

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2015

MODULE III



**THE INSTITUTE OF
Company Secretaries of India**

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

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

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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(i)

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

PROFESSIONAL PROGRAMME
UPDATING SLIP
ADVANCED TAX LAWS AND PRACTICE

MODULE – III – PAPER 1

<i>Examination Session</i>	<i>Question No.</i>	<i>Updation required in the answer</i>
All Previous Sessions	—	<p>The Income Tax, Central Excise and Customs Laws are subject to changes by the Annual Finance Acts. In order to update all the answers, the students are advised to refer to the latest law keeping in mind the following amendments for December 2015 examination.</p> <ul style="list-style-type: none">(i) For Direct Taxes, Finance (No.2) Act, 2014 relevant to Assessment year 2015-16 (Previous Year 2014-15) is applicable. Further, all the Circulars, Clarifications, Notifications, issued by CBDT / Central Government etc. which became effective, on or before six months prior to the date of the respective examinations are applicable.(ii) For Indirect Tax, all changes made by the Finance Act, 2015 are applicable. Further, all Circulars, Clarifications, Notifications, etc. issued by CBEC / Central Government which became effective, on or before six months prior to the date of the respective examinations are applicable.(iii) Wealth Tax Act, 1957 has been abolished w.e.f. 1st April, 2016. The questions from the same will not be asked in examination from December 2015 session onwards. <p>The questions based on case laws, in conflict with the latest law be treated as of academic interest only.</p>

(ii)

UPDATING SLIP

DRAFTING, APPEARANCES AND PLEADINGS

MODULE – III – PAPER 2

<i>Examination Session</i>	<i>Question No.</i>	<i>Updation required in the answer</i>
All Previous Sessions	—	Notified provisions of Companies Act, 2013 and the provisions of Companies Act, 1956 which is still in force.

(iii)

UPDATING SLIP

BANKING LAW AND PRACTICE

MODULE – III – ELECTIVE PAPER 9.1

<i>Examination Session</i>	<i>Question No.</i>	<i>Updation required in the answer</i>
All Previous Sