are the measures to be taken under detailed methodology :

1. Analyse and investigate the financial records of the company from the beginning.
2. The examining team to be divided into three groups to understand the work and give a comprehensive report.
3. One group to scrutinize and analyse the documents and records.
4. Second group to examine third parties to investigate into the affairs of the said companies.
5. Third group to verify the relevant management standard of the company and its performance.
6. The team to inspect all books of accounts and statutory records and photocopies of all necessary documents to be taken into custody.
7. Details of cash deposits received from various depositors and of non cash payment made by the company to be examined.
8. Certified copies of statement of all bank accounts to be obtained. Further, an examination needs to be held to find out other undisclosed bank account in India and abroad.

9. Examination of records with statutory authorities like Registrar of Companies 'ROC'.
10. Collect the relevant documents regarding the immovable properties from registration authorities.
11. A proper evidential analysis of the entire circumstances on the basis of evidence gathered, examination and inspection of records and interviewing people including depositors.
12. Frequent changes in top management including the Board of Director to be thoroughly investigated along with the flow of power channelized time and again.
13. Refer to relevant guidelines relating to acceptance of deposits by an NBFC to identify apparent non-compliances by the alleged entity.
14. Statutory Audit report and Internal Audit Report of last 5 years to be scrutinized to check for any qualifications.
15. Carry out market intelligence in the form of a site visit to the location of company and its Directors.
16. Disk imaging of directors and KMPs.

#### **Answer 1(b)**

##### **Findings of the case based on Methodology**

###### Misappropriation of funds and acquiring Immovable Properties

1. It was observed that the company made huge payments to the various directors without proper and necessary resolutions, Minutes of Meeting or other statutory records.
2. The Company purchased immovable property by Mr. X who is related person of Ex-director without having a proper authorisation. The certified copies of land records are to be part of the report.
3. It is observed that investors were promoted to invest in various schemes through cash deposit as a preference means.
4. The Company has failed to comply with almost all the norms prescribed for a non-banking financial company.
5. The company in financial troubles and is found struggling to pay interest and principal to depositors.
6. It was observed and noted that most of records are not available with the Company.
7. A formal case of misappropriation and cheating may be lodged against the Company and its Directors.

#### **Answer 1(c)**

##### **Limitation to a Forensic Report**

1. *Time Constraints* : Various persons could not be interviewed.
2. Company officials not co-operated to provide the exact details of the investors to the team member.



3. Since the company is old, all documents were not properly maintained and made available.
4. Some of the old vouchers and records were destroyed by banks in terms of the rules of preservation of records.
5. Ex-management did not respond to the questions being asked by the team.
6. There have been reliance on judgement on interpretation of certain information as made available by management.
7. The audit findings are presented purely on the basis of information as made available as part of our investigation and there could be a possibility of certain key information being withheld by the management in connivance with statutory auditors.

#### **Answer 1(d)**

**Legal Steps** : A formal case for cheating and fraud and siphoning of money of the Company is to be lodged against the Company and its directors for siphoning of money of the company in the garb of deposit schemes being floated by the company.

- Acquisition of properties in the name of Directors, Ex-Directors or their Benamies being an illegal act can lead to prosecution.
- Non- Adherence to Income Tax Act and rules regarding receipts of money by cash.
- Cancellation of the license for not conducting the business as per prescribed regulations.
- Benami Act may also be considered to take back the properties acquired in different names.

Under Section 447 of the Companies Act, 2013, punishment has been provided for fraud which says without prejudice to any liabilities including repayment of any debt under this act or any other law for time being in force, any person who is found to be guilty of fraud shall be punishable with imprisonment for a term which shall not be less than 6 month but which may extend to 10 years and shall also be liable to fine which shall not be less than amount involved in the fraud, but which may extend to 3 times the amount involved in the fraud.

Indian law also provides under Criminal Procedure Code 1973 and under Indian Penal Code 1860 for punishing when fraud is found under IPC Section 421,422,423 and 424.

#### **Question 2**

*PQR & company are the manufacturers of sophisticated consumer products. They have a system of getting certain work done by Job Workers. The costly raw material will be sent to the Job Worker through the company's transport and delivery challan will be prepared by the Stock Manager and acknowledgement obtained from the Job-workers on delivery. Job Worker will process the material as per the company's instruction and specification and the same will be inspected by the Quality Controller of the company at the premises of the Job Worker; entire quantity of material sent earlier now in semi-finished form will be returned to the company for which the company*

*itself provides their own transport. A reasonable percentage for shortage and wastage and rejections of a maximum of 2% was allowed by the company to the Job Worker. This engagement was established for some years and was found to be working well. Processing charges are paid to the Job Workers on receipt of the processed material along with his challan. However, some complaints have come recently from some sources that some processed materials was selling in the market.*

*Management is desirous of conducting a Forensic Audit. In the background of aforesaid facts, you are required to :*

- (a) *Indicate your line of Investigation.* (8 marks)
- (b) *Do the facts fall to be considered as fraud as per sec. 447 of the Companies Act, 2013 ? Discuss.* (4 marks)

### **Answer 2(a)**

On going through the case, certain points arise viz. materials sent to job worker are costly and the company itself sends through its transport and brings back by their own transport and returned materials are accounted after deduction at 2% for wastages. It is said that it is their practice.

As an auditor, we planned to have a casual discussion with the Stock Manager on the arrangement that is going on. He explained raw material being costly, it is transported to job worker considering the safety and that after approving the process, the same is brought back by the company itself by certain authorised transporters for safety purpose. On the challan prepared by Job worker while sending back the stock, he clarified that since other document prepared by the Quality controller after allowing 2% for wastage will be accounted as usual and challan of job worker will not be considered. Regarding the wastage, he said that much importance is not given to small things.

We have decided to visit the place where the Job Work process is carried out to know the operation. He is doing the job for PQR Company only. On wastage and rejection, he said that earlier job was carried manually and some wastage or rejection had arisen but now the job is done by latest technology and very rarely wastage or rejection occurs. Now it is clear that there is no wastage and that the entire quantity was going back and therefore a deduction of 2% was unwarranted. To tackle the situation, we have taken the address of the transporters who bring back the materials.

Questioning them and investigating further, the driver of the vehicle admitted that on instruction of stock manager, every time some quantity of the processed material was under dispatch from the Job worker to the factory, a part of it would be unloaded in the premises of the stock manager and the balance alone will be delivered in the office.

With the facts ascertained, the Stock Manager was cornered who accepted that unknown to the management, he was selling the processed material and pocketing money.

The Forensic Auditor has finally unearthed the fraud for management to take action.

### **Answer 2(b)**

Fraud as per Section 447 of the Companies Act, 2013 is defined as below:

1. In relation to affairs of a company or a body corporate, includes any act, any omission, concealment of any fact or abuse of position.

2. Committed by a person or any other person with the connivance in any manner with intent to deceive, to gain undue advantage from, or to injure the interests of the company or its shareholders or its creditors or any other person.
3. Whether or not there is any wrongful gain, or any wrongful loss.

On the strength of the facts found in this case, fraud u/s 447 of the Companies Act, 2013 is established.

### Question 3

- (a) *Agarwal & Company is one of the major infrastructure companies, deals with building of bridges, roads etc. They obtained road construction contract from the Government for execution of a project. They called for tender area wise and bids were received from subcontractors. It is the policy to entrust the job only to the person who has a class I status in contracting. Bids were finalised and the one who quoted lower price was awarded construction of road etc. in a particular area. In one of the contract the estimated value of contract was ₹ 20 lakh and the winner of the subcontract was LM. Past records show that LM had undertaken such type of contract earlier, say five years back, for this company and he was very familiar to Executive Engineer of the company. He used to visit the company frequently and finally succeeded in getting the contract now. LM has made the request for advance of 50% of the contract amount, but the company policy was to give advance only 20% subject to production of a bank guarantee from a nationalized bank in favour of the company. In the instant case LM persuaded the company to accept his FD receipt i.e. two receipts for each ₹ 2 lakh issued by the banker in lieu of bank guarantee. After prolonged discussion among the Executives, the company has agreed to accept FD receipt and paid advance money.*

*LM commenced work and finished only 10% of the road construction contract. Information reached the company that LM stopped the work abruptly and no further work was carried out. The company made efforts to contact him but to no avail. Company issued notice to LM and there was no response. The legal notice was also issued and returned with the remark that "addressee not found".*

**Recovery process :** *The company approached the bank for the purpose of encashing the two FD receipts of ₹ 4 lakh endorsed in favour of Company by LM. To the disappointment of the company, the bank said that they had not issued the said FD receipts to LM and that the said two receipts were fake. Denial by the bank does not seem to be correct and require further investigation. The company decided to have the matter investigated. Your help is sought to conduct a Forensic Audit.*

- (i) *What may be your assumption before proceeding to undertake this case ?*  
(3 marks)
  - (ii) *What will be your mechanism of Forensic Audit to help the Company to recover the advance money ?*  
(5 marks)
  - (iii) *What will be liability of bank in this case ?*  
(1 mark)
- (b) *Discuss "Direct evidence and Circumstantial evidence" under the Evidence Act.*  
(3 marks)

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

1. The Executive Engineer's activity requires a probe since he is the sole authority to accept the bid for road construction. The reason for accepting the lower bid by Mr. LM and considering the facts that LM was associated with the company for a long five years throws some doubt.
2. Whether any person from the Company influenced bank for helping Mr. LM to get fake deposit receipts.
3. Reason for deviation from the practice of accepting bank guarantee.

**Answer 3(a)(ii)****Mechanism of Forensic Audit**

Having accepted to audit this case, permission will be taken from the Managing Director to interview the Executive Engineer. The response from the engineer are given as under:

- LM was not given contract for the past 5 years because he quoted high amount.
- His work done in previous period was satisfactory.
- Is he your friend because he frequently comes and meet you? No.
- Then why he comes and meets you? He comes and pleads for a contract. That's why you have given contract to him now. Not like that. He quoted low price and therefore awarded.
- Was he having any difficulty for undertaking the work? Has he expressed to you any time? No
- Why your company accepted FD receipts instead of Bank Guarantee? You have pity on him and hence accepted. He smiled and no concrete reply.

It is clear that because of some gratification from LM, the contract was given to LM despite the fact that LM was having financial problem.

Our next meeting was with Accounts Department to know as to why they did not check the genuineness of the Fixed Deposit receipts. They should have gone to the bank and got a lien on the said receipts recorded without lien, how is it possible to get the money from the bank? There is absolute failure on the part of the accounts department. Surprisingly, accounts department denied that such acceptance of FD receipts was not known to them. It is now clear that Executives has kept the accounts department in dark and it appears that there is collusion among the executives to help Mr. LM.

We took the Accounts Officer to bank with the F.D. receipts. We introduced ourself as Forensic Auditor to the Manager and discussed on the FD receipts and asked him as to how his bank can issue such fake receipts. The person who issues F.D. receipts was called for and could explain. We said that we are going to make Police complaint against the Bank. The truth came out that LM had approached this person and this person accepted consideration and issued two receipts not from the current receipt book but

from the old receipt book which was discarded. Enquiry also revealed that the Executive Engineer had phoned this person to help Mr. LM.

The entire episode was reported to the Management for taking needful action on executive engineer because he played a main role in this episode so that this kind of fraud should not take place in future. It is clear that executive engineer has played a foul role against the monetary interest of the company. Now, the company may resort a mechanism to trace Mr. LM with the help of executive engineer or may initiate the recovery of their loss from the monetary fund of executive engineer available with the company and may also initiate recovery proceeding under applicable procedure code.

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

The company can give a police complaint and a criminal action can be taken. Recovery of money from the bank may not be possible but for violation, bank should be issued notice.

### **Answer 3(b)**

**Direct Evidence** : Evidence is either direct or indirect. Direct Evidence is that evidence which is very important for the decision of the matter in issue. The main fact when it is presented by witnesses, things and witnesses is direct, evidence whereby main facts may be proved or established that is the evidence of person who had actually seen the crime being committed and has described the offence. We hardly need to point out that in the illustration given by us, the evidence of the witness in Court is direct evidence as opposed to testimony to a fact suggesting guilt. The statement before the police only is called circumstantial evidence of, complicity and not direct evidence in the strict sense. It directly related to the real point in issue.

For example, testimony of an eye witness will be treated as direct evidence. In another example if one person is alleging that another person has breached the terms of the agreement and hence he is liable to pay compensation to the first person in such category the original document of the agreement will constitute a direct evidence.

Direct evidence is considered to be superior to circumstantial evidence because it creates a direct nexus between the evidence and fact in question.

**Circumstantial Evidence** : There is no difference between circumstantial evidence and indirect evidence. Circumstantial Evidence attempts to prove the facts in issue by providing other facts and affords an instance as to its existence. It is that which relates to a series of other facts than the fact in issue but by experience have been found so associated with the fact in issue in relation of cause and effect that it leads to a satisfactory conclusion.

According to decided case, the acceptance of evidence and there appreciation thereof is not a rigid mathematical formulae and hence the circumstantial evidence plays a significant role in any matter before the court to make it possible that the court should reach to truth, reality and actual happenings of the things to the matter.

Further, circumstantial evidence is like a light in the dark which slowly touches all corners of a matter and bring the reality in front of the adjudicator. He further observes that circumstantial evidence has to be appreciated with utmost caution because if light

is strong enough to remove all darkness then it will uplift the justice in the matter but if the light is weak and removes darkness from some part of the matter it may result into grave injustice to both the parties.

The Hon'ble Supreme Court observed in *Hanumant Govind Nargundkar v/s State of MP AIR 1952 SC 343* that "In dealing with circumstantial evidence there is always the danger that suspicion may take the place of legal proof. It is well to remember that in cases where the evidence is of a circumstantial nature the circumstances from which the conclusion of guilt is to be drawn should in the first instance, be fully established and all the facts so established should be consistent only with the hypothesis of the guilt of the accused. In other words there can be a chain of evidence so far complete as not to leave any reasonable ground for a conclusion consistent with the innocence of the accused and it must be such as to show that within all human probability the act must have been done by the accused." The same test has been reiterated by the apex court in *Sharad Birdichand Sarda v. State of Maharashtra AIR 1984 SC*.

#### Question 4

- (a) "The Company secretary plays an important role as Forensic Auditor". Explain. (8 marks)
- (b) Briefly explain the power of National Financial Reporting Authority in respect of misconduct of a professional. (4 marks)

#### Answer 4(a)

##### Role of Company Secretary as a Forensic Auditor

1. *Criminal Investigations* : A Company Secretary should use his/her investigative accounting skills to examine the documentary and other available evidence to give his/her expert opinion on the matter. Their services could also be required by Government departments, the Revenue Commissioners, the Fire Brigade, etc. for investigative purposes. Practicing forensic accountants could be called upon by the police to assist them in criminal investigations which could either relate to individuals or corporate bodies.
2. *Personal Injury Claims* : Where losses arise as a result of personal injury, insurance companies sometimes seek expert opinion from a forensic auditors before deciding whether the claim is valid and how much to pay.
3. *Fraud Investigations* : A Company Secretary might be called upon to assist in business investigations which could involve funds tracing, asset identification and recovery, forensic intelligence gathering and due diligence review. In cases involving fraud perpetrated by an employee, the forensic auditors will be required to give his/her expert opinion about the nature and extent of fraud and the likely individual or group of individuals who have committed the crime. The forensic expert undertakes a detailed review of the available documentary evidence and forms his/ her opinion based on the information gathered during the course of that review.
4. *Investigation and Inspection* : Company Secretary may help the Police, ACB and other investigating authorities in collecting evidences and for other investigation

purposes. For example, section 157 Cr.P.C, 1973; sections 17 and, 18 of the Prevention of Corruption Act, 1988; Section 6 of The Bankers Books Evidence Act, 1891; Section 78 of Information Technology Act, 2000; Section 447 of the Companies Act, 2013 wherein the Court or Police may require the skills of forensic auditors while inspecting any books in so far as related to the accounts of an accused.

5. *Expert Opinion* : Company Secretaries see and carefully examine the accounts and balance sheets and use his skills to find out whether there is any fraud committed or any anomaly associated with it by giving his expert opinion. He can also be called as an expert under section 45 of the Indian Evidence Act, 1872
6. *Professional Negligence* : The forensic auditor might be approached in a professional negligence matter to investigate whether professional negligence has taken place and to quantify the loss which has resulted from the negligence. A matter such as this could arise between any professional and their client. The professional might be an accountant, a lawyer, company secretary etc. The forensic expert uses his / her investigative skills to provide the services required for this assignment.
7. *Expert Witness Cases* : Company Secretary as Forensic Auditor often attend court proceedings to testify in civil and criminal court hearings, as expert witnesses. In such cases, they attend to present investigative evidence to the court so as to assist the presiding judge in deciding the outcome of the case. He can also be called as an expert under section 45 of the Indian Evidence Act, 1872.
8. *Mediation and Arbitration* : Some forensic auditors because of their specialist training they would have received in legal mediation and arbitration, have extended their forensic auditing practices to include providing Alternative Dispute Resolution (ADR) services, in absence of which a matter could be expensive and time consuming for individuals or businesses involved in commercial disputes with a third party. [Section 89 of the Civil Procedure Code, 1908]
9. *Litigation Consultancy* : Company Secretaries are eligible to be engaged in litigation and assisting with evidence, strategy and case preparation.
10. *Computer Forensics* : A Company Secretary is trained to assist in electronic data recovery and enforcement of IP rights etc. Company Secretary plays an important role in mitigating the Corporate Frauds.

#### **Answer 4(b)**

#### **National Financial Reporting Authority (NFRA)**

NFRA is constituted under Section 132 of Companies Act 2013 to make recommendation to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by company or class of companies and their auditors. It also monitor to enforce the compliance with accounting standards and Auditing Standards and oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measure required for improvement in quality of service.

Regarding investigating the misconduct committed by any member or firm of Chartered Accountant NFRA has the power to investigate either suo-motu or on a reference made to it by the Central Government. When NFRA initiates investigation no other institute or body can initiate investigation. When the professional misconduct is proved, NFRA has the power to impose penalty of not less than one lakh rupees but which may extend to five times of the fees received in case of individuals and not less than ten lakhs rupees but which may extend to 10 times of the fees received in case of firms. NFRA has also the power to debar the member or the firm for minimum period of six months or such higher period not exceeding 10 years.

### Question 5

*ABC Computers Services Ltd. has been a pioneering force in the global information technology (IT), outsourcing market — the company prefers the term right sourcing since late 2013 the company provides full range of IT services including software and systems management and development, engineering solutions, infrastructure management, and enterprise business solutions. They also serve the business processing outsourcing (BPO), market in particular through majority held subsidiary providing back office customer care, product and technical support, human resources, finance and accounting, and many other related services. The company also provides e-commerce and website development and management operations including web based financial, supply chain, customer relationship and other services. They operate on global level with offices in 40 countries and more than 50,000 employees serving nearly 600 clients and companies. The company offers outsourcing services through its network offices throughout India. The company also provides onsite services and offsite operations in other western countries and in India. The company has also been developing network of near shore offices, filling the gap between offshore and onsite segment. The company is listed on the New York stock exchange. The company has been recognised as part of the growing computer industry and the rapid incorporation of computer technology into the corporate market would create demand for new type of specialised services. Their operation started in the year 2013 and within a span of 5 years its turnover reached ₹ 7,162 crore. Each and every year turnover is rapidly increasing. The company was also accepting fixed deposits from the public. It pays interest in crore and also the company took loans from the reputed banks each year. The yearwise details of the related figures are given below:*

Year ended	Balance Sheet					₹ in Crore
	Mar. 18	Mar. 17	Mar. 16	Mar. 15	Mar. 14	
<i>Sources of Funds</i>						
Total Share Capital	6855	4557	3839	3169	2438	
Reserves	800	450	400	300	250	
Loans from Banks	111	89	45	25	8	
Deposits from public	180	65	20	25	40	
Current liabilities and Provisions	174	180	116	50	72	



	103		PP-FA-December 2019		
Total Liabilities	8120	5341	4420	3569	2808
<i>Application of Funds</i>					
Fixed Assets	2205	2180	1162	1147	1128
Investments	3840	2020	2060	1660	1297
Cash and Bank Balance	1415	900	650	435	310
Other Current Assets	660	241	548	327	73
<b>Total Assets</b>	<b>8120</b>	<b>5341</b>	<b>4420</b>	<b>3569</b>	<b>2808</b>

<b>Standalone Profit &amp; Loss account</b>					₹ in Crore
Year ended	Mar. 18	Mar. 17	Mar. 16	Mar. 15	Mar. 14
<i>Income</i>					
<i>Sales Turnover</i>					
IT Services	7162	5413	3933	2825	2296
BPO	145	68	35	7	0
Total Income	7307	5481	3968	2832	2296
Less : Cost of Revenue	4688	3445	2534	1718	1376
Gross Profit	2619	2036	1434	1114	920
	—	—	—	—	—
Less : operating expenses	1161	938	622	508	502
<i>(Selling, General and Administration Expenses)</i>					
Operating Income	1458	1098	812	606	418
Add : Interest income	186	132	112	102	36
Less : Interest expenses	18	7	2	3	4
<b>Net Income</b>	<b>1626</b>	<b>1223</b>	<b>922</b>	<b>705</b>	<b>450</b>

Assume that the company was involved in falsifying accounts and inflating the company revenue and the profit and profit margin. If you are appointed as the Forensic auditor, answer the following questions :

- (a) Identify the Green flags and Red flags indicators. What may be the reasons for such unusual increase in Turnover ? (6 marks)
- (b) How would you proceed to unearth fraud in this case ? (3 marks)
- (c) Comment on unusual Turnover and payment of Interest to Depositors. (3 marks)

**Answer 5(a)**

The Green flags are turnover and the profits of 5 years as the P&L account shows a rapid Growth in Turnover and there is an indication of unusual increase of Profits. For the companies which is in this line of business achieves only 7% to 9% growth is normal. But in this case, the growth rate is very high and hence it may be due to manipulation of financial accounts.

The red flags are cash rich company that generally doesn't require any loans but in this case, as shown in Balance sheet, it is increasing year to year. It is an unusual happening. As per P&L, the profit and turnover is rapidly increasing meaning thereby that the company's loan should decrease. Hence we can easily identify that the company is doing theft.

**Answer 5(b)**

By using the Red and Green flags indicator's we can check related documents like sales register, invoices to know whether sales really happened or not. Further, we can counter check with the companies that has received the services or products to ascertain whether they really received the same amount of invoice and that can be checked with related payments against the invoices raised. Mainly we can ask the directors to give explanation why the company needs so much of loans even though the company is performing very well.

**Answer 5(c)**

The reason behind the unusual increase in turn over may be due to manipulation of accounts. It's main intention may be projecting the company's position at a high level to make more profits to enhance the image of the company. This also implies that there is possibility of Insider Trading to boost the value of the shares. One of the desired objectives of the management could be to off-load its holding of equity to a new purchaser at an inflated price.

On reviewing the balance sheet, the company has availed deposit from the public and in particular there is an increase in deposits of Rs. 115 crores in the financial year 2017-18. As shown in the Balance sheet it is alarming to notice that when they are having cash balance in the bank what was the necessity for going to public deposit and paying huge Interest (Rs. 18 crores for the year 2017-18)

**Question 6**

- (a) *Raj & Company has been dealing with reputed company's TVs. They are the agents of many company's TVs. They offer instalment systems payments which attracts customers and their turnover has been improving. They have a spacious office where TVs are displayed which naturally tempts the customers to visit and buy. Adjacent to their office they have taken a warehouse to keep stock of TVs received from companies and would draw stocks from the warehouse as and when required. They maintain necessary records like goods received report, sales register and stock statement on daily basis. They have the system of maintaining parallel stock ledger at the office also. There was an outbreak of fire in the warehouse and stocks and records have been completely destroyed. Raj & Company preferred their claim with the underwriters for ₹15 lakh being the cost of 50 TVs, which seems to be very high according to Insurance Company.*

*Insurance Company is of the view that the claim requires to be probed before accepting.*

*They doubt that there is a possibility of manipulation in the claim. If you are appointed as Forensic Auditor*

*(i) What investigation would you follow to detect the genuineness of the claim?  
(4 marks)*

*(ii) Highlight the important differences between audit and forensic audit.  
(4 marks)*

*(b) What is ethical hacking and what are the different classes of hackers ?  
(4 marks)*

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

The Insurance Company has handed over to us to audit the claim preferred by Raj & Co. All records are completely destroyed along with TVs. The only material available was the parallel stock ledger at the office. After ascertaining the details of their business, we started gathering the information of quantity purchased during the past six months and the sales effected.

On going through the records of parallel register, it is observed that average sale of TVs during the past six months was 20 numbers and the purchases also an average of 20 to 25 numbers. The credit period allowed by the supplier was 30 days and customers are paying through installment and it is also seen cash sales. Raj & Co. says there is a sales drive to earn incentive and sometime they purchase increased quantity and stock in the warehouse so that they do not enter into a stock out situation and therefore, they stock in the warehouse more than 50 TVs.

On going through purchase details and sales pattern, bulk purchase of 40 or 50 numbers had not taken place but still their contention is that they had 50 TVs in the warehouse on the day of the outbreak of fire. Not being satisfied with their explanation, we have decided to inspect the warehouse. It is a small warehouse and considering the size of TV boxes, stacking norm permitted is only three boxes in a column and vacant space needed for human movement. Taking into consideration the storage volume for each model and the space required, they can store the warehouse only 8 columns and the number of TVs cannot exceed at best 24 numbers. When these queries were put up, they were shocked and accepted to reduce the claim unconditionally. It is now left to accept the claim or not since claim was inflated.

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

Major difference between Audit and Forensic Audit are as under:

1. Objective of financial auditing is to express opinion as to 'true & fair' presentation. Forensic Audit determines correctness of the accounts or whether any fraud has actually taken place or not.
2. Techniques used in the financial auditing are more of 'Substantive' and 'compliance' procedures. The techniques used in the forensic auditing are analysis of past trend and substantive or 'in depth' checking of selected transactions.

3. Normally all transactions for the particular accounting period are covered under the financial audits. Forensic audits don't face any such limitations. Forensic auditors may be appointed to examine the accounts from the beginning.
4. For ascertaining the accuracy of the current assets and the liabilities, the financial auditor relies on the management certificate or representation of management. Forensic auditors are required to carry out the independent verification of suspected or selected items.
5. Whenever the financial auditor has adverse findings, then the auditor expresses the qualified opinion, with/without quantification. In case of the adverse findings, the forensic auditors are required to quantify the damages to the clients and is also supposed to point the culprit. Many a times, legal action will be sought.
6. A Statutory auditor has to be appointed by the shareholders and has access to all books, documents etc. maintained by the company. A forensic auditor, on the other hand, is appointed specifically for the purpose and reports to whoever appoints him.
7. Statutory Auditor has a particular manual to follow whereas a Forensic Auditor may rely more on his experience and judgement.

#### **Answer 6(b)**

**Ethical Hacking:** An ethical hacker, also referred to as a 'white hat hacker', is an information security expert who systematically attempts to penetrate a computer system, network, application or other computing resource on behalf of its owners and with their permission to find security vulnerabilities that a malicious hacker could potentially exploit.

**Hacking Computer System :** Hacktivism attacks those including Famous Twitter, blogging platform by unauthorized access/control over the computer. Due to the hacking activity there will be loss of data as well as cause damage to the computer. Also research indicates that those attacks were not mainly intended for financial gain too and to diminish the reputation of particular person or company.

A hacker is an unauthorized user who attempts to or gains access to an information system. Hacking is a crime even if there is no visible damage to the system, since it is an invasion in to the privacy of the data.

There are different classes of Hackers.

- (a) *White Hat Hackers* - They believe that information sharing is good, and that it is their duty to share their expertise by facilitating access to information. However there are some white hat hackers who are just "joy riding" on computer systems.
- (b) *Black Hat Hackers* -They cause damage after intrusion. They may steal or modify data or insert viruses or worms which damage the system. They are also called 'crackers'.
- (c) *Grey Hat Hackers* - Typically ethical but occasionally violates hacker ethics. Such hackers hack into networks, stand-alone computers and software. Network hackers try to gain unauthorized access to private computer networks just for challenge, curiosity, and distribution of information. Crackers perform unauthorized intrusion with damage like stealing or changing of information or inserting malware (viruses or worms).

**DIRECT TAX LAWS & PRACTICE**  
(Elective Paper 9.5)

Time allowed : 3 hours

Maximum marks : 100

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

2. All the references to sections in the Question Paper relate to the Income-tax Act, 1961 and relevant to the Assessment Year 2019-20, unless stated otherwise.
3. Working notes should form part of the answer.

**Question 1**

*Samode Group, comprised of diversified business entities, is having its registered office located at Jaipur with various business verticals located at different places within and outside the country. The Board of directors regularly have meetings with the heads of each of the business verticals, along with group Finance Director, Company Secretary, Director Taxation and other senior managers and consultants, for reviewing the business results of each of the units and to sort out the various issues. A meeting of all these heads was scheduled for 30th August, 2019 to discuss the various matters relating to taxation and to ascertain as to filing of the return of income of the group companies for the A.Y. 2019-20. The matters which were scheduled for discussion in this meeting, as listed were as under :*

- (1) *The main line of business activity of the group is of running of various hotels under Samode Group Hotels Ltd. located at different places in the country. The Finance Director has indicated that the statement of profit & loss drawn as on 31st March, 2019 shows a Net Profit of ₹172 lakhs after debiting and/or crediting the following items :*
  - (a) *Payment of ₹35,000 and of ₹50,000 made in cash on 3rd December, 2018 and 10th December, 2018 for purchase of crab, lobster and squibs to Mr. Rajamani, a fisherman, and Mr. Khalid, a middleman for these products, respectively.*
  - (b) *Contribution towards employees pension scheme notified by the Central Government under section 80CCD, made at 12% of the basic salary and dearness allowance (forming part of retirement benefits) payable to the employees. The total outlay of such basic salary and D.A. is ₹100 lakhs.*
  - (c) *Payment of ₹5.25 lakhs towards transportation of various materials procured by one of its hotels to M/s Jaipur Transport company, a partnership firm, without deduction of tax at source. The firm declared having opted for presumptive taxation under section 44AE and has also furnished its Permanent Account Number and a declaration to this effect in the tender document.*
  - (d) *Profit of ₹22 lakhs on sale of a piece of land to Avinash Private Limited, a domestic company, the entire shares of which are being held by Samode Group Hotels Ltd. The piece of land was acquired by Samode Group Hotels Pvt. Ltd. on 1st June, 2016.*

- (e) Contribution of ₹2 lakhs to Indian Institute of Technology with a specific direction to use the amount for scientific research programme approved by the prescribed authority.
  - (f) Expense of ₹ 15 lakhs on foreign travel of its two directors for entering into a collaboration agreement with a foreign company for a brewery project to be set up at Thane, Mumbai. However, the negotiation did not succeed and the project was abandoned.
  - (g) Fees of ₹ 2 lakh paid to an independent director for attending board meetings, without deduction of tax at source.
  - (h) Depreciation charged as per the Companies Act, 2013 on its assets for the year of ₹13 lakhs.
  - (i) Amount of ₹12 lakhs being the additional compensation received from the State Government pursuant to an interim order of Court, in respect of land acquired by the State Government of Karnataka in the previous year 2013-14.
  - (j) Dividend received from a foreign company of ₹7 lakhs. The Director Finance had also made available the following additional details and information relating to the year :
    - (i) As a corporate debt restructuring, Bank Of India has converted unpaid interest of ₹15 lakhs upto 31st March, 2018 into a new loan account repayable in five equal annual installments. The first installment of such converted loan was paid in March, 2019 by debiting the amount to new loan account.
    - (ii) Depreciation as per the Income-tax Act, 1961 ₹18 lakhs.
- (2) One of the companies of the Samode Group had taken over a running business of a sole-proprietor firm by executing a sale deed. The company taking over the business as per terms of the sale deed is required to make payment of overriding charges of ₹1,50,000 per annum to the wife of the sole proprietor, in addition to the sale consideration. It is also specifically mentioned in the sale deed that the amount so to be paid would be a charge on the net profits of the company which had been accepted as an obligation, being a condition of purchase of the business as a going concern.
- (3) Another company of the Samode Group has received duty drawback under a scheme framed by the Central Government as per the provisions of the Customs Act, 1962 of ₹20 lakhs. This company is entitled to claim a deduction under section 80-IB of the Income-tax Act, 1961 and wants to claim the amount of duty drawback so received as forming part of profits of the eligible undertaking for claiming deduction u/s 80-IB.
- (4) Another company of the Samode Group is having a block of Plant & Machinery with 20 different machinery items chargeable to depreciation @ 15%. One of the machines out of the 20 different machinery items used for packing, became obsolete and was discarded from use in July, 2018 but value thereof was appearing in the block. Return of income for the A.Y. 2019-20 is to be filed by claiming depreciation on the machine so discarded in July, 2018 of ₹90,000.
- (5) Samode Group Hotels Ltd. has distributed dividend of ₹230 lakh on 1st Jan.,

2019 to its shareholders. Samode Group Hotels Ltd. has received dividend of ₹60 lakh on 30th Dec., 2018 from the domestic subsidiary company, on which the subsidiary company has paid the dividend distribution tax, as specified in section 115-O.

- (6) The net result of the business carried on by one company of the Samode Group Hotels Ltd., as a branch of Swiss Electronics Pvt. Ltd. of UK, a foreign company, located in Mumbai, for the year ended 31st March, 2019 was a loss of ₹150 lakh, arrived at after charge of head office expenses of ₹210 lakh so allocated by the foreign company to the Indian branch.
- (7) A notice under section 148 to reopen the assessment made earlier for Asst. Year 2013-14 under section 143(3) in the case of one of the companies of the Samode Group Hotels Ltd. was issued by the Assessing Officer after forming belief and recording of the reasons as per section 147 of the Act to issue such notice. The Manager (Taxation) of the company wants to challenge the validity of the notice on the ground of sufficiency of belief of the Assessing Officer for the recorded reasons.

In the back-drop of the aforesaid agenda items, details, information and issues put before in the meeting by different heads of the group companies you are being asked by the directors of Samode Group Hotels Ltd., as the Taxation Consultant, to answer the following questions :

- (a) Compute total income of Samode Group Hotels Ltd. for the Assessment Year 2019-20 from the information and details given in para (1) by giving brief reasons for the treatment given to each of the items in the computation. (12 marks)
- (b) (i) Examine whether payment of overriding charges made by the group company to the wife of the sole-proprietor (whose business was purchased) is in the nature of diversion of income or application of income. Explain in the context of provisions contained under the Act and support your answer with decided case law, if any. (4 marks)
- (ii) Advise the company as to whether the amount of duty drawback received will form part of the profits derived by the eligible undertaking for claiming deduction under section 80-IB. Support your advice with the ruling given by the Court, if any. (5 marks)
- (c) (i) State the provisions of the Income-tax Act, 1961 as to payment of dividend distribution tax and compute the amount of dividend distribution tax payable by the company on the basis of information and details given in para (5) supra. (6 marks)
- (ii) Stating the provisions of the Income-tax Act, 1961, compute the income to be declared by the branch of Swiss Electronics Pty. Ltd. in India in its return for the assessment year 2019-20. (4 marks)
- (d) (i) Advise as an expert, as to the validity of the notice issued under section 148 of the Income-tax Act, 1961 and comment upon the correctness of the view of Manager (Taxation). Support your answer with the provisions of Act and decided case laws. (5 marks)
- (ii) Examine and state in the context of provisions contained under the

*Income tax Act, 1961 as to the validity of the claim of depreciation on the discarded/obsolete machine of ₹90,000 in A.Y. 19-20 [Refer para (4) supra].* (4 marks)

**Answer 1(a)****Samode Group Hotel Ltd.****AY 2019-20****Computation of Total Income**

<i>Particulars</i>	<i>Amount (₹)</i>
Profits and Gains Business and Profession	172,00,000
Profit as per Statement of profit and loss	
<i>Add:</i> Items debited but to be considered separately or to be disallowed.	
(a) Payment to middleman in cash for purchase of crab etc. in an amount exceeding Rs. 10,000 [Cash payment exceeding Rs. 10,000 made on a day to a person attract disallowance as per section 40A(3)]	50,000
Payment of Rs. 35,000 to fishermen for purchase of crab etc., is covered by exception under Rule 6DD. Payment of Rs.50,000 to middlemen for purchase of crab etc. is not covered under exception-CBDT Circular 10/2008 dated 5/12/2008	----
(b) Contribution towards employee's pension scheme in excess of 10% of salary [Basic Salary + Dearness Allowance (if it is forms a part of payment for retirement benefits)] not allowed under section 36(1)	2,00,000
(c) Payment to transport contractor without deduction of tax at source of Rs. 5.25 lakh [since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to deducted at source under section 194C in respect of payment to transport contractor]	----
(f) Expense on foreign travel of two directors for a collaboration agreement which failed to materialize [Where expenditure is incurred for a project not related to	15,00,000



existing business and the project is abandoned without creating a new asset, the expenses are capital in nature *Mc Gaw – Ravinder Laboratories (India) Ltd. Vs. CIT (1994) 210 ITR 1002 (Guj)*. Brewery project is not related to the existing business of hotels]

(g) Fees paid to directors without deducting tax are source [30% of Rs. 2 lakh] [Disallowance @ 30% would be attracted under section 40(a) (ia) for non-deduction of tax at source under section 194J]	60,000	18,10,000
		190,10,000

**Less : Items credited but to be considered separately/  
expenditure to be allowed**

(d) Profit on sale of plot of land to 100% subsidiary of the company. [Long-term capital gains arise on sale of plot of land but when the transfer is to a 100% subsidiary company which is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income]	22,00,000	
(e) Contribution of Rs. 2 lakhs to IIT for scientific research [Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for weighted deduction @ 150% under section 35(2AA). Since 100% of contribution has already been debited to the statement of P&L, the balance 50% has to be debited while computing business income.	1,00,000	
(ii) Depreciation [Depreciation allowable under the Income-tax Act, 1961 is Rs. 18 lakh where as the depreciation as per books of account debited to the statement of profit and loss is Rs. 13 Lakhs. Hence, the additional amount of Rs. 5 lakhs has to be deducted while computing business income]	5,00,000	
(i) Additional compensation received from State Government. [Since the additional	12,00,000	

compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]

(j) Dividend received from foreign company. [Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to Statement of P&L, the same has to be deducted while computing business income.]	7,00,000
(i) Interest paid during the year. [The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since Rs. 3 lakhs has been paid in the P.Y, 2018-19, the same is allowable as deduction]	3,00,000
	(50,00,000)
<b>Income under the head "Profit and Gains from Business or Profession"</b>	140,10,000
<b>Income from other Sources</b>	
Dividend received from foreign company	7,00,000
<b>Gross Total Income</b>	1,47,10,000
Less : Deduction under Chapter VI-A	Nil
<b>TOTAL INCOME</b>	1,47,10,000

### Answer 1(b)(i)

#### Overriding Charges: Diversion of income by overriding title

This issue came up for consideration before the Allahabad High Court in *Jit & Pal X-Rays (P) Ltd. v. CIT (2004) 267ITR 370* and the High Court held that the overriding charges which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee.

The obligation, therefore, was attached to the very source of income i.e. the purchase of business as a going concern by the assessee under the sale deed.

The sale deed also specifically states that the amount payable was charged on the

net profits of the company and the company had accepted the obligation as a condition of purchase of business as a going concern.

Hence, it is clearly a case of diversion of income by an overriding title and not a mere application of income.

### **Answer 1(b)(ii)**

#### **Duty drawback, whether profit derived from Industrial Undertaking**

Duty drawback is an incentive given to the person as an export incentive under the Customs Act, 1962.

The object behind the duty drawback is to neutralize the incidence of customs duty payment on the import content of export product.

The profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" as specified in section 80-IB of the Act.

The Supreme Court in the case of *Liberty India vs. CIT [2009]*, held that the duty drawback receipt/ DEPB benefits do not form part of the net profits of eligible industrial undertaking for the purposes of section 80-1/80-IA/80-IB.

The company is thus advised that the amount of duty drawback received will not form part of profits of the eligible undertaking for claiming the benefit of deduction u/s 80-IB.

### **Answer 1(c)(i)**

#### **Dividend Distribution tax**

Tax @ 15% is payable by a domestic company for any assessment year on the amount declared, distributed or paid by way of dividend whether out of current or accumulated profits. The amount shall be reduced by the amount of dividend if any received by the domestic company during the financial year from its subsidiary if the subsidiary has paid tax under section 115-O on such dividend so paid.

The dividend paid is required to be grossed up with the income distributed for computing the tax liability on account of dividend distribution tax. With the grossing up, the effective tax rate on the amount of dividend distributed shall be:

Effective rate of dividend distribution tax when surcharge and education cess is excluded then be 20.56% [17.647% (100 x 15/85) + 12% surcharge and 4% Health and Education Cess.

#### **Computation of Dividend Distribution Tax payable by Samode Group Hotels Ltd.**

*(Dividend distribution tax when Surcharge and Health & Education Cess is excluded in gross-up rate)*

<i>Particulars</i>	<i>Rs. (lakhs)</i>
Dividend distributed	230
Less : Dividend received from subsidiary company	(60)

Net Distributed profits	170
<i>Add</i> : Increase for the purpose of grossing up of dividend (100 x 170/100 - 15)	30
Gross-up Dividend	200
Additional Income tax payable u/s 115-0 (15% of Rs. 200 lakhs)	30.00
<i>Add</i> : Surcharge @ 12%	3.60
Tax excluding cess	33.60
<i>Add</i> : Health and Education cess @ 4%	1.344
DDT payable	34.944

**Alternate Answer 1(c)(i)****Dividend Distribution tax**

Tax @ 15% is payable by a domestic company for any assessment year on the amount declared, distributed or paid by way of dividend whether out of current or accumulated profits. The amount shall be reduced by the amount of dividend if any received by the domestic company during the financial year from its subsidiary if the subsidiary has paid tax under section 115-O on such dividend so paid.

The dividend paid is required to be grossed up with the income distributed for computing the tax liability on account of dividend distribution tax. With the grossing up, the effective tax rate on the amount of dividend distributed shall be:

Effective rate of dividend distribution tax when surcharge and Health & Education Cess is included then the rate would be  $21.171\% = (100 \times 17.472/82.528)$ .

**Computation of Dividend Distribution Tax payable by Samode Group Hotels Ltd.**

*(Dividend distribution tax when Surcharge and Education Cess is included in gross-up rate)*

<i>Particulars</i>	<i>Rs. (lakhs)</i>
Dividend distributed	230
<i>Less</i> : Dividend received from subsidiary company	(60)
Net Distributed profits	170
<i>Add</i> : Increase for the purpose of grossing up of dividend (100 x 170/100 - 17.472)	36
Gross-up Dividend	206
Additional Income tax payable u/s 115-0 (15% of Rs. 206 lakhs)	30.9
<i>Add</i> : Surcharge @ 12%	3.708
Tax excluding cess	34.608
<i>Add</i> : Health and Education cess @ 4%	1.38432
DDT payable	36.00

**Answer 1(c)(ii)**

**Quantum of H.O. expenses allowable** : Section 44C of the Income-tax Act, 1961 restricts the allowability of the head office expenses allocated by the foreign company to the Indian branch to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

<i>Particulars</i>	<i>Rs. (Lakhs)</i>
Net loss for the year ended on 31.03.2019	(150)
<i>Add</i> : Amount of head office expenses to be considered separately as per section 44C	210
Adjusted total income	60
<i>Less</i> : Head Office expenses allowable being lower of:-	
(i) 5% of Rs. 60 lakhs being Rs. 3 lakhs	
(ii) Rs. 210 lakhs	(3)
Income to be declared in return for AY 19- 20	57

**Answer 1(d)(i)**

**Validity of notice issued u/s 148** : The issuance of notice u/s 148 of the Income Tax Act, 1961 is governed by the provisions of section 147 of the Income Tax Act, 1961, where the Assessing Officer has reasons to believe that any income chargeable to tax has escaped assessment for any assessment year.

The Apex Court in the case of *CIT v/s. Kelvinator of India Ltd. (2010) 320 ITR 561* has held that "the Assessing Officer has power to re-open an assessment, provided there is "tangible material to come to the conclusion that there was escapement of income. Reason must have a link with the formation of belief".

The Assessing Officer in the given case had issued the notice u/s 148 after forming his belief and reasons of forming of such belief were also recorded by him prior to the issue of such notice.

The challenge of the assessee as to sufficiency of the belief being formed by the Assessing Officer for issuance of such notice was examined by the Apex Court in the case of *Raymond Woolen Mills Ltd. V/S ITO (1999) 103 ITR 437* and it was held that the same is not maintainable.

Therefore, the assessee cannot challenge about the sufficiency of belief of the Assessing Officer for issuance of notice u/s 148 as the notice so issued by the A.O is valid.

**Answer 1(d)(ii)****Depreciation on discarded asset forming part of large block**

The issue under consideration is whether claim of depreciation with regard to the discarded asset, in arriving at the written down value of the block of assets, is justified.

One of the conditions for claim of depreciation under section 32 of the Income Tax Act, 1961 is that the eligible asset must have been put to use for the purpose of business or profession.

The other aspect is whether merely discarding an obsolete machinery, which is physically available, will attract the expression "moneys payable" as appearing in section 43(6) so as to deduct its value from the written down value of the block. In the present case, the machinery has not been sold as machinery or scrap and continues to exist in the physical form. Hence, there is no 'moneys payable' in this case, which is deductible while computing the WDV of the block to which it belongs.

The facts in the present case are similar to the facts in the case of *CIT vs. Yamaha Motor India Pvt. Ltd, (2010) 328 ITR 297*, where the Delhi High Court held that the expression 'used for the purposes of the business' in section 32 when applied with respect to discarded machine would mean the use in the business not only in the relevant financial year/previous year, but also in the earlier financial years.

The machinery in present case was not used for full year as being discarded in July, 2018. However, depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. Therefore, the condition for claiming depreciation in respect of the discarded machine stands satisfied as the machine was used in part during the year and in earlier years for the purpose of business.

The claim of depreciation of Rs. 90,000/- on discarded machinery in July, 2018 for A.Y. 2019-20 is valid. However It will not be allowed separately but as a part of closing WDV of the block.

## Question 2

- (a) Xavier had taken a loan from a bank by executing registered mortgage deed for the purchase of house at Ajmer on 26th May, 2001. The cost of house so purchased was ₹10 lakh. The said property was inherited by his son Abraham as per will, in the financial year 2008-09, after the death of Xavier.

*Abraham paid the outstanding amount of loan taken by father to bank on 12th Feb., 2009 of ₹ 8 lakh, for obtaining the clear title of the house. The said house property was sold by Abraham on 16th March, 2019 for ₹80 lacs.*

*Work out the amount chargeable to capital gains for A.Y. 2019-20 and support your answer by giving brief reasons.*

*(Cost inflation Index 2001-02 : 100, 2008-09 : 137 and 2018-19 : 280)*

*(6 marks)*

- (b) *Vishwa Bharti Charitable Trust, registered under section 12AA, for the previous year 2018-19 derived gross income of ₹15 lakh from various sources consisting of the following :*

<i>Particulars</i>	<i>Amount (₹ in lakh)</i>
<i>(a) Income from properties held by trust (net)</i>	<i>6</i>
<i>(b) Income (net) from business (incidental to main objects)</i>	<i>3</i>

(c) Voluntary contributions from public (identified donors) 6

The trust had applied a sum of ₹9.60 lakh towards charitable purposes during the year ended on 31st March, 2019 which included repayment of loan taken for construction of orphanage at Kota of ₹3.60 lakh.

The trust has given in the year, corpus donation of ₹2 lakh to another charitable trust registered u/s 12AA.

Determine the total income of the trust for the assessment year 2019-20.  
(6 marks)

### Answer 2(a)

#### Treatment of amount paid for discharge of mortgage: Capital Gain

The cost of inherited property for Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(l)(iii) of the Income Tax Act, 1961 and therefore, the cost paid by his father i.e. Mr. Xavier on 26.05.2001 for acquiring the property of Rs. 10 lakhs shall be the cost of acquisition to Mr. Abraham who is the new owner.

Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition to the successor under section 48 read with section 55(2) of the Income-tax Act, 1961 as held by the Apex Court in case of *RM Arunachalam vs. CIT (1997) 227 ITR 222*.

#### Computation of Capital Gain for A.Y. 2019-20 of Abraham

<i>Particulars</i>	<i>(Amount)</i>
Sale consideration of the house property sold	80,00,000
Less : Indexed cost of acquisition	
Cost to previous owner	
(Rs. 10,00,000 x 280 / 137)	20,43,796
Loan amount paid by Mr. Abraham to bank for obtaining clear title. (Benefit of CII is available since the loan amount of Rs. 8 lakh was paid in the financial year 2008-09)	16,35,037
(Rs.8,00,000 x 280 / 137)	(36,78,833)
Long-term Capital Gains	43,21,167

#### Working Note:

- The property was acquired by Mr. Abraham through inheritance being as per Will of father. Thus, the cost of acquisition will be cost to the previous owner being the amount paid by Xavier for purchase of house of Rs.10 lakhs.
- As per the definition of indexation, cost of acquisition under clause (iii) of explanation below section 48, indexation benefit will be available only from the previous year in which Abraham first held the asset being the financial year 2008 - 09.

**Alternate Answer 2(a)**

The cost of inherited property for Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(l)(iii) of the Income Tax Act, 1961 and therefore, the cost paid by his father i.e. Mr. Xavier on 26.05.2001 for acquiring the property of Rs. 10 lakhs shall be the cost of acquisition to Mr. Abraham who is the new owner.

Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition to the successor under section 48 read with section 55(2) of the Income-tax Act, 1961 as held by the Apex Court in case of *RM Arunachalam vs. CIT (1997) 227 ITR 222*.

However, as per the view expressed by Bombay High Court, in the case of *CIT v. Manjula J. Shah (2013) 355 ITR 474*, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner.

**Computation of Capital Gain for the A.Y. 2019 - 20 of Abraham**

<i>Particulars</i>	<i>(Amount)</i>	
Sale consideration of the house property sold		80,00,000
<i>Less</i> : Indexed cost of acquisition		
Cost to previous owner		
(Rs. 10,00,000 x 280 / 100)	28,00,000	
Loan amount paid by Mr. Abraham to bank for obtaining clear title. (Benefit of CII is available since the loan amount of Rs. 8 lakhs was paid in the financial year 2008-09)	16,35,037	44,35,037
(Rs.8,00,000 x 280 / 137)		
Long –term Capital Gains		35,64,963

*Working Note* : The property was acquired by Mr. Abraham through inheritance being as per Will of father. Thus, the cost of acquisition will be cost to the previous owner being the amount paid by Xavier for purchase of house of Rs.10 lakhs.

**Answer 2(b)**

**Vishwa Bharti Charitable Trust**  
**Computation of Taxable Income**  
**A.Y. 2019-20**

<i>Particulars</i>	<i>(Amount)</i>
(i) Income from property held under trust (net)	600000
(ii) Income (net) from business (incidental to main objects)	300000
(iii) Voluntary contributions from public	600000



[Voluntary contribution made with a specific direction towards corpus are to be excluded under section 11(1)(d). In this case, there is no such direction and hence, total contribution is included

Total	1500000
Less : 15% of the income eligible for retention / accumulation without any conditions.	(225000)
Total	1275000
Less : Amount applied for the objects of the trust	
(i) Amount spent for charitable purpose	
(Rs.9,60,000 - Rs. 3,60,000)	(600000)
(ii) Repayment of loan for construction of orphanage home at Kota also treated as applied for charitable purpose	(360000)
<hr/>	
Total Income	315000

*Note* : Corpus donation of Rs. 2 lakhs given to another trust registered u/s 12AA will not be regarded as application of income. [Explanation 2 to section 11(1)]

### Question 3

- (a) *X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill in March, 2019 and had a profit of ₹100 lakh (before depreciation) in Assessment Year 2019-20. X Ltd. claimed depreciation of ₹120 lakh on windmill against the profit of ₹100 lakh from power generation business which was eligible for deduction under section 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of ₹70 lakh for Assessment Year 2019-20.*

*The loss of ₹20 lakhs, i.e. balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd.*

*The Assessing Officer was of the view that depreciation relating to a business eligible for deduction under section 80-IA cannot be set-off against non-eligible business income. Hence, according to the AO, the unabsorbed depreciation should be carried forward to the subsequent year to be set off against eligible business income of the assessee of that year.*

*Give your comments on the correctness of the view of the Assessing Officer and support your answer with a decided case law, if any. How will the profit of unit N be calculated in the A.Y. 2020-21 vis-a-vis ₹20 lakhs depreciation, if allowed to be set off against profits of unit 'Y' in the current year ? (6 marks)*

- (b) (i) *Ram & Co., the sole proprietorship concern of late Ram, got converted into partnership, after his death on May 10, 2018, by his two sons Luv and*

*Kush. The business of Ram & Co. was continued to be carried in the same manner by both of them as a going concern. There was business loss of ₹4.25 lakh for the year ended March 31, 2018. The net results of the business for the year ended March 31, 2019 was profits of ₹5 lakh. The partners want to set off the loss of ₹4.25 lakh from the profits of the firm for the previous year 2018-19.*

*Advise them whether they can do so. Support your answer with provisions of Act and decided case law, if any. (3 marks)*

- (ii) *“If an assessee, fails to make claim for any deduction in the return of income, he loses his opportunity for claiming such deduction at the assessment stage or at subsequent stage”.*

*Do you agree with the proposition and if not, state how such deduction will be allowed to the assessee ? (3 marks)*

### **Answer 3(a)**

#### **Se-off of unabsorbed depreciation of eligible business against profit of non-eligible business**

The Karnataka High Court in *CIT vs. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245*, observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1) of the Income Tax Act, 1961.

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of Rs. 120 lakhs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is, thereafter, that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income.

Accordingly, X Ltd. is entitled to the benefit of set off of loss of Rs.20 lakhs (representing business depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of Rs.70 lakhs of unit Y carrying on non-eligible business. Therefore, the net profit of Rs.50 lakhs would be taxable in the A.Y. 2019-20.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e. the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y. 2020 - 21, the net profits of unit N has to be reduced by Rs. 20 lakhs for computing the profits eligible for deduction under section 80-IA in that year.

The view of the Assessing Officer in “not permitting set-off of depreciation of eligible business against profits of non-eligible business in this case, therefore, **not correct**.”

**Answer 3(b)(i)****Set-off of loss suffered in deceased's business**

It has been held by the Apex Court in the case of CIT vs. Madhukant M. Mehta [2001] that where legal heirs of a deceased proprietor enters into partnership and carries on the same business in the same premises under the same trade name, there is a succession by inheritance as contemplated in section 78(2) of the Income-tax Act, 1961.

The partnership firm so constituted by the sons of late Ram is entitled to carry forward and set off of the deceased's business loss against its income from the subsequent years, because of succession by inheritance.

In view of the aforesaid case and provision of section 78(2) in the present case, partners are entitled to set off the losses of Rs.4.25 lakhs of A.Y. 2018-19 from business income of the firm for the A.Y. 2019-20.

**Answer 3(b)(ii)****Failure to make claim for deduction in the Return of Income 'ROI'**

As per section 80A(6) of the Income Tax Act, 1961, If the assessee fails to make a claim in his return of Income for any deduction under sections 10A, 10AA, 10B, 10BA, 80HH to 80RRB, no deduction shall be allowed to him thereafter.

In respect of the other deductions not being claimed in the return of income, the assessee can file a revised return for claiming such deductions as held by the Apex Court in the case of *Goetze (India) Ltd. vs. CIT*[2006] 157.

If however, sufficient information is available in the return of income so filed, a revised return is not required and deduction can be claimed at the time of assessment or subsequent at the appeal stage as held by the Apex Court in the case of *CIT vs. Ramco International* [2009].

**Question 4**

*Vishnu Textiles Ltd. (VTL), an Indian company, holds 100% shares in Laskhmi Textiles Ltd. (LTL), also an Indian company.*

*LTL had sold shares held by it in Bharat Textiles Ltd. (BTL), an unlisted company, on 21st November, 2012 to VTL for a sum of ₹50 lakhs. These shares had been acquired by it on 12th Aug., 2003 for ₹21.8 lakhs.*

*During the PY 2018-19, the following transactions were done by VTL :*

- (i) Shares in BTL were sold for ₹ 72 lakhs on 23rd Feb., 2019.*
- (ii) 10% of the shareholding in LTL was disinvested by sale to public on 25th Feb., 2019.*

*The Board of Directors in VTL want to know the capital gains implications in the hands of VTL and LTL for the relevant assessment years (assuming that there is no change in law), for each of the above two transactions. You are required to help the Board with your computation, along with working note.*

*Additional information :*

- *FMV of shares in BTL as on 1st April, 2001, was ₹55 lakhs.*
- *Cost inflation index for FY 2003-04 is 109, FY 2012-13 is 200 and for FY 2018-19 is 280.* (12 marks)

#### **Answer 4**

- **Sale of Shares of Bharat Textiles Limited 'BTL' by Laskhmi Textiles Ltd 'LTL' to Vishnu Textiles Limited 'VTL' on 21st Nov, 2012**

Since VTL is an Indian company which holds 100% shares of LTL, the transfer of capital assets, namely, shares of BTL by LTL to VTL would not be treated as transfer for attracting capital gain tax liability as per section 47(v) of the Income Tax Act, 1961.

Consequently, no capital gains tax would have been attracted on such transfer in the hands of LTL.

- **Disinvestment by Vishnu Textiles Limited 'VTL' of 10% shares in Laskhmi Textiles Ltd 'LTL' on 25th Feb, 2019**

As per section 47A(1) of the Income Tax Act, 1961, where holding company ceases to hold 100% of shares of the subsidiary company before the expiry of a period of eight year from the date of transfer of capital assets, the amount of capital gains not charged to tax at the time of transfer would be deemed to be income chargeable under the head Capital Gains of the previous year in which such transfer took place.

In this case, the above deeming provision would apply because the eight year period from the transfer expires on 20th Nov, 2020 and the disinvestment by VTL Ltd of 10% shares held in LTL Ltd was in February, 2019.

So, whatever LTCG was not taxed earlier in the AY 2013-14 will become taxable in AY 2019-20 in the hands of LTL.

<i>Particulars</i>	<i>Amount (Rs.)</i>
Sale Consideration	5000000
Less : Indexed cost of acquisition (Rs. 2180000*200/109)	(4000000)
LTCG which becomes chargeable to tax	1000000
Tax Liability @ 20.80% [20% + HEC @ 4% on 20%]	208000

Note:

1. Shares transferred to public (Disinvestment) by Vishnu Textiles Limited 'VTL' of 10% shares in Laskhmi Textiles Ltd 'LTL' on 25th Feb, 2019 will also attract tax liability.
2. Surcharge is not considered will computing the capital gain tax liability.

- **Sale of shares of Bharat Textiles Limited 'BTL' by Vishnu Textiles Limited VTL on 23rd Feb, 2019**

This transaction would attract capital gains tax in the hands of VTL Ltd. for the AY 2019-20. The Capital Gains would be long term, since the period of holding is more than 24 months.

#### **Computation of Capital Gains in the hands of VTL for AY 2019-20**

<i>Particulars</i>	<i>Amount (Rs.)</i>
Sale Consideration	7200000
Less : Indexed cost of acquisition (Rs. 5000000*280/200) Note - 2	(7000000)
LTCG	200000
Tax Liability @ 20.80% [20% + HEC @ 4% on 20%]	41600

**Note:**

1. Surcharge is not considered while computing the capital gain tax liability.
2. The Indexed cost of acquisition has been computed by considering the cost of acquisition at which the shares have been acquired by VTL as per the provision of section 49(3) of the Income-tax Act, 1961.

#### **Question 5**

- (a) *Examine in the context of provisions contained under the Income-tax Act, 1961 in each of the following independent cases, and state in brief, whether there exists a business connection in India, so as to bring the income earned by them, if any, to the tax net in India :*
- (i) *Ali & Ali Ltd., a company resident in Abu Dhabi, had set up a liaison office at Hyderabad to receive trade inquiries from customers in India. The work of the liaison office is not only restricted to forwarding of the trade inquiries to the company in Abu Dhabi but also to negotiate and enter into the contracts on behalf of Ali & Ali Ltd. with the customers in India.*
  - (ii) *John Miller Inc., a resident company of UK, has set up a branch office at Delhi for the purpose of purchase of raw materials to be used for manufacturing its products. The branch office is also engaged in selling the products manufactured by John Miler Inc. and in providing sales related services to the customers in India on behalf of the UK company.*
  - (iii) *Mr. Rajveer, a resident in India and based at Gurugram in India, is appointed as agent by POK Pty Inc., a company incorporated in USA, for tracking the Indian markets. He has no authority to accept the orders but is allowed to canvass for the orders and then to communicate the same to POK Pty Inc. in USA. All the orders were directly received, accepted and after receiving the price/value, the delivery of goods was given by POK Pty Inc. from outside India. Neither purchase of raw material, nor manufacturing of finished*

*goods took place in India. The agent is entitled to receive the commission on the sales so concluded by POK Pty. Inc. of USA. (6 marks)*

- (b) *Examine in the context of provisions contained under section 92A, whether their exist any, relationship as an Associated Enterprises in each of the following independent cases :*
- (i) *X Ltd., of USA is having a subsidiary in India and have given guarantee to the financial institution from whom the subsidiary had taken a loan of ₹100 crores, that in the case of default it will make the entire payment. The total borrowings of the subsidiary are of ₹ 500 crores.*
  - (ii) *Zebra Inc. of UK had supplied the Trade Mark and the Business Commercial Rights to Nargis Ltd. of India to carry out business throughout the globe. The business of Nargis Ltd. of India to be carried out is totally dependent on the Trade Mark and the business commercial rights as given by Zebra Inc. of U.K.*
  - (iii) *Krishan Kanhiya HUF, resident in India and proprietor of Pankaj Agro, is dealing in edible oils. The business of Pankaj Agro is being controlled by Suresh Seeds run in partnership of brother and son of the Karta of Krishan Kanhiya HUF. Suresh Seeds operates from Singapore. (6 marks)*

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

##### **Existence of Business Connection**

All income accruing or arising directly or indirectly through or from any business connection in India is chargeable to tax in India as per section 9(1)(i) of the Income Tax Act, 1961 and in the given case the non-resident company Ali & Ali Ltd. is having a liaison office in India, having authority to negotiate and conclude the contracts on behalf of the non-resident company and therefore, as per Explanation 2 of section 9(1)(i) of the Income Tax Act, 1961, there exists a business connection in India and therefore the income of the liaison office located at Hyderabad shall be taxable in India in the hands of Ali & Ali Ltd.

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

The branch office of John Miller Inc. located at Delhi constitutes a business connection in India as per section 9(1)(i) of the Income Tax Act, 1961, since there is an element of continuity in the business transactions with the UK based company John Miller Inc. The branch office besides, purchase of raw material, is also engaged in selling the products manufactured by John Miller Inc. and in providing sales related services to customers in India on behalf of UK Company. Branch is considered to be an extended arm of the company.

Therefore, in this case, the profits attributable to the operations conducted in India by the branch will be taxable in India in the hands of John Miller Inc. as per Income-tax Act, 1961

#### **Answer 5(a)(iii)**

All income accruing or arising directly or indirectly through or from any business connection in India is chargeable to tax in India as per section 9(1)(i) of the Income Tax

Act, 1961 and in the given case Mr. Rajveer does not have any authority to accept or conclude any contracts on behalf of the company POK Pty. Inc. of USA or procure any raw material. It means that business connection does not exist in India in the case of POK Pty. Inc. and the income of the work done by the agent shall not be taxable in India in the hands of POK Pty. Inc. of USA.

**Answer 5(b)(i)**

In the given case, X Ltd of USA is standing as guarantor for the borrowing of its Indian subsidiary to the extent of Rs. 100 crores where the total borrowing of the Indian subsidiary are of Rs.500 crores constituting the guarantee being given to the extent of 20% of total borrowing of the Indian subsidiary. According to the provisions of section 92A of the Income-tax Act, 1961, "where one enterprise guarantee not less than 10% of the total borrowing of the other enterprise, there exist the relationship as "associate enterprise". In the present case, the extent of guarantee is 20% and therefore, there exists a relationship between the two entities as an "Associate Enterprise".

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

Zebra Inc. of UK has supplied Commercial Right and Trade Mark to the company in India i.e. Nargis Ltd. and without such right a Nargis Ltd. in India cannot carry out its business.

As per the provisions of section 92A of the Income-tax Act, 1961, Entities are considered to be Associate Enterprise, if the manufacture or processing of goods or articles of business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licenses, 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.

Therefore, there exists a relationship between both the companies (i.e. Zebra Inc. of UK and Nargis Ltd. in India) as an Associate Enterprise.

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

The business of Krishan Kanhiya HUF (Proprietor of Pankaj Agro) is being controlled by Suresh Seeds (partnership firm operates from Singapore) in which the son and the brother of Karta of Krishan Kanhiya HUF are Partners.

As per the provisions of section 92A of the Income-tax Act, 1961, Entities are considered to be Associate Enterprise, where one enterprise is controlled by a Hindu Undivided Family and the other enterprise is controlled by a member of such Hindu Undivided Family or by a relative of a member of such Hindu undivided family or jointly by such members and his relative.

Therefore, there exists a relationship between both the Enterprise (i.e. Pankaj agro and Suresh Seeds) as an Associate Enterprise.

**Question 6**

(a) *Examine and state the correctness or otherwise of each of the following*

statements in the context of provisions contained under the Income-tax Act, 1961 by giving brief reasons/contents :

- (i) Double taxation avoidance treaties (DTAA) entered into by the Government of India do not override the domestic law in force.
- (ii) Business transaction done through e-commerce is not different from the modes of business transaction carried out through traditional means.
- (iii) Ramesh, resident in India during the previous year 2018-19 had agricultural income of ₹15 lacs from the lands located in Malaysia. He had paid tax on such agricultural income in Malaysia, for which he is entitled to claim a rebate/relief from the tax payable in India. (6 marks)
- (b) Cash of ₹35 lakh was seized on 12th Sept., 2018 in a search conducted in the premises of an assessee as per section 132 of the Act. The assessee moved an application on 27th Oct., 2018 to release the cash, after explaining the source thereof, which was turned down by the Department. The assessee seeks your opinion on the following issues :
- (i) Can the Department withhold the explained money ?
- (ii) If yes, then to what extent and up to which period ? (3 marks)
- (c) Alfa Pvt. Ltd., an Indian Company, has made payments to Beeta Enterprises, a resident partnership firm on different dates during the year 2018-19 towards the job work done by them under different contracts :

Contract No.	Date of payment	Amount (₹)
1	15-05-2018	28,000
2	26-06-2018	22,500
3	18-08-2018	24,000
4	20-12-2018	15,000
5	23-01-2019	18,000

Alfa Pvt. Ltd. claims that it is not liable for deduction of tax at source as per section 194C from such payments made to Beeta Enterprises. Examine the correctness of the stand taken by the company.

What would be the position, if the value of the contract No. 5 is ₹10,000 only and there was no further contract during the year ? (3 marks)

#### Answer 6(a)(i)

**Incorrect** : Section 90(2) of the Income Tax Act, 1961 provides that where a double taxation avoidance treaty (DTAA) is entered into by the Government of India, the provisions of Income Tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

#### Answer 6(a)(ii)

**Incorrect** : There are three means/methods of doing the business through e-commerce:

- (a) Electronic advertising
- (b) Electronic Sales
- (c) Electronic delivery



**Answer 6(a)(iii)****Correct**

Rebate /Relief of taxes of foreign taxes will depend on the fact whether India has a DTAA with Malaysia or not.

If India has a DTAA with Malaysia, Rebate/Relief will be allowed u/s 90

However if there is no DTAA with Malaysia, he is entitled to relief as per section 91 of the Income Tax Act, 1961, from the tax payable by him to the following extent:

- (a) Amount of tax paid in Malaysia on such income liable to tax in India, or
- (b) Of a sum calculated on that income at the Indian rate of tax; whichever is less

**Answer 6(b)****Seeking release of cash seized in search**

The provision to section 132B(l)(i) of the Income Tax Act, 1961 provides that where the person makes an application within 30 days from the end of the month in which the asset was seized, for release of the asset by explaining the nature and source of acquisition of the asset to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Principal Commissioner, release the asset after recovering the existing liability under the Act out of such assets. 'Existing liability', however, does not include advance tax payable.

Such asset has to be released within 120 days from the date on which the last of the authorization for search under section 132 was executed.

In this case, since the application was made to the A.O. within the 30 days period from the end of the month in which the asset was seized, the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

**Answer 6(c)****Applicability of TDS provisions u/s 194C of the Income tax Act, 1961**

As per section 194C(5) of the Income-tax Act, 1961, tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds Rs. 30,000 in a single payment or Rs. 1,00,000 in aggregate during the financial year.

Therefore, in the given case, even-though the value of each individual contract does not exceed Rs. 30,000 but the aggregate amount exceeds Rs. 1,00,000. Hence, contention of Alfa Ltd. is not correct and tax is required to be deducted at source under section 194C @ 2% on the whole amount of Rs. 1,07,500/- from the payment of Rs. 18,000 towards Contract No. 5 on account of which the aggregate amount exceeded Rs. 1,00,000.

However, no tax deduction is required to be made if the value of the last contract i.e. contract no. 5 is Rs. 10,000 as the aggregate amount in such case would be Rs. 99,500 which is below the aggregate threshold monetary limit of Rs. 1,00,000.

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## **LABOUR LAWS & PRACTICE** (Elective Paper 9.6)

Time allowed : 3 hours

Maximum marks : 100

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

### **Question 1**

*Read the case below and answer the questions at the end :*

*There arose a dispute between the management and two rival trade unions over the dismissal of some employees. Both the trade unions served notices for strike on the management on 21st July 2018, specifying their demands and their intention to go on strike from 10th August 2018. An attempt was made to conciliate between parties involved and conciliation proceedings lasted between 26th July 2018 to 8th August 2018. A failure report was sent to the Government by the Conciliation officer. A large number of workmen went on strike on 10th August, 2018. The management of the company alleged that they forcibly entered the company's premises and other places and obstructed the work of the loyal workers. The workmen turned violent and therefore the District Magistrate issued prohibitory orders on 10th August 2018. On the same day, the company declared a lock out.*

*Around a week later on 19th August 2018, the trade unions called off the strike, whereas company lifted the lock out on 27th August 2018. The company suspended those workmen whom it claimed to have obstructed the loyal ones and dismissed those who were convicted for violation of prohibitory orders.*

*The Industrial Tribunal held that the strike although illegal, was justified, and the company was not entitled to dismiss the workmen. The company was directed to reinstate the workers except those who have been convicted under Indian Penal Code. It was also directed to reinstate the workers dismissed originally due to which the dispute arose.*

*The company wants to appeal against this order by special leave to the Supreme Court.*

*Questions :*

- (a) State the chances of the management in getting relief from Supreme Court, assuming that it is a case of a public utility service. Was the strike of the workers on 10th August 2018 consistent with the provisions ?*
- (b) Explain the meaning of 'justified' and 'unjustified' strikes.*
- (c) Are wages payable to the workers for the strike period ?*
- (d) Are there general rules prescribed for the prohibition of strikes and lockouts in public utility and non-utility service ?*
- (e) Explain the meaning of public utility services, also state that is it true that these services can be carried out only by government and public Companies ?*

*(8 marks each)*

**Answer 1(a)**

The conciliation proceedings shall be deemed to have concluded when the conciliation officer served its report to Government on 8th August 2018. The strike commenced on 10th August, 2018, is in contravention of the provisions of Section 22 of the Industrial Disputes Act, 1947. Section 22 as mentioned above provides that no person employed in a public utility service shall go on strike in breach of contract and during the pendency of any conciliation proceedings before a conciliation officer and seven days after the conclusion of such proceedings. Here in the present case strike was started before the expiry of seven days after the conciliation proceeding. Section 24 of the Industrial Disputes Act, 1947 categorically provides that a strike or lock-out shall be illegal if it is commenced or declared in contravention of section 22. Hence the strike is illegal under Section 24 of the Industrial Disputes Act, 1947 as it violates the provisions of Section 22 of the Act.

In the case of *Indian General Navigation and Rly. Co. Ltd.v. Their Workmen*, (1960) I L.L.J. 13, the Supreme Court held that the law has made a distinction between a strike which is illegal and one which is not, but it has not made distinction between an illegal strike which may be said to be justifiable and one which is not justifiable. This distinction is not warranted by the Act and is wholly misconceived, specially in the case of employees in a public utility service. Therefore, an illegal strike is always unjustified.

It is well settled that in order to entitle the workmen to wages for the period of strike, strike should be legal as well as justified. A strike is legal if it does not violate any provision of the statute. Again a strike cannot be said to be unjustified unless the reasons for it are entirely perverse or unreasonable.

In the present case company has got better chance to get relief from Supreme Court. The strike of the workers on 10th August 2018 in the circumstances as explained here in above is in contravention to the provisions of the Section 22 read with Section 24 of Industrial Disputes Act, 1947.

**Answer 1(b)**

If a strike is in contravention of the provisions of the Industrial Disputes Act, 1947, it is an illegal strike. Since strike is the essence of collective bargaining, if workers resort to strike to press for their legitimate rights, then it is justified. Whether strike is justified or unjustified will depend upon the fairness and reasonableness of the demands of workers.

In the case of *Chandramalai Estate v. Its Workmen*, (1960) II L.L.J. 243 (S.C.), the Supreme Court observed: "While on the one hand it be remembered that strike is a legitimate and sometimes unavoidable weapon in the hands of labour, it is equally important to remember that indiscriminate and hasty use of this weapon should not be encouraged. It will not be right for labour to think that for any kind of demand a strike can be commenced with impunity without exhausting reasonable avenues for peaceful achievement of their objects. There may be cases where the demand is of such an urgent and serious nature that it would not be reasonable to expect labour to wait till after asking the Government to make a reference. In such cases, strike even before such a request has been made, will be justified".

If workmen go on strike without contravening statutory requirements, in support of their demands, the strike will be justified. In the beginning strike was justified but later on workmen indulged in violence, so it will become unjustified.

**Answer1(c)**

The payment of wages for the strike period will depend on legality and justifiability of strike. If strike is legal but unjustified or justified but illegal, the employees would not be entitled to wages during strike period. The view is that for such entitlement the strike must be both legal as well as justified.

This also depends upon several factors such as service conditions of workman, the cause which led to strike, the urgency of cause or demand of workman, the reason for not resorting to dispute settlement machinery under the Act or service rules/regulations etc.

No wages are payable if the strike is illegal or it is unjustified. Further, if the workers indulge in violence, no wages will be paid even when their strike was legal and justified (*Dum Dum Aluminium Workers Union v. Aluminium Mfg. Co.*). The workmen must not take any hasty steps in resorting to strike. They must, first take steps to settle the dispute through conciliation or adjudication except when the matter is urgent and of serious nature.

It was observed that when workmen might have waited for some time, after conciliation efforts had failed, before starting a strike, and in the meantime could have asked the Government to make a reference, the strike would be unjustified and the workmen would not be entitled to wages for the strike period.

**Answer 1(d)**

Section 23 of the Industrial Disputes Act, 1947 provides that no workman who is employed in any industrial establishment shall go on strike in breach of contract and no employer of any such workman shall declare a lock-out:

- (a) during the pendency of conciliation proceedings before a Board and seven days the conclusion of such proceedings;
- (b) during the pendency of proceedings before a Labour Court, Tribunal or National Tribunal and two months after the conclusion of such proceedings;
- (bb) during the pendency of arbitration proceedings before an arbitrator and two months after the conclusion of such proceedings, where a notification has been issued under Section 10A(3A); or
- (c) during any period in which a settlement or award is in operation, in respect of any of the matters covered by the settlement or award.

Section 22 of the Industrial Disputes Act, 1947 provides additional safeguards for the smooth and uninterrupted running of public utility services and to obviate the possibility of inconvenience to the general public and society.

**Answer 1(e)**

According to Section 2(n) of the Industrial Disputes Act, 1947 public utility service means—

- (i) any railway service or any transport service for the carriage of passengers or goods by air

- (ia) any service in, or in connection with the working of, any major port or dock;
- (ii) any section of an industrial establishment, on the working of which the safety of the establishment or the workmen employed therein depends;
- (iii) any postal, telegraph or telephone service;
- (iv) any industry which supplies power, light or water to the public;
- (v) any system of public conservancy or sanitation;
- (vi) any industry specified in the First Schedule of the ID Act which the appropriate Government may, if satisfied that public emergency or public interest so requires, by notification in the Official Gazette, declare to be a public utility service for the purposes of the Act, for such period as may be specified in the notification.

In view of the above it is not true that public utility services can be carried out only by government and public companies.

### Question 2

- (a) *What rights does a woman has upon her return to work from maternity leave ?  
(6 marks)*
- (b) *GMC runs a public utility transport service in Lucknow managed by a committee known as Grand Electric Supply and Transport Committee (GEST). GEST owns a number of buses and corporation employs staff including bus drivers for conducting the said service. A bus driver has to drive a bus allotted to him from morning till evening with necessary intervals and for that purpose he has to reach the depot. concerned early in the morning and go back to his home after his work is finished and bus is lodged in the depot. GEST permits the staff to travel in a bus without payment of fares, in the morning while coming to duty and in the evening, while going home after the duty.*

*On November 25th, 2018, Mr. Arun finished his work for the day at about 8:30 p.m. At Alambagh bus depot, he boarded another bus in order to go to his residence at Gomti Nagar. The said bus collided with stationary lorry parked at an awkward angle near Charbagh. Because of collision, Arun was thrown out on the road and injured. He was sent to hospital for treatment where he expired on December 1st, 2018. His widow filed an application before Commissioner for workman's compensation, claiming compensation by reason of death of her husband in an accident which arose "out of and in course of his employment". State whether she will succeed ?  
(6 marks)*

### Answer 2(a)

When a female employee resumes her employment, then she is entitled to following benefits:

- Every woman who has delivered a child and returns to duty after such delivery shall, in addition to the interval for rest allowed to her, be allowed in the course of her daily work two breaks of the prescribed duration for nursing the child until the child attains the age of fifteen months.

- Every establishment having fifty or more employees shall have the facility of creche within such distance as may be prescribed, either separately or along with common facilities. The employer shall allow four visits a day to the creche by the woman, which shall also include the interval for rest allowed to her.
- Every establishment shall intimate in writing and electronically to every woman at the time of her initial appointment regarding every benefit available under the Maternity Benefits Act, 1961.

### Answer 2(b)

As per Section 3 of the Employee's Compensation Act, 1923, to make the employer liable, it is necessary that the injury is caused by an accident which must be arising out of and in the course of employment.

The expression "arising out of employment" suggests some causal connection between the employment and the accidental injury. The cause contemplated is the proximate cause and not any remote cause. The expression "in the course of employment" suggests the period of employment and the place of work. In other words, the workman, at the time of accident must have been employed in the performance of his duties and the accident took place at or about the place where he was performing his duties.

The expression "employment" is wider than the actual work or duty which the employee has to do. It is enough if at the time of the accident the employee was in actual employment although he may not be actually turning out the work. Even when the employee is resting, or having food, or taking his tea or coffee, proceeding from the place of employment to his residence, and accident occurs, the accident is regarded as arising out of and in the course of employment.

A workman while returning home after duty was murdered within the premises of the employer. It was held that there was casual and proximate connection between the accident and the employment. Since the workman was on spot only for his employment and his wife is entitled for compensation [*Naima Bibi v. Lodhne Colliery (1920) Ltd.*, 1977 Lab. I.C. NOC 14]. If an employee in the course of his employment has to be in a particular place by reason where he has to face a peril which causes the accident then the casual connection is established between the accident and the employment (*TNCS Corporation v. Poonamalai*, 1994 II LLN 950).

Hence, the widow of the deceased employee in the present case will succeed in her claim for death compensation.

### Question 3

- State the specific directions issued by Supreme Court to the State Government in case of Bandhua Mukti Morcha Versus Union of India.*
- Explain any two most important recent reforms/ammendments in labour laws.*  
(6 marks each)

### Answer 3(a)

In the case of Bandhua Mukti Morcha versus Union of India AIR 1984 SC 802, the

Supreme Court issued directions to the Central government, the government of Haryana and various authorities as:

- The Central Government and State Government will immediately ensure that mine lessees and stone crusher owners start supplying pure drinking water to the workmen on a scale of at least 2 litres for every workmen at conveniently accessible points, in clean and hygienic conditions. In case of default, action to be taken against defaulter.
- The mine owners and stone crusher owners are to obtain water from unpolluted sources and transport it by tankers to the work site with sufficient frequency so as to keep the vessels filled up for supply of clean drinking water for workmen.
- The State Government must ensure that conservancy facilities in the shape of latrines and urinals in accordance with the Section 20 of the Mines Act 1952 and Rules 33 to 36 of the Mines Rules, 1955 were to be provided at the latest by 15th February 1984.
- To ensure that appropriate and adequate medical and first aid facilities are provided to workmen as required by Section 21 of the Mines Act 1952 and Rules 40 to 45-A of the Mines Rules 1955.
- To ensure that every workmen who is required to carry out blasting with explosives is trained under the Mines Vocational Training Rules, 1966 and also holds first aid qualifications and carries a first aid outfit while on duty.
- To ensure that the mine lessees and owners of stone crushers provide proper and adequate medical treatment to the workmen and their families free of cost.
- The Central Government and the Government of Haryana will ensure that payment of wages is made directly to the workmen by the mine lessees and stone crusher owners or at any rate in the presence of a representative of the mine lessees or stone crusher owners and the inspecting officers of the Central Government as also of the Government of Haryana shall carry out periodic checks in order to ensure that the payment of the stipulated wage is made to the workmen.

**Answer 3(b)**

Ministry of Labour and Employment has taken a number of initiatives for bringing transparency and accountability through reforms and enforcement of Labour Laws, with the objective of strengthening the safety, security, health, social security for every worker and bringing ease of compliance for running an establishment to catalyze creation of employment opportunities. These initiatives include:

- Legislative reforms by simplifying, amalgamating and rationalizing the existing labour laws into 4 labour codes i.e., Labour Code on Wages, Labour Code on Industrial Relations, Labour Code on Occupational Safety, Health & Working Conditions and Labour Code on Social Security & Welfare.
- Governance reforms through use of e-governance measures: Unified Online Annual Returns have been made mandatory in respect of eight (8) Central Labour Acts.

- Facility for exemption from Labour Inspections under six (6) Central Labour Acts is being provided to the Start-ups which submit self-certified declarations through Shram Suvidha Portal.
- Government of India has launched two pension schemes for old age protection and social security of Unorganized Workers in 2019.
- The Payment Of Gratuity (Amendment) Act, 2018, provides flexibility to the Central Government firstly to increase the ceiling limit of gratuity to such amount as may be notified from time to time and secondly to enhance the calculation of continuous service for the purpose of gratuity in case of female employees who are on maternity leave to such period as may be notified from time to time.
- Payment of Wages (Amendment) Act, 2017 enabling payment of Wages to employees by Cash or Cheque or crediting it to their bank account.
- Maternity Benefit Amendment Act, 2017, increases the paid maternity leave from 12 weeks to 26 weeks.
- The Employee Compensation (Amendment) Act, 2017 seeks to rationalize penalties and strengthen the rights of the workers under the Act.

#### Question 4

- (a) *The employees of company Old Limited had been getting the maximum bonus of 20%. The company was amalgamated with certain other companies, on the stipulation that employees of amalgamating companies would become employees of the new company on terms not favourable to them and that a separate profit and loss account would be prepared for each of the amalgamating companies. The new company allowed the said employees only the minimum bonus 8.33% on the basis of consolidated profit and loss accounts and contended that section 3 was not applicable as there was no stipulation for preparing separate balance sheets for each amalgamating companies. State as to who will succeed, the employees of Old Limited or the management of the new company ? (6 marks)*
- (b) *On every working day, when the workers canteen of the company is opened, there would be a big rush of employees for purchase of snacks and tea. Normally employees stand in queue for the purchase of various items from two different counters. The canteen remains open for half-an-hour and all employees who come there can conveniently purchase eatables, if they stand in queue. One day, Shubham came to canteen when in both counters people were standing in queue, and he tried to purchase the snacks through Sarvesh, a co-worker who was in queue. This was objected by Prashant who was standing just behind Sarvesh. Arguments started between Shubham and Prashant. They were both angry and in the process, Shubham slapped Prashant. The canteen supervisor intervened and separated them. Both of them were active members of two different rival unions. Analyse the point of issue in the case and state the main points of chargesheet to be issued to the employees concerned for this misconduct.*

*Also state any six matters to be provided in the standing orders under the Industrial Employment (Standing Orders) Act 1946. (6 marks)*



**Answer 4(a)**

Section 3 of the Payment of Bonus Act, 1965 provides that the word establishment shall include all its departments, undertakings and branches wherever it has so whether situated in the same place or in different places and the same shall be treated as parts of the same establishment for the purpose of computation of bonus under this Act.

Provided that where for any accounting year, a separate balance-sheet and profit and loss account are prepared and maintained in respect of any such department or undertaking or branch then such department, undertaking or branches shall be treated as a separate establishment for the purpose of computation of bonus under this Act for that year, unless such department, or undertaking or branch was, immediately before the commencement of that accounting year treated as part of establishment for the purpose of computation of bonus.

In the case of the *Workman Of M/S. Binny Ltd vs. The Management of Binny Ltd*. 1986 AIR 509, 1985 SCR the Supreme Court observed that in matters of welfare legislation, especially involving labour, the terms of contracts and the provisions of law should be liberally construed in favour of the weaker one. Section 3 is an enabling provision in favour of the employers. When an establishment consists of different departments, undertakings or branches, all such departments, under takings or branches shall be treated as part of the same establishment for the purpose of computation of bonus under the Act. This means that the employees will be entitled to bonus on the basis of the surplus available from all the units put together. The proviso speaks of separate balance-sheet and profit and account being prepared and maintained for any accounting year in respect of one of the units of the whole undertaking. In such cases, the computation of allocable surplus for the payment of bonus should be on the basis of such separate profit and loss account and balance-sheet thus prepared and the employees will be entitled to claim bonus on this basis. The claim of the employees on this basis can be defeated only if this separate unit was treated as part of the establishment for the computation of bonus immediately before commencement of the accounting year in question.

The mere omission to prepare a separate balance sheet for one of the amalgamating units will not by itself help the company to deny bonus to the employees of such a unit. When profit and loss account and trial balance-sheet are prepared there should be difficulty in preparing the regular balance sheet.

In view of the above, it can be concluded that the employees of Old Limited will succeed.

**Answer 4(b)**

The point of issue in the given case is indiscipline and non-adherence to the Company's Standing order/Rules leading to clash between two workers belonging to two different trade unions.

The main points which should be included in the charge sheet are:

- Act of misconduct
- Violence in factory premises
- Violation of establishment standing orders.

Some matters to be provided in the standing order under the Industrial Employment (Standing Orders) Act, 1946:

1. Classification of workmen, e.g., whether permanent, temporary, apprentices, probationers or badlis.
2. Manner of intimating to workmen periods and hours of work, holidays, pay-days and wage rates.
3. Shift working.
4. Attendance and late coming.
5. Conditions of, procedure in applying for, and the authority which may grant leave and holidays.
6. Requirement to enter premises by certain gates, and liability to search.
7. Closing and reopening of sections of the industrial establishment, and temporary stoppage of work and the rights and liabilities of the employer and workmen arising therefrom.
8. Termination of employment, and the notice thereof to be given by employer and workmen.
9. Suspension or dismissal for misconduct, and acts or omissions which constitute misconduct.
10. Means of redress for workmen against unfair treatment or wrongful exactions by the employer or his agents or servants.

### Question 5

- (a) *Mr. Bharat wants to set up an industrial establishment for collecting and manufacturing quarry products. He has been told that there is no significant difference between contract labour and employees. Is there any difference between two terms ? He also wants to know whether contract labour can be employed for any nature of work ? Will the contract employees automatically become the employees of the principal employer ?*
- (b) *Casual Company Limited was being headed and run by Mr. Questionable, its Chairman cum Managing Director (CMD) from his residence. He used to come to the office only in cases of emergency and if there was some important business requiring his physical presence, he was assisted by Miss Victim who was his personal secretary. The personal secretary wanted to complain about objectionable acts by her boss, but there was no internal complaints committee in the organisation. Also she was not comfortable in making the complaint directly due to mental stress. She was also advised that no action can be taken against her boss, as the wrongful act was done at the 'residence' of the boss and not at the workplace. Advise. (6 marks each)*

### Answer 5(a)

According to the Contract Labour (Regulation and Abolition) Act, 1970 a "contract labour" is hired in or in connection with such work by or through a contractor and such hiring is with or without the knowledge of the principal employer.

"Contract labour" can be distinguished from employees in terms of employment

relationship with the principal establishment and the method of wage payment. A workman is deemed to be a contract labour when he/she is hired in connection with the work or contract for service of an establishment by or through a contractor. They are indirect employees. Contract labour is neither borne on pay roll or muster roll or wages paid directly by the employer.

The landmark judgement in *Standard Vacuum Refining Company v. Its Workmen*, [1960] 3 SCR 466 in which the Supreme Court said that contract labour should not be employed where

- (a) the work is perennial and goes on from day to day;
- (b) the work is necessary for the factory;
- (c) the work is sufficient to employ a considerable number of whole-time workmen; and
- (d) the work is being done in most concerns through regular workmen.

It has been well settled by the various judgements of Apex Court & High Courts that the contractor's employees will not automatically become the employees of the principal employer, even if the principal employer does not get registration and the contractor does not hold licence, though employing contract labour without obtaining registration or without obtaining licence is an offence under the Act.

#### **Answer 5(b)**

The Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 was enacted to ensure a safe working environment for women. It provides for protection to women at their workplace from any form of sexual harassment and for redressal of any complaints they may have launched.

According to section 4 the Act requires an employer to set up an 'Internal Complaints Committee' ("ICC") at each office or branch, of an organization employing 10 or more employees, to hear and redress grievances pertaining to sexual harassment.

In terms of Section 2(o) of the Act workplace includes private sector organisation / private venture / undertaking / enterprise / institution / establishment / society / trust / non-governmental organisation / unit or service provider and places visited by employee (arising out of or during the course of employment, including transportation provided by employer for undertaking journey). Hence, if harassment takes place even during transportation or during a lunch meeting at a restaurant, the same will be covered under the Act.

If the office is being run by Chairman cum Managing Director (CMD) from his residence and if such an officer indulges in an act of sexual harassment with an employee, say the personal secretary, it would not be appropriate for him to say that he had not committed the act at workplace, but at the residence and get away with the same.

Where the aggrieved woman is unable to make a complaint on account of her physical or mental incapacity or death or otherwise, her legal heir or her relative or friend or her coworker an officer of the national or State Commission for Women or any person who has knowledge of the incident, with the written consent of aggrieved woman may make

a complaint to the Internal Committee if so constituted, or the Local Committee, in case it is not so constituted

### Question 6

*The certified standing orders of a company provided that the retirement age of the workman would be 58 years of age. The company enhanced the age to 60 years, as a temporary measure to retain the employees and to cut costs. However, the financial performance of the company still did not improve and few years later, the company withdrew the enhancement and restored the retirement age back to 58 years. The company contended that it was just a temporary measure and even if the benefit of enhancement of age of superannuation from 58 to 60 years has been extended in favour of the workmen, they have got no right to retain the same for the reason that Service Rules and Certified Standing Orders applicable to the workmen stipulates the age of 58 years and since the same has not been amended in accordance with law, hence the provisions of Service Rules and Certified Standing Orders are binding upon the workmen.*

*The trade union wants to challenge this action of the company as bad in the eyes of law, as the employer was bound to give prior notice. Will the trade union succeed ? (12 marks)*

### Answer 6

Section 9A of the Industrial Disputes Act, 1947 lays down that any employer who proposes to effect any change in the conditions of service applicable to any workman in respect of any matter specified in Fourth Schedule is required to follow the procedure laid down in Section 9A of the Act.

According to Section 9A, the workmen likely to be affected by the proposed changes are to be given a notice in the prescribed manner. No change can be made within 21 days of giving such notice. However, no notice is required for effecting any such change when it is in pursuance of any settlement or award.

In the instant case, the grievance of the trade union is justified as the withdrawal of the age of superannuation i.e. restoration of age from 60 years to 58 years without prior notice amount to contravention of the Fourth Schedule of the Industrial Disputes Act, 1947. Hence employer was bound to give proper notice.

The Industrial Disputes Act, 1947 intends to provide and protect the interest of employees. If the company freely allowed to do so, then it could defeat the objective of the Act. It shall also defeat the rule of natural justice. Right to work is a vital right of every employee and it should not be taken away without giving reasonable opportunity of being heard.

Moreover company's plea that Standing Orders stipulated the age of 58 years as superannuation age does not stand, as it had already implemented the change to enhance the superannuation age to 60 years without making amendment in the Standing Orders, while same had been accepted by the employees.

Any unilateral withdrawal of such privilege amounts to contravention of Section 9A of the Act and such act of the employer is not appropriate in the eyes of law, therefore the trade union will succeed.

**VALUATIONS & BUSINESS MODELLING**  
(Elective Paper 9.7)

Time allowed : 3 hours

Maximum marks : 100

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

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

3. Working notes should form part of answer.

**PART A**

**Question 1**

Everest Manufacturing Industrial Limited started 4 years ago, is expected to grow at a higher rate of 4 years in the coming years and thereafter the growth rate will fall and stabilize at a lower level. The following information has been made available to you for your analysis :

<b>Base Year (Year 0) Information</b>	
	(In Million ₹)
Revenues	3000 Million
EBIT	500 Million
Capital Expenditure	350 Million
Depreciation	250 Million
Net Working Capital as a percentage of EBIT	25%
Corporate tax rate (for all scenarios)	30%
Paid-up Equity Capital (10 Face Value)	400 Million
Market value of debt	1200 Million
<b>Inputs for the High Growth Phase</b>	
Length of high growth phase	4 years
Growth rate in revenues, depreciation	20%
EBIT and Capital expenditure :	
Net Working Capital as a percentage of EBIT	25%
Cost of debt (pre-tax)	13%
Debt-equity ratio	1 : 1
Risk-free rate	11%
Market risk premium	7%
Equity Beta	1.129

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**Inputs for the Stable Growth Phase**

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<i>Expected growth rate in revenues and EBIT</i>	10%
<i>Capital expenditure are offset by depreciation</i>	
<i>Net Working Capital as a percentage of EBIT</i>	25%
<i>Cost of debt (pre-tax)</i>	12.14%
<i>Risk-free rate</i>	10%
<i>Market risk premium</i>	6%
<i>Equity Beta</i>	1.0
<i>Debt-equity ratio</i>	2 : 3

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*With above information background, answer the following questions of the Management :*

- (i) *What is the Cost of Capital and Weighted Average Cost of Capital (WACC) for the high growth phase and for the stable growth phase. (10 marks)*
- (ii) *What is the Value of the Firm ? (10 marks)*
- (iii) *What will be the Cost of Capital and WACC for the high growth phase and for the stable growth phase, if the debt-equity ratio is 1 : 2 during high growth phase and 3 : 2 in the stable growth phase ? Will this change impact the Value of the Firm ? If yes, what will be the value of the Firm with revised debt equity ratio ? (10 marks)*
- (iv) *Comparing the given case, discuss on the advantages and disadvantages of the Dividend Discount Models. (10 marks)*

**Answer 1(i)**

**WACC during high growth period**

$$\text{Expected rate of Return on Equity} = R_f + B_i (R_M - R_f)$$

$R_f$  = Rate of Risk free return

$B_i$  = Beta

$E(R_M)$  = Expected rate of return on market

$$= 11\% + 1.129 (7\%) = 11\% + 7.90\% = 18.90\%$$

The Cost of Debt during the high growth phase will be:

$$= 13\%(1-0.30)=9.10\%$$

Weighted Average Cost of Capital =  $W_E r_E + W_D r_D$

$$\text{WACC} = 0.5 * 18.90 + 0.5 * 9.10$$

$$= 9.45 + 4.55 = 14.0\%$$

**WACC during stable growth period**

$$\text{Cost of Equity} = R_f + B_i [E_f(RM) - R_f]$$

$$= 10\% + 1.0 (6\%) = 10\% + 6.00\% = 16.00\%$$

The Cost of Debt during the stable growth phase will be:

$$= 12.14\% (1 - 0.30) = 8.50\%$$

$$\text{Weighted Average Cost of Capital} = W_E r_E + W_D r_D$$

$$\text{WACC} = 0.6 * 16.00 + 0.4 * 8.50$$

$$= 9.60 + 3.40 = 13.0\%$$

WACC during High growth phase = 14%

WACC during Stable growth phase = 13%

**Answer 1(ii)**

<i>Particulars</i>	<i>0</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>Terminal Year</i>
1 Revenue	3000.00	3600	4320.00	5184.00	6220.80	6842.88
2 EBIT	500.00	600.00	720.00	864.00	1036.80	1140.48
3 EBIT(1-t)	350.00	420.00	504.00	604.80	725.76	798.34
4 Capital expenditure (less) depreciation	100.00	120.00	144.00	172.80	207.36	0.00
5 Net Working Capital	125.00	150.00	180.00	216.00	259.20	155.50
6 FCF(3-4-5)	125.00	150.00	180.00	216.00	259.20	642.84

The present value of the FCF during the explicit forecast period is:

$$\begin{aligned} & [150/(1.14)] + [180/(1.14)^2] + [216/(1.14)^3] + [259.20/(1.14)^4] \\ &= [150/1.14] + [180/1.300] + [216/1.482] + [259.20/1.689] \\ &= [131.58] + [138.50] + [145.79] + [153.47] \\ &= 569.3 \text{ million} \end{aligned}$$

PV of FCF during High Growth period = 569.3 million

The present value of the terminal value is:

$$\begin{aligned} \text{Terminal Value} &= [\text{FCF}_5 / (\text{WACC} - g)] * [1 / (1.14)^4] \\ &= [642.8 / (0.13 - 0.10)] * [1 / (1.14)^4] \\ &= [642.8 / 0.03] * [0.5921] \\ &= [21,426.67] * [0.5921] = 12,686.63 \text{ million} \end{aligned}$$

PV of Terminal Value = 12,686.63 million

**The Value of the Firm is:**

$$= \text{PV of FCF during high growth period} + \text{PV of Terminal Value}$$

$$= 569.3 \text{ million} + 12,686.63 \text{ million} = 13,255.6 \text{ million}$$

**Value of the Firm = 13,255.6 million****Answer 1(iii)**

If the debt equity ratio is 1:2 during high growth phase, then WACC will be:

$$\text{Weighted Average Cost of Capital} = W_E r_E + W_D r_D$$

$$\text{WACC} = 0.67 * 18.90 + 0.33 * 9.10$$

$$= 12.667 + 3.003 = 15.67\%$$

If the debt-equity ratio is 3:2 during stable growth phase, then WACC will be:

$$\text{WACC} = 0.40 * 16.00 + 0.60 * 8.50$$

$$= 6.40 + 5.10 = 11.50\%$$

WACC during High growth phase = 15.670%

WACC during Stable growth phase = 11.50%

The present value of the FCF during the explicit forecast period is:

$$[150/(1.1567)] + [180/(1.1567)^2] + [216/(1.1567)^3] + [259.20/(1.1567)^4]$$

$$= [150/1.1567] + [180/1.338] + [216/1.548] + [259.20/1.790]$$

$$= [129.68] + [134.53] + [139.57] + [144.80]$$

$$= 548.58 \text{ million}$$

PV of FCF during High Growth period = 548.58 million

The present value of the terminal value is:

$$\text{Terminal Value} = [\text{FCF}_5 / (\text{WACC} - g)] * [1/(1.1567)^4]$$

$$= [642.8 / (0.115 - 0.10)] * [1/(1.1567)^4]$$

$$= [642.8 / 0.015] * [0.55862]$$

$$= [42853.33] * [0.55862] = 23,938.73 \text{ million}$$

PV of Terminal Value = 23,938.73 million

**The Value of the Firm is**

$$= \text{PV of FCF during high growth period} + \text{PV of Terminal Value}$$

$$= 548.58 \text{ million} + 23,938.73 \text{ million} = 24,487.31 \text{ million}$$

**Value of the Firm = 24,487.31 million**

As the cost of Debt is cheaper Value of the Firm Increases considerably during the growth period.



**Answer 1(iv)****Dividend Discount Model**

It is a way of valuing a company based on the theory that a stock is worth the discounted sum of all of its future dividend payments. In other words, it is used to evaluate stocks based on the net present value of the future dividends.

Financial theory states that the value of a stock is the worth all of the future cash flows expected to be generated by the firm discounted by an appropriate risk-adjusted rate. We can use dividends as a measure of the cash flows returned to the shareholder.

Some examples of regular dividend paying companies are TCS, Infosys, Coal India etc. We can use Dividend Discount Model to value these companies.

The dividend discount model (DDM) seeks to estimate the current value of a given stock on the basis of the spread between projected dividend growth and the associated discount rate. The DDM calculates this present value in the following manner:

$$\text{Present Stock Value} = \text{Dividend}_{\text{Share}} / (R_{\text{Discount}} - R_{\text{Dividend Growth}})$$

In the DDM, a present stock value that is higher than a stock's market value indicates that the stock is undervalued and that it is a good time to purchase shares.

**Advantages**

There are three major reasons why the dividend discount model is a popular valuation technique:

**1. Simplicity of Calculations**

Once investors know the variables of the model, calculating the value of a share of stock is very straightforward. It only takes a little of algebra to calculate the price of stock.

**2. Sound and Logical Basis for the Model**

The model is based on the premise that investors purchase stocks so that they can get paid in the future. Even though there are a number of reasons that investors may purchase a security, this basis is correct. If investors never received a payment for their security it wouldn't be worth anything.

**3. The Process Can Be Reversed to Determine Growth Rates Experts Predicted**

After looking at the price of a share of stock, investors can rearrange the process to determine the dividend growth rates that are expected for the company. This is useful if they know the predicted value of a share of stock but want to know what the expected dividends are.

**Disadvantages**

Although many investors still use the model, it has become a lot less popular in recent years for a variety of reasons:

- (a) **Reflects Rationality, Not Reality** : The dividend discount model is based on the concept that investors invest in stocks that are most likely to pay them the

most. Although this is the way that investors should behave, it does not always reflect the way investors actually behave. Many investors purchase stocks for reasons that have nothing to do with the company's financial position or its future dividend payments. Some investors purchase a company that happens to be more glamorous or interesting. This often explains why there is a discrepancy between a stock's intrinsic value and the actual market value.

- (b) **Difficulty Determining the Variables that go into the Model** : The dividend discount model is simple to use, however, it is difficult to determine the numbers that go into it, which can yield inaccurate results. Companies are often unpredictable with their dividends, so forecasting them for this model is difficult. It is also very difficult to estimate the future sales of a company, which influences a corporation's abilities to maintain or grow dividends.
- (c) **Dividends Aren't the Only Way Earnings Have Value to Investors** : Investors may be primarily concerned with dividends, but all earnings are still owned by investors. Dividends only represent the share of earnings that a corporation chooses to payout. Retained earnings are still owed to investors and still count towards their wealth. This is why newer models evaluate the overall cash flow of a company, not the amount that is paid back to investors.
- (d) **Investor Bias** : Investors have a tendency to confirm their own expectations. This means that most investors are going to come up with their own values for a stock since many of the inputs here are somewhat subjective. Only those who can force themselves to be objective are likely to find accurate variables for the model.

## Question 2

- (a) *Autumn Spring Limited has FCFF of ₹2.0 billion and FCFE of ₹1.5 billion. Autumn Spring's WACC is 11 percent, and its required rate of return for equity is 13 percent. FCFF is expected to grow forever at 7 percent, and FCFE is expected to grow forever at 7.5 percent. Autumn Spring has debt outstanding of ₹20 billion.*
- (i) *What is the total value of Autumn Spring's equity using the FCFF valuation approach ?*
- (ii) *What is the total value of Autumn Spring's equity using the FCFE valuation approach ?*
- (b) *'Different bases of value may require a particular Premise of Value or allow the consideration of multiple Premises of Value'—Referring International Valuation Standards discuss briefly on different Premises of Valuation. (5 marks each)*

## Answer 2(a)

- A. The firm value is the present value of FCFF discounted at the WACC, or

$$\begin{aligned} \text{Firm Value} &= \frac{\text{FCFE}_1}{r-g} = \frac{\text{FCFE}_0(1+g)}{r-g} = \frac{1.5 \times (1.075)}{0.13-0.075} = \frac{1.6125}{0.055} \\ &= \mathbf{53.50 \text{ Billion}} \end{aligned}$$

The market value of equity is the value of the Firm minus the value of debt:  
Equity Rs. 53.50 - 20.0 billion = 33.50 billion

- B. Using the FCFE valuation approach, we find the present value of FCFE discounted at the required rate of return on equity to be

$$\text{Firm Value} = \frac{\text{FCFE}_1}{r-g} = \frac{\text{FCFE}_0(1+g)}{r-g} = \frac{1.5 * (1.075)}{0.13 - 0.075} = \frac{1.6125}{0.055}$$

= **Rs. 29.32 Billion**

**The value of equity using this approach is = Rs. 29.32 Billion**

### Answer 2(b)

#### Premise of Value/Assumed Use

A Premise of Value or Assumed Use describes the circumstances of how an asset or liability is used. Different bases of value may require a particular Premise of Value or allow the consideration of multiple Premises of Value. Some common Premises of Value are:

- highest and best use,
- current use/existing use,
- orderly liquidation, and
- forced sale.

#### Premise of Value - Highest and Best Use

- Highest and best use is the use, from a participant perspective, that would produce the Highest value for an asset. Although the concept is most frequently applied to non-financial assets as many financial assets do not have alternative uses, there may be circumstances where the highest and best use of financial assets needs to be considered.
- The highest and best use must be physically possible (where applicable), financially feasible, legally allowed and result in the highest value. If different from the current use, the costs to convert an asset to its highest and best use would impact the value.
- The highest and best use for an asset may be its current or existing use when it is being used optimally. However, highest and best use may differ from current use or even be an orderly liquidation.
- The highest and best use of an asset valued on a stand-alone basis may be different from its highest and best use as part of a group of assets, when its contribution to the overall value of the group must be considered.
- The determination of the highest and best use involves consideration of the following:
  - To establish whether a use is physically possible, regard will be had to what would be considered reasonable by participants.

- To reflect the requirement to be legally permissible, any legal restrictions on the use of the asset, eg, town planning/zoning designations need to be taken into account as well as the likelihood that these restrictions will change.

### Premise of Value - Current Use/Existing Use

Current use/existing use is the current way an asset, liability, or group of assets and/or liabilities is used. The current use may be, but is not necessarily, also the highest and best use.

### Premise of Value - Orderly Liquidation

An orderly liquidation describes the value of a group of assets that could be realised in a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis.

### Premise of Value - Forced Sale

The term "forced sale" is often used in circumstances where a seller is under compulsion to sell and that, as a consequence, a proper marketing period is not possible and buyers may not be able to undertake adequate due diligence. The price that could be obtained in these circumstances will depend upon the nature of the pressure on the seller and the reasons why proper marketing cannot be undertaken. It may also reflect the consequences for the seller of failing to sell within the period available.

### Question 3

- (a) Aneez Biotech Private Limited is a start-up Venture in Biotech field and expects a Private Equity investment shortly from a Venture Capital investor. In this scenario the Company has approached you to value its business. As a Valuation Consultant, list out various methods of Valuation of these types of entities and explain a method suitable for Aneez Biotech Private Limited. (5 marks)
- (b) Sanju Limited is studying the possible acquisition of Manju Ltd. by way of merger.

The following data is available :

Particulars	Sanju Ltd.	Manju Ltd.
Profits after Tax (PAT)	₹600 Lakh	₹1000 Lakh
No. of equity shares	5,00,000	1,50,000
Market value per share	₹350	₹210

If the merger goes through and the exchange ratio is based on current market prices, what is the new EPS for Sanju Ltd. ? (5 marks)

### Answer 3(a)

The following are some of the generally acceptable methods of valuation of start-ups:

**Venture Capital (VC) method** : Venture Capitalist Method is one of the globally acceptable methodologies in estimating the value of start-ups. In this method the

valuation of the start-up is done from the venture capitalist point of view. It indicates the value of pre-money ventures by following the process that VCs go through, where they exit an investment within three to seven years. It estimates the expected exit price of a similar mature business venture and discounts it back to present value considering the risks involved.

**First Chicago Method** : The First Chicago Method is one of the context specific valuation methodologies which consider payouts to the investor during the holding period. This method takes into consideration three scenarios: Success, Failure and Survival case and associate probability to each case to find the weighted average price of a start-up business. Compared to the Venture Capital Method, the First Chicago Method has conceptual advantages but is also characterized by a more complex valuation process.

**Adjusted discounted cash flow method** : This method is the scientific tool used to judge the value of a start-up on the basis of its potential which is converted in the form of cash flow and adjusted with differential discount rates based upon the risk perception of a start-up entity. The most common problem with applying a DCF method to a start-up is that "business stabilization" is not reached in 4-5 years (the usual forecast period). Similarly, listed business' multiples do not reflect the growth potential of a start-up. Start-ups can be valued using an extended DCF to capture their full growth, or even a two-stage DCF model that applies a formula to reflect a gradually decreasing growth.

**Berkus Method** : According to super angel investor, Dave Berkus, the Berkus Method, "assigns a number, a financial valuation, to each major element of risk faced by all young companies after crediting the entrepreneur the basic value for the quality and potential of the idea itself." The Berkus Method uses both qualitative and quantitative factors to calculate a valuation based on five elements:

- Sound Idea (basic value)
- Prototype (reduces technology risk)
- Quality Management Team (reduces execution risk)
- Strategic Relationships (reduces market risk)
- Product Rollout or Sales (reduces production risk)

**Scorecard Valuation Method** : It is also known as 'Bill Payne valuation method' and is one of the most preferred methodologies used by angels. This method compares the startup (raising angel investment) to other funded startups modifying the average valuation based on factors such as region, market and stage.

### Answer 3(b)

If the exchange ratio is based on market prices it is  $350/210$  that is, for every 5 shares of Manju Ltd., the target shareholders would receive 3 shares of Sanju Ltd.

Hence, for 1,50,000 shares of Manju Ltd. they will receive  $3/5 \times 1,50,000$  shares in Sanju Ltd., that is 90,000 shares.

Hence, the new EPS of Sanju Ltd. is as under

<i>Particulars</i>	<i>In Rs.</i>
Combined PAT	1600 Lakhs
No. of Equity Shares	5,90,000
<b>Revised EPS</b>	<b>271.19.</b>

#### Question 4

- (a) A listed Company has a beta of 1.5 and the riskless rate for one-year Treasury bills is 5.2% and the expected return for the market is 13.5%. What is the company's capitalization rate? Suppose the company has expected earnings of ₹6.80 per share that have been growing at a rate of 5.5%. The Company retains 25%. What should be the company's share price using a capitalization of earnings approach?
- (b) Abishek Powers Ltd. has a constant dividend growth rate of 5% per annum for perpetuity. This year the company has given a dividend of ₹6 per share. Further, the required rate of return for the company is 10% per annum. Then, what should be the purchase price for a share of Abishek Powers Ltd.? (5 marks each)

#### Answer 4(a)

Using the CAPM straight-line formula, the capitalization rate (the required return an investor would demand to invest in the company) is

$$\text{Expected rate of Return} = R_f + B_i (R_M - R_f)$$

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

$$B_i = \text{Beta}$$

$$E(R_M) = \text{Expected rate of return on market}$$

$$5.2\% + 1.5 \times (13.5\% - 5.2\%)$$

$$5.2\% + 12.45\% = 17.65\%$$

Applying the Gordon model, the price should be

$$P_0 = E_i(1-b) / (k-br)$$

$$[\text{Rs. } 6.80 \times (1 + 0.055)] \times (1 - 0.25) = 7.174 \times 0.75 = 5.3805 / (.1765 - .055) = 0.1215$$

$$\text{Rs. } 5.3805 / .1215 = \text{Rs. } 44.284$$

**Share price of the Company = Rs. 44.284**

#### Answer 4(b)

$$\text{Div} = \text{Dividend at Current year} = \text{Rs. } 6$$

$$r = \text{required rate of return} = 10\%$$

$$g = \text{constant growth rate of dividends till perpetuity} = 5\%$$

$$\text{Div } 1 = \text{Dividend per share expected to be received at the end of first year}$$

$$= \text{Div} (1+g) = 6 (1+0.05) = \text{Rs. } 6.3$$

$$\text{Value of share (P)} = \text{Div}_1 / (r-g) = 6.3 / (0.1 - 0.05) = 6.3 / 0.05 = \text{Rs. } 126$$

**PART B****Question 5**

- (a) Mohit, a Techie, who is fond of online games, has developed an online version of 'Trade Game'. The online game has allowed multiple persons from different location to login and play the game. After successfully developing the game, Mohit wondered how to select a business model for it and approached you for suggesting a suitable business model.

Suggest a suitable Business Model to Mohit and explain with example how your model will suit his online gaming portal.

- (b) Brief the purpose and usage of the following excel functions :

(i) EFFECT

(ii) ACCRINTM

(iii) NPER

(iv) XNPV

(v) DB.

- (c) A Company's paid up Capital is ₹1000 lakh (Owner's Equity). The Ratios for the Company are :

— Current Debt to Total Debt	0.40
— Total Debt to Owner's Equity	0.60
— Fixed Assets to Owner's Equity	0.60
— Total Assets Turnover	2 times
— Inventory Turnover	8 times

Complete the following Balance Sheet given the information above :

In Lakh ₹

Liabilities		Assets	
Owner's Equity	xxx	Fixed Assets	Xxx
Long Term Debt	Xxx	Cash	Xxx
Current Debt	Xxx	Inventory	Xxx
Total Debt	xxx	Total Current Assets	Xxx
Total Liabilities	xxxx	Total Assets	Xxxx

(5 marks each)

**Answer 5(a)**

**Virtual Good Model** : We all knew the game Candy Crush and its addictive qualities that have wasted more hours than most of us are willing to share. Candy Crush understands the power of the virtual good model, and made a ton of its revenues for digital products like extra lives or features like a "color bomb". Virtual goods are online only products users pay for normally in games or apps such as upgrades, points, gifts, or weapons. The app Hot or Not used this model well by allowing its users to send virtual roses to other users costing between \$2 to \$10, and the game Clash of Clans has users that spend thousands of dollars each month on their in-app purchases.

*Why It Works* : One of the greatest advantages of virtual goods are the high margins, since they cost only what the bandwidth required to serve them does. The objects sold create real value for consumers, for example, in a game, buying a sword adds to the real fun people are having playing a game. Market liquidity continues to increase as more gamers live in virtual worlds.

Virtual goods are also more increasingly becoming a way for people to show affection and meaning as we continue moving more into an app obsessed world.

*Others Who Have Followed* : Facebook added this revenue model to its social aspect by allowing users to give virtual gifts to one another. Other startups like Acclaim Games, Meez, and Weeworld have also implemented virtual goods from the gaming aspect.

**Answer 5(b)****Excel Functions**

- (i) **EFFECT** - this function returns the effective annual interest rate for a given nominal interest rate and number of compounding periods per year.
- (ii) **ACCRINTM** - this function returns the accrued interest for a security that pays interest at maturity.
- (iii) **NPER** - this function is a financial function that returns the number of periods for loan or investment.
- (iv) **XNPY** - this function calculates the net present value (NPV) of an investment using a discount rate and a series of cash flows that occur at irregular intervals.
- (v) **DB** - this function returns the depreciation of an asset for a given time period based on the fixed-declining balance method.

**Answer 5(c)**

<i>Liabilities (Rs. In Lakhs)</i>		<i>Assets (Rs. In Lakhs)</i>	
Owner's Equity	1000	Fixed Assets	600
Long Term Debt	360	Cash (Balancing figure)	600
Current Debt	240	Inventory	400
Total Debt	600	Total Current Assets	1000
<b>Total Liabilities</b>	<b>1600</b>	<b>Total Assets</b>	<b>1600</b>



Total Debt to Owner's Equity = 0.6 - Total Debt =  $1000 \times 0.6 = 600$

Current Debt to Total Debt = 0.4 - Current Debt =  $600 \times 0.4 = 240$  ( $600 - 240 = 360$ )

Fixed Assets to Owner's Equity = 0.60 =  $1000 \times 0.6 = 600$

Total Assets Turnover = 2 times = ( $1600 \times 2 = 3200$ )

Inventory Turnover = 8 times Inventory = ( $3200/8 = 400$ ) Cash = ( $1000 - 400 = 600$ )

### Question 6

- (a) 'Business leader of business model innovation need to embrace uncertainty, come to the work with a sense of curiosity and patience, and take the time to unpack the learning from what they are seeing around them.' Brief the important principles of designing successful business model. (5 marks)
- (b) Sibaca Textiles Limited is carrying on dyeing and printing of fabrics. The business of the Company is of a seasonal nature. Peak seasons for the business are January to March and July to September. During peak season monthly sale will be ₹2000 Lakh per month. During each of the off season month the monthly Sales will only be 50% of the Peak season sale.

Out of Total Sales, 10% is cash sale and Credit Sale is 90% and normal credit period allowed is 60 days (received at the end of second month ex. January Sale is received during March). Presently, out of credit sales customers' at least 30% delay the payment and makes payment only at the end of third month.

Fixed Expenses are ₹400 Lakh per month and Variable expenses are 60% of the monthly sales of that month and payment for the same have to be made at the end of second month. In the month of September the Company requires ₹2000 lakh for new machinery. Bankers of the Company are ready to fund upto ₹1700 Lakh.

Opening Cash and Bank Account available is ₹500 Lakh. Cash Management policy of the company is to maintain atleast ₹500 Lakh as minimum Balance.

The Management is requesting you to prepare :

- (i) Cash projections for 6 months commencing from July to December with your suggestion that how much the Company need to borrow for new machinery.
- (ii) Prepare sensitivity analysis of projections, if credit sales customers who are delaying payment (payment received at the end of third month) increases from 30% to 40%. Will it have any impact on new machinery to be bought in September and amount to be borrowed for the same ? (10 marks)

### Answer 6(a)

#### The Nine Design Principles for Exponential Transformation

There are nine design principles. Each of these is tied to one of the boxes on the Business Model Canvas.

- (1) *Customer Segments* : Solve a problem for the masses: Technology is enabling

organizations to reach entirely new markets in massive and viral ways. As the world's population approaches 7.5 billion, companies and organizations with exponential business models can help close the gap between our growing population and the resources they need. Many companies start with one core offering to customers to serve one need-like Uber and personal transportation-then expand their services to meet other needs, like UberEATS or Uber HEALTH.

- (2) *Value Proposition* : Information-based services: As companies digitize their products and services, they aren't just creating new versions of their traditional offerings, they're creating entirely new market places. Airbnbs platform re-imagines short-term accommodations; Slack digitizes collaboration and knowledge sharing; the consumer genetics firm 23 and Me offers affordable DNA sequencing to anyone. Every business, regardless of industry, should be exploring how and what to digitize in their existing value proposition to not only serve existing customers better, but to potentially open up foundationally new exchanges of value.
- (3) *Relationships* : Build a community of fans: When you want to work towards a IOX solution, you need to build your customers into a fan base and then collaborate with these fans. User-empowered customization of basic functions, such as the filters on Instagram, the augmented lenses on Snap and the mashup functionality on Musical.ly allow users to create something unique and share their creations across multiple touch points, acting as a viral distribution and marketing channel.
- (4) *Channels* : Multi-modal and Social: Many exponential businesses are using social collaboration to connect physical and multiple digital outlets to enhance the value of their core offering. Think of this as user-generated content amplified through network externalities-the more people that contribute to the platform, the more valuable the service becomes. The fastest-growing companies use this strategy as a driver of customer acquisition, engagement and lifetime value. The traffic app Waze married GPS data with real-time traffic input from users, using gamification methods to make the process fun and engaging. Waze was bought by Google for \$1.3 billion when they had only 100 employees, and it has since become the go-to service for commuters.
- (5) *Key Activities : Ultra scalable processes* : Technology can help analyze and automate routine activities to disrupt traditional manufacturing or delivery methods. Amazon has long used robots to stock and retrieve products from its warehouses and is getting closer to delivering its products via drones. It also realized one of its most important strategic activities - cloud and data storage- could become a valuable resource for others. Amazon Web Services (AWS) - rented access to computing infrastructure - was launched in 2006. Ten years on, it contributed 56 percent of Amazon's growth and is on target to be a \$100 billion business in less than five years.
- (6) *Key Activities : Lean Approach* : Why is GE becoming more exponential ? They use a lean approach for all core functions in their business, emphasizing rapid cycles of experimentation and learning. By instituting lean processes across your functions, you allow people to take risks, and you gain data about your business that you can study and learn from.

- (7) *Key Activities, Resource and Partners* : Algorithm to the core: Google is one of the best examples of a company built on an algorithm (to rank websites), that is then augmented by machine learning. StichFix, one of the fastest-growing on-demand retail companies, has a team of over 65 data scientists and uses algorithms to drive nearly every part of its business. It even has a well-respected public blog on data science (remember, this is a retail company!).
- (8) *Key Resources : Self managed teams* : Employees must work in networked ways to socialize and share real-time insights and experiences. Giving employees autonomy to do what they need to in a supportive and open culture decentralizes and speeds up decision-making, opening up the possibility of a IOX business model. Zappos has been one of the early pioneers of building a "holocracy" culture, eliminating professional management positions and empowering workers without additional bureaucracy. Companies like Microsoft are betting long on social software to support spontaneous collaboration efforts, building networking and social functionality into all of their new office suites.
- (9) *Partners* : Build uncommon relationships: Many exponential business models stem from "uncommon partners" - different types of companies from different industries that work together to benefit from integrated value. Drone company Matternet and Mercedes-Benz recently joined forces to create an integrated delivery solution designed to transform how people receive lightweight goods on demand.

Concluding the above discussion it can be said that business leaders of business model innovation need to embrace uncertainty, come to the work with a sense of curiosity and patience, and take the time to unpack the learning from what they are seeing around them.

### Answer 6(b)

#### (i) Cash Projections

<i>Cash Projections</i>	<i>July</i>	<i>Aug</i>	<i>Sep</i>	<i>Oct</i>	<i>Nov</i>	<i>Dec</i>
			<i>(Rs. In Lakh)</i>			
Total Sales during the month	2000	2000	2000	1000	1000	1000
Credit Sales during the month	1800	1800	1800	900	900	900
Cash and Bank at the beginning	500	600	700	500	800	1100
Cash Sales (10% on monthly sale)	200	200	200	100	100	100
Collection from Credit Sale-70%	630	630	1260	1260	1260	630
Collection from Credit Sale delay payments 30%	270	270	270	540	540	540
Loan to be borrowed for new Machinery			1670			
<b>Total Inflows</b>	<b>1600</b>	<b>1700</b>	<b>4100</b>	<b>2400</b>	<b>2700</b>	<b>2370</b>
	1200	1200	1200	600	600	600

PP–VBM–December 2019	154					
Additional investment in Machinery			2000			
Fixed Expenses	400	400	400	400	400	400
Variable Expenses	600	600	1200	600	600	600
<b>Total Outflows</b>	<b>1000</b>	<b>1000</b>	<b>3600</b>	<b>1600</b>	<b>1600</b>	<b>1000</b>
Cash and Bank at the close	600	700	500	800	1100	1370
Minimum Balance to be maintained	500	500	500	500	500	500
Balance available after Minimum Cash	100	200	0	300	600	870

**(ii) Sensitivity Analysis of Projections**

	July	Aug	Sept	Oct	Nov	Dec
<i>Sensitivity Analysis</i>						
<i>(Rs. In Lakhs)</i>						
Total Sales during the month	2000	2000	2000	1000	1000	1000
Credit Sales during the month	1800	1800	1800	900	900	900
Cash and Bank at the beginning	500	600	700	740	500	800
Cash Sales (10% on monthly sale)	200	200	200	100	100	100
Collection from Credit Sale - 60%	540	540	1080	1080	1080	540
Collection from Credit Sale delay payments 40%	360	360	360	720	720	720
<b>Loan to be borrowed for new Machinery</b>				<b>1460</b>		
<b>Total Inflows</b>	<b>1600</b>	<b>1700</b>	<b>2300</b>	<b>4100</b>	<b>2400</b>	<b>2160</b>
	1200	1200	1200	600	600	600
Additional investment in Machinery				2000		
Fixed Expenses	400	400	400	400	400	400
Variable Expenses	600	600	1200	1200	1200	600
<b>Total Outflows</b>	<b>1000</b>	<b>1000</b>	<b>1600</b>	<b>3600</b>	<b>1600</b>	<b>1000</b>
Cash and Bank at the close	600	700	740	500	800	1160
Minimum Balance to be maintained	500	500	500	500	500	500
	100	200	240	0	300	660

Due to increase in customers delaying the payment the new Machinery purchase can be made only during the month of October. However, the amount to be borrowed reduces to Rs. 1460 Lakh instead of Rs. 1670 Lakh.

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## **INSOLVENCY - LAW AND PRACTICE**

**(Elective Paper 9.8)**

Time allowed : 3 hours

Maximum marks : 100

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

### **Question 1**

*Facts of the case :*

*Richa Infrastructure Limited engaged in the construction of roads is in default in repayment of loans due to general slowdown in construction industry. Repeated follow-up by the financial institutions with the Corporate Debtor, 'Richa Infrastructure Ltd.' for submitting its specific plan for repayment of dues did not evoke any response.*

*One of the financial creditors filed a case against Richa Infrastructure Ltd. before the Debt Recovery Tribunal.*

*Richa Infrastructure Ltd. had issued some cheques to some Operational Creditors. All the cheques issued to creditors were dishonored/returned by the banker due to insufficient funds in the account. Consequently, Operational Creditors issued legal notices to Richa Infrastructure Ltd, with clear intimation that if due amount is not paid within 15 days from the date of receipt of legal notice, criminal complaint shall be filed against Richa Infrastructure Ltd. under the Negotiable Instrument Act, 1881 and criminal complaints were filed. After a joint lenders meeting, all the financial institutions unanimously decided to apply under the provisions of the Insolvency and Bankruptcy Code, 2016 to the National Company Law Tribunal (NCLT) for starting the process of Insolvency Resolution. Their application was admitted by NCLT on 30th June, 2018 and orders were issued for commencement of a moratorium period of 180 days, appointment of an Interim Resolution Professional and issue of public announcement inviting claims from all concerned.*

*After public announcement and the responses thereto, following details were brought out :*

- (1) Financial debts due to unsecured creditors (F1) - ₹15 Crores.*
- (2) Workmen's due for the period of 24 months preceding the liquidation commencement date (F2) - ₹25 Crores.*
- (3) Debts due to a secured creditor who has relinquished his security (F3) - ₹30 Crores.*
- (4) Amount due to the Central Government (F4) - ₹27 Crores.*
- (5) Debts due to a secured creditor after the enforcement of security interest (F5) - ₹36 Crores.*

*Insolvency Resolution Professional (IRP) approached the promoters, directors and officials of Richa Infrastructure Ltd to provide the necessary information, documents, statutory records, books of accounts to verify the claims filed by creditors. The promoters, directors and officials of Richa Infrastructure Ltd. ignored the request of Resolution Professional.*

*M/s ANG & Associates, Chartered Accountants were the Statutory Auditors of Richa Infrastructure Ltd. They audited the accounts for the financial year end March, 2018 of Richa Infrastructure Ltd. and submitted the Annual Accounts for approval of the Board of Directors.*

*The Resolution Professional has appointed valuers and has received the valuation reports. The Resolution Professional then started the efforts to get resolution proposals.*

*However during the normal resolution process period of 180 days, no resolution proposal could be finalized. The Committee of Creditors decided that Resolution Professional should get the extension as per the provisions of Insolvency and Bankruptcy Code, 2016.*

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

- (a) Can a Financial Creditor proceed against a Corporate Debtor under the Insolvency and Bankruptcy Code, 2016, when the matter is already pending before the Debt Recovery Tribunal ? Examine the issue with the help of decided case law/laws. (8 marks)*
- (b) Is it necessary that application for extension of time period of 90 days must be filed before the completion of 180 days ? What precautions should be taken by Insolvency Professional while applying to NCLT for extension of time period by 90 days ? Examine the issue by referring to decided case law, if any. (8 marks)*
- (c) Can criminal proceedings under Section 138 of Negotiable Instrument Act, 1881 continue even after initiation of Corporate Insolvency Resolution Process ? Examine the issue by referring to decided case law, if any. (8 marks)*
- (d) Who will sign the Annual Financial Statements of the Corporate Debtor undergoing Corporate Insolvency Resolution Process ? (8 marks)*
- (e) Can IRP take action against employees of the Corporate Debtor in terms of employment agreement ? (8 marks)*

### **Answer 1(a)**

Section 238 of the Insolvency and Bankruptcy Code, 2016 (the Code) provides that the provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

National Company Law Tribunal (NCLT), Ahmadabad Bench, in the case of *Sarthak Creations Pvt. Ltd v. Bank of Baroda & Others* held that the pendency of proceedings before Debt Recovery Tribunal (DRT) is no ground for not to commence Corporate Insolvency Resolution Process (CIRP) in view of non-obstante clause under Section 238 of the Insolvency and Bankruptcy Code, 2016.

In the case of *PR Commissioner of Income Tax, New Delhi vs. Monnet Ispat & Energy Ltd.*, the Delhi High Court held that the moratorium period under Section 14 of the Code announced by the National Company Law Tribunal would also apply to the order of the Income Tax Appellate Tribunal in respect of the tax liability of the assessee.

Upholding the Delhi High Court Judgment (*PR Commissioner of Income Tax, New*

*Delhi vs. Monnet Ispat & Energy Ltd.*) which held that moratorium under the Insolvency and Bankruptcy Code (IBC) will apply to the order of Income Tax Appellate Tribunal, the Supreme Court has observed that IBC will override anything inconsistent contained in any other enactment, including the Income Tax Act, 1961.

In view of the above, financial creditor can initiate proceedings under the Code even if the matter is already pending before DRT.

### **Answer 1(b)**

Section 12(2) of the Insolvency and Bankruptcy Code, 2016 provides that the Resolution Professional shall file an application to the Adjudicating Authority to extend the period of the Corporate Insolvency Resolution Process (CIRP) beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of sixty-six per cent of the voting shares.

However, reading the aforesaid provision, it appears that provision does not stipulate that such application for extension of period of CIRP is to be filed before NCLT within 180 days.

The very same issue had come up for consideration before the NCLAT in case of *Quantum Ltd. v. Indus Finance Corporation Ltd.* decided on 20th February, 2018, wherein NCLAT allowed an application filed after 180 days. However, the resolution of the committee of the creditors has to be passed within 180 days.

In view of the aforesaid judgment passed by NCLAT, when it becomes clear to the Resolution Professional that CIRP cannot be completed within the specified period of 180 days, he should propose to the Committee of Creditors for direction to seek extension of time from the Adjudicating Authority so that the process does not get derailed because of technical reasons.

On receipt of an application under sub-section (2) of section 12 of the Code, if the Adjudicating Authority is satisfied that the subject matter of the case is such that Corporate Insolvency Resolution Process cannot be completed within one hundred and eighty days, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but not exceeding ninety days. [Section 12(3)]

### **Answer 1(c)**

Section 14(1) of the Insolvency and Bankruptcy Code, 2016 prohibits, *inter alia*, the institution of suits or continuation of pending suits or proceedings against the Corporate Debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority.

From the provision and the words used therein, it becomes clear that the prohibition is not applicable to criminal proceedings which can continue to be pursued. The proceedings under Section 138 of the Negotiable Instruments Act, 1881 can thus continue even after initiation of CIRP.

In the appeal of *Shah Brothers Ispat (P) Ltd. Vs. P. Mohanraj* before the NCLAT, the very same question arose for consideration. The question was whether the order of moratorium covers a criminal proceeding under Section 138 of the Negotiable Instruments

Act, 1881 which provides punishment of imprisonment or imposition of fine. It was held that the court of competent jurisdiction may proceed with the proceeding under Section 138 of Negotiable Instruments Act, 1881 even during the period of moratorium.

It is pertinent to note that Section 14 of the Insolvency and Bankruptcy Code, 2016 prohibits any proceeding or judgment or decree of money claim against the Corporate Debtor after the order of moratorium which is passed on the insolvency commencement date.

The Appellate Tribunal observed that Section 138 is a penal provision. The imposition of a fine cannot be held to be a money claim or recovery against the Corporate Debtor. As such the said section is not covered within the purview of Section 14 of the Insolvency and Bankruptcy Code, 2016. In fact, no criminal proceeding is covered under section 14 of the Code.

#### **Answer 1(d)**

Section 17(1)(b) of the Insolvency and Bankruptcy Code, 2016 provides that the powers of the Board of directors (Board) or the partners of the corporate debtor, shall stand suspended and be exercised by Interim Resolution Professional (IRP). It may be noted that though the powers of the Board are suspended, they are bound to provide all assistance to Insolvency Professional as only the powers of the Board are suspended and not their duties.

Further, Section 19 of the Insolvency and Bankruptcy Code, 2016 imposes an obligation on the personnel and promoters of the corporate debtor to extend all assistance and cooperation required by the IRP in the management of the affairs of the corporate debtor. Where the personnel of the corporate debtor or any other person required to co-operate with the IRP do not extend co-operation or assistance to the IRP, he may apply to the Adjudicating Authority for an order. The Adjudicating Authority may, by order, direct the personnel to comply with the instructions of the IRP or to provide information to the IRP. 'Personnel' includes the directors, managers, key managerial personal, designated partners and employees, if any, of the corporate debtor.

Moreover, the powers of the resolution professional do not include the power to represent the corporate debtor or initiate proceedings on behalf of the corporate debtor. The suspension is of the functioning of the Board and not of the directors. Signing of the Annual Report is a duty of the Board and the Board as a whole has to take the legal responsibility for the correctness of the report.

This is further clarified by the NCLAT in the matter of *Steel Konnect (India) Pvt. Ltd. v. M/s. Hero Fincorp Ltd.* that directors of the company do not cease to be directors, as they are not suspended but their function as 'Board of directors' is suspended.

The members of the Board also has to work under the Insolvency Professional which again means that if the professional asks them to consider the financial statement, they have to do so. In the aforesaid context, the existing directors of corporate debtor shall sign the financial statements of Corporate Debtor undergoing CIRP.

#### **Answer 1(e)**

Section 28(1)(j) and (l) of the Insolvency and Bankruptcy Code, 2016 provides that



Resolution Professional, during the Corporate Insolvency Resolution Process (CIRP), shall not make any change in the management of the corporate debtor or its subsidiary, make changes in the appointment or terms of contract of such personnel as specified by the Committee of Creditors, without prior approval of the Committee of Creditors.

Thus, if action of IRP / RP has effect of change in management of corporate debtor or has the effect of making changes in appointment of such persons as may be specified by Committee of Creditors, he shall take approval of Committee of Creditors in terms of Section 28 (1)(j) and (l) of the Code.

IRP may take action against an employee of corporate debtor for hindering the CIRP process if he does not provide assistance and co-operation to IRP. However, by way of abundant caution, IRP may also place the matter before Committee of Creditors before taking any action. IRP may also approach Adjudicating Authority under section 19(2) of the Code for necessary directions.

The Adjudicating Authority, on receiving an application under Section 19(2) of the Code, shall by an order, direct such personnel or other person to comply with the instructions of the Resolution Professional and to co-operate with him in collection of information and management of the Corporate Debtor.

## Question 2

- (a) *XYZ Ltd. was intending to initiate voluntary liquidation proceedings. A declaration was made by way of affidavit by some of the directors of XYZ Ltd. stating that the company will be able to pay its debts in full from the proceeds that may be realized from its assets sold during the process of Voluntary Liquidation.*
- (i) *Can XYZ Ltd initiate Voluntary Liquidation proceeding in compliance with the conditions given in the Insolvency and Bankruptcy Code, 2016 ?*  
(2 marks)
  - (ii) *What are the documents required to accompany the declaration ?* (2 marks)
  - (iii) *What are the consequences, if the Articles of the Company fixed the period or duration for which company may be active and that period expires ?*  
(2 marks)
- (b) (i) *What is the purpose of enactment of the Insolvency and Bankruptcy Code, 2016 ?*  
(3 marks)
- (ii) *Can an assignee of Financial Contract make an application under Corporate Insolvency Resolution Process ?*  
(3 marks)

## Answer 2(a)(i)

Section 59(1) of the Insolvency and Bankruptcy Code, 2016 provides that a corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of the Code.

A corporate person registered as a company has to meet the following conditions to initiate a Voluntary Liquidation Process:

- (a) A declaration from the majority of the directors of the company verified by an

affidavit stating they have conducted a full inquiry into the affairs of the company and have formed an opinion that either the company has no debts or that it will be able to pay its debts in full from the proceeds of assets to be sold in the Voluntary Liquidation; and

- (b) That the company is not being liquidated to defraud any person.

In this case it is stated that some of the directors signed the declaration and it is not coming out clearly that the directors who signed were in the majority. Moreover, the declaration relating to fraud is not there. Therefore, in this scenario, XYZ Ltd. cannot initiate Voluntary Liquidation proceedings in accordance with the Code.

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

As per section 59(3)(b) of the Code, the declaration shall be accompanied with the following documents:

- (a) Audited Financial Statements and a record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later.
- (b) A report of the valuation of the assets of the company, if any, prepared by a registered valuer.

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

If the articles of the company fixed the period of duration of continuation of the company and that period expires, XYZ Ltd. under section 59(3)(c)(ii) of the Code shall pass a resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator.

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

As per Preamble to the Insolvency and Bankruptcy, Code, 2016, the purpose of this Code is as under:

- (a) To consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals.
- (b) To fix time periods for execution of the law in a time bound manner.
- (c) To maximize the value of the assets of interested persons.
- (d) To promote entrepreneurship.
- (e) To increase availability of credit.
- (f) To balance the interest of all the stakeholders including alteration in order of priority of payment of Government dues.
- (g) To establish Insolvency and Bankruptcy Board of India as a regulatory body for Insolvency and Bankruptcy Law.

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

Yes, as per Rule 4(2) of Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, where an applicant for a Corporate Insolvency Resolution Process is an assignee or transferee of a Financial Contract the application shall be accompanied with a copy of the assignment or transfer agreement and other relevant documents as may be required to demonstrate the assignment or transfer.

**Question 3**

- (a) *Liquidation of ABC Private Ltd. has been ordered by Adjudicating Authority, Mumbai vide its order dated 27th May, 2018. Amit Kumar was appointed as Liquidator of ABC Private Limited. The particulars relating to ABC Private Ltd. which has gone into liquidation are as follows :*

<i>Sl. No.</i>	<i>Particulars</i>	<i>Amount (₹)</i>
1.	<i>Amount realized from the sale of liquidation of assets</i>	<i>16,00,000</i>
2.	<i>Secured Creditor who has relinquished the security</i>	<i>5,00,000</i>
3.	<i>Unsecured Financial Creditors</i>	<i>4,00,000</i>
4.	<i>Income-tax payable within a period of 3 years preceding the Liquidation commencement date. The Income Tax payable is ₹25,000 in each Financial Year.</i>	<i>75,000</i>
5.	<i>CESS payable to State Government within a period of one year preceding the liquidation commencement date.</i>	<i>20,000</i>
6.	<i>Fees payable to Resolution Professional</i>	<i>75,000</i>
7.	<i>Expenses incurred by the Resolution Professional in running the business of the ABC Private Ltd. as a going concern.</i>	<i>25,000</i>
8.	<i>Workmen salary payable for a period of thirty months preceding the liquidation commencement date. The workmen's salary is the same for each of the 30 months.</i>	<i>3,00,000</i>
9.	<i>Preference Shareholders</i>	<i>1,00,000</i>
10.	<i>Equity Shareholders</i>	<i>10,00,000</i>

*Distribute the proceeds among all categories of dues as per the priority order in terms of the provisions of the IBC, 2016. While distributing the proceeds, it may be presumed that the proportionate contribution of each in all categories to the fees payable to the Resolution Professional has been taken into account already and need not be recalculated.* (6 marks)

- (b) (i) *In an Insolvency Resolution Process, a secured creditor enjoys preferential treatment in the process when compared to other categories of creditors. What are the rights of a secured creditor ?* (4 marks)
- (ii) *What shall be treated as Debt under the Code ?* (2 marks)

**Answer 3(a)**

<i>S. No.</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>
(i)	Fees payable to Resolution Professional in full (deducted from the amounts payable to all categories below as per the provision of sub-section 3 of section 53 of the Code. The amount shown as payable is after deducting proportional amount})	75,000
(ii)	Expenses incurred by the Resolution Professional in running the business on going concern (deducted from sale proceeds)	25,000
(iii)	Workmen Salary outstanding for a period of 24 months (proportionate to 24 months only). The balance Rs.60,000 is considered as remaining debts and dues and will be settled before preference shareholder / equity shareholder.	2,40,000
(iv)	Secured creditor who has relinquished the security.	5,00,000
(v)	Unsecured Financial Creditors	4,00,000
(vi)	Income-Tax payable within the period of 2 years	50,000
(vii)	CESS to State government payable within a period of one year	20,000
(viii)	Balance amount in workmen salary	60,000
(ix)	Balance amount for income tax	25,000
(x)	Total distribution in the above priority	13,95,000
	Amount realized from the sale of Liquidation of Assets	16,00,000
(xi)	Preference shareholders	1,00,000
(xii)	Balance available to Equity Shareholders on pro-rata basis	1,05,000

**Alternate Answer**

<i>S. No.</i>	<i>Particulars</i>	<i>Amount (Rs.)</i>
A	Insolvency resolution process cost <b>(to be paid in full)</b>	
	Fees payable to Resolution Professional in full (deducted from the amounts payable to all categories below as per the provision of sub-section 3 of section 53 of the Code. The amount shown as payable is after deducting proportional amount)	75,000

		Expenses incurred by the Resolution Professional in running the business on going concern (deducted from sale proceeds)	25,000
B	Workmen's dues (24 months preceding liquidation commencement date) and debts owed to secured creditors who have relinquished their security interest (equally ranked)	Workmen Salary outstanding for a period of 24 months (proportionate to 24 months only). The balance Rs.60,000 is considered as remaining debts and dues and will be settled before preference shareholder / equity shareholder.	2,40,000
		Secured creditor who has relinquished the security.	5,00,000
C.	Financial debts owed to unsecured financial creditors		4,00,000
D.	Amount due to Central govt. and State govt. (two years preceding liquidation commencement date)	Income - Tax payable within the period of 2 years.	50,000
		CESS to State government payable within a period of one year.	20,000
E.	Any remaining debts and dues	Balance amount in workmen salary	60,000
		Balance amount in Income Tax	25,000
	<b>Total distribution in the above priority</b>		<b>13,95,000</b>
	<b>Amount realized from the sale of Liquidation of Assets</b>		<b>16,00,000</b>
F.	Preference Shareholders		1,00,000
G.	Equity Shareholders		1,05,000

### Answer 3(b)(i)

Section 31B of the Recovery of Debts and Bankruptcy Act, 1993: Priority to Secured Creditors.

Notwithstanding anything contained in any other law for the time being in force, the rights of secured creditors to realize secured debts due and payable to them by sale of assets over which security interest is created, shall have priority and shall be paid in priority over all other debts and government dues including revenues, taxes, cesses and other rates due to the Central Government, State Government or local authority.

*Explanation* - For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016, in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.

Section 53(1)(e) of the Code provides that the following dues shall rank equally between and among the following:

- (i) any amount due to Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;
- (ii) debts owed to secured creditor for any amount unpaid following the enforcement of security interest;

#### **Answer 3(b)(ii)**

As per section 3(11) of the Insolvency and Bankruptcy Code, 2016, 'debt' means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt.

#### **Question 4**

- (a) *Naveen Kumar, a Financial Creditor filed an Insolvency Application under Section 7 of Insolvency and Bankruptcy Code, 2016 against M/s ABC Private Ltd, Corporate Debtor (Defaulter) before the National Company Law Tribunal on 1st July, 2018.*

*National Company Law Tribunal after satisfying that the default has occurred and the application is complete in all respects and all the related compliances have been met, admitted the application, by an order passed on 10th July, 2018 and appointed Kamal Kishore as Interim Resolution Professional (IRP).*

*As per the Insolvency and Bankruptcy Code, 2016, state the following :*

- (i) *Initiation date for the Corporate Insolvency Resolution Process.*
  - (ii) *Date of commencement of Insolvency.*
  - (iii) *Date of issuance of Public Announcement.*
  - (iv) *Tenure of Interim Resolution Professional.*
  - (v) *Last Date for Creditors to file their Claims.*
  - (vi) *Calculate Time Period for the completion of the Insolvency Resolution Process by the NCLT. (1 mark each × 6 = 6 marks)*
- (b) (i) *Under what circumstances Debtor is not entitled to make an application to the NCLT ? (3 marks)*
- (ii) *What is the relevant period for avoiding any undervalued transactions ? (3 marks)*

**Answer 4(a)**

- (i) As per section 5(11) of the Insolvency & Bankruptcy Code, 2016 (the Code), initiation date for Corporate Insolvency Resolution Process is the date on which a financial creditor, corporate applicant or operational creditor, as the case may be, makes an application to the Adjudicating Authority for initiating Corporate Insolvency Resolution Process. So 1st July, 2018 would be the initiation date.
- (ii) According to section 5(12) of the Code, insolvency commencement date is the date of admission of an application for initiating Corporate Insolvency Resolution Process by the Adjudicating Authority under Sections 7, 9 or Section 10, as the case may be. Accordingly, 10th July, 2018 is the insolvency commencement date.
- (iii) As per Regulation 6 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, an Insolvency Professional shall make a public announcement not later than three days from the date of his appointment as an Interim Resolution Professional. Accordingly, 13th July, 2018 is the date of making public announcement.
- (iv) Section 16(5) of the Code originally provided that the term of the Interim Resolution Professional shall not exceed thirty days from the date of his appointment, i.e., 9th August, 2018. But this sub-section was amended by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018. Now the term of the Interim Resolution Professional continues till the date of appointment of the Resolution Professional under Section 22 of the Code.
- (v) As per regulation 12(1) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, subject to sub-regulation (2), a creditor shall submit claim with proof on or before the last date mentioned in the public announcement. However, as per regulation 12(2) a creditor, who fails to submit claim with proof within the time stipulated in the public announcement, may submit the claim with proof to the Interim Resolution Professional or the Resolution Professional, as the case may be, on or before the ninetieth day of the insolvency commencement date. Accordingly, 7th October, 2018 is last date of submission of claim. However, in many judgments, this timeline is held to be directory in nature.
- (vi) Section 12 of the Code states that any Insolvency Resolution Process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate the process. Accordingly, Corporate Insolvency Resolution Process should be completed by 6th January, 2019. However, the NCLT may on an application made by the Resolution Professional, under a resolution passed by the Committee of Creditors, by a vote of 66% of voting shares, after consideration provide extension which shall not exceed 90 days. Further, Insolvency and Bankruptcy Code (Amendment) Act, 2019 w.e.f. 6th August, 2019, has added a proviso to section 12(3) stating that corporate insolvency resolution process shall mandatorily be completed within a period of three hundred and thirty days from the insolvency commencement date, including any extension of the period of corporate insolvency resolution process granted under this section and the time taken in legal proceedings in relation to such resolution process of the corporate debtor.

**Answer 4(b)(i)**

Section 11 of the Insolvency and Bankruptcy Code, 2016 lists out the persons who are not eligible to make an application to initiate the corporate insolvency resolution process. According to section 11, the following persons shall not be entitled to make an application to initiate corporate insolvency resolution process under Chapter II of Part II of the Insolvency and Bankruptcy Code, 2016:

- (a) a corporate debtor undergoing a corporate insolvency resolution process; or
- (b) a corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or
- (c) a corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application under this Chapter; or
- (d) a corporate debtor in respect of whom a liquidation order has been made.

**Answer 4(b)(ii)**

The relevant period for avoiding any undervalued transaction is contained in section 46 of the Insolvency and Bankruptcy Code, 2016. It states that if in an application, the Liquidator or Resolution Professional demonstrates,

- (a) That the transaction was entered with any person within the period of one year preceding the Insolvency Commencement Date; or
- (b) That the transaction was made within a related party within a period of two years preceding the Insolvency Commencement Date.

The Adjudicating Authority may require an independent expert to assess evidence relating to the value of the transactions mentioned in this section.

**Question 5**

- (a) *If there is NO Financial Creditor, how will the Committee of Creditors be constituted?* (4 marks)
- (b) *What will be the consequence if Demand of Debt is disputed ?* (4 marks)
- (c) *What shall be included in "Financial Information" as defined under IBC, 2016 ?* (4 marks)

**Answer 5(a)**

As per Regulation 16 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, where the corporate debtor has no financial creditor or where all financial creditors are related parties of the Corporate Debtor, the Committee shall be formed comprising of the following members:

- (a) 18 largest Operational Creditors by value.
- (b) 1 representative elected by all workmen other than those workmen included under sub-clause (a).
- (c) 1 representative elected by all employees other than those employees included under sub-clause (a).



Where the number of Operational Creditors is less than 18, the Committee shall include all such Operational Creditors.

#### **Answer 5(b)**

If demand of debt is disputed and such dispute has been raised before the issuance of notice under section 8 of the Insolvency and Bankruptcy Code, 2016, the application shall not be admitted as the Adjudicating Authority is not empowered to go into the dispute. Thus, application can be admitted only if the demand of debt is undisputed.

The Supreme Court has categorically dealt with the definition of 'dispute' in the matter of *Mobilox Innovations Private Limited v. Kirusa Software Private Limited* by inserting the test of 'plausible contention' while analyzing the existence of dispute. The Supreme Court also clarified that the moonshine defence raised for the very first time by the corporate debtor after the service of the demand notice under section 8 of the Code does not qualify as 'dispute' within the definition of 'dispute' as per section 5(6) of the Code.

#### **Answer 5(c)**

As per section 3(13) of the Insolvency and bankruptcy Code, 2016, 'financial information', in relation to a person, means one or more of the following categories of information, namely:

- (a) Records of debt of the person.
- (b) Records of liabilities when the person is insolvent.
- (c) Records of assets of the person over which security interest has been created.
- (d) Records, if any, of instances of default by the person against any debt.
- (e) Records of the Balance Sheet and Cash Flow Statements of the persons; and
- (f) Such other information as may be specified.

#### **Question 6**

- (a) *General Car Company (GCC) is a manufacturer of passenger cars. It sells the cars through single brand dealerships across different cities. Because of its inability to compete in the market and continuous losses, GCC has decided to exit the passenger car business and notified its dealers about shutdown of passenger car manufacturing and sales in India.*

*Pioneer Cars Ltd. is a passenger car dealer for GCC in Kanpur with an office cum showroom and having three service centers in Kanpur. Pioneer Cars Ltd. has Bank Loan from ABC Bank (B1) and DEF Bank (B2) for ₹10 Crores and ₹7 Crores respectively. The promoters cum directors of Pioneer Cars Ltd. have also given their Personal Guarantee to the bankers along with mortgage charge on the office premises cum showroom of Pioneer Cars Ltd. Pioneer Cards Ltd. failed to repay the amount borrowed from the Banks. The banks have issued notice to Pioneer Cars Ltd. On receipt of the notice makes the representation that due to the present market conditions, the company is not able to repay the loan amount to the Banks.*

*One of the Operational Creditors, M/s Radha Automobiles Private Ltd. having an outstanding payment of ₹1 Crore has filed an application to initiate insolvency process under the Insolvency and Bankruptcy Code, 2016.*

*The NCLT has admitted the Insolvency Application and appointed Ranjeev Kumar Singh, Insolvency Resolution Professional as Interim Resolution Professional. The NCLT has declared moratorium under Section 14 of the Insolvency and Bankruptcy Code, 2016.*

*Subsequently, M/s Radha Automobiles Private Ltd. was informed by the consultant about the Fast Track Insolvency Process. M/s Radha Automobiles Private Limited want to convert the existing Resolution Process to Fast Track Corporate Insolvency Resolution Process.*

*Pioneer Cars Ltd. has contested the application for 'Conversion of the Corporate Insolvency Process' into 'Fast Track Corporate Insolvency Resolution Process'. The promoters and directors have taken a stand that Resolution Process cannot be initiated against them before the NCLT for Corporate Insolvency Resolution Process and it should be filed before Debt Recovery Tribunal.*

*Question :*

*Examine whether the NCLT has power to convert the 'Corporate Insolvency Resolution Process' as a 'Fast Track Corporate Insolvency Resolution Process', under Insolvency and Bankruptcy Code, 2016 as request by M/s Radha Automobiles Ltd. Explain with the help of decided case law(s). (6 marks)*

- (b) *"A domestic business may have foreign branches or subsidiaries, or a foreign business may have domestic branches or subsidiaries. Foreign creditors may have valid claims in domestic bankruptcy cases, and domestic creditors may have valid claims in foreign bankruptcy cases".*

*Elucidate with reference to the objectives and scope of Model Law developed in this regard ? (6 marks)*

### **Answer 6(a)**

The Fast Track Corporate Insolvency Resolution Process is different from Corporate Insolvency Resolution Process.

As per sub-section (2) of Section 55 of the Insolvency and Bankruptcy Code, 2016, an application for fast track corporate insolvency resolution process may be made in respect of the following corporate debtors, namely:

- (a) a corporate debtor whose assets and income is below a level as may be notified by the Central Government.
- (b) The corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government.
- (c) Such other category of corporate persons as may be notified by Central Government.

In the question the level of assets of the corporate debtor has not been given and therefore the only conclusion that can be made is that the Corporate Debtor does not come within the category of corporate debtor in terms of clauses (a), (b) or (c) of sub-

section (2) of Section 55 of the Code. Therefore, section 55 of the Code cannot be invoked against the corporate debtor.

The Adjudicating Authority has no power to convert Corporate Insolvency Resolution Process as Fast Track Corporate Insolvency Resolution Process under Section 55 of Insolvency and Bankruptcy Code, 2016.

The NCLAT in the matter of *Sanjay Kumar Ruia v. Catholic Syrian Bank Ltd & Anr.* held that the Adjudicating Authority has no power to convert the 'Corporate Insolvency Resolution Process' into a 'Fast Track Corporate Insolvency Resolution Process' under Section 55 of the Insolvency and Bankruptcy Code, 2016.

### **Answer 6(b)**

The Preamble to UNCITRAL Model Law on Cross-Border Insolvency provides that:

The purpose of this Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

- (a) Co-operation between the courts and other competent authorities of this State and Foreign States involved in cases of Cross-border insolvency;
- (b) Greater legal certainty for trade and investment;
- (c) Fair and efficient administration of Cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- (d) Protection and maximization of the value of the debtor's assets; and
- (e) Facilitation of the rescue of financially troubled business, thereby protecting investment and preserving employment.

UNCITRAL Model Law on Cross-Border Insolvency applies where:

- (i) Assistance is sought in this State by a foreign court or a foreign representative in connection with foreign proceeding; or
- (ii) Assistance is sought in a foreign State in connection with a proceeding under [identify laws of the enacting State relating to insolvency]; or
- (iii) A foreign proceeding and a proceeding under (identify laws of the enacting State relating to insolvency) in respect of the same debtor are taking place concurrently; or
- (iv) Creditors or other interested persons in a foreign State have an interest in requesting the commencement of or participating in a proceeding under (identify laws of the enacting State relating to insolvency).

UNCITRAL Model Law on Cross-Border Insolvency does not apply to a proceeding concerning (designate any types of entities, such as Banks or Insurance Companies, that are subject to a special Insolvency regime in this State and that this State wishes to exclude from this Law).

The acceptance of the cross border insolvency norms was observed in the CIRP of Jet Airways Limited where the NCLAT has allowed Dutch Administrator to attend the meeting of the Committee of Creditors, however, with limited or no power to participate directly.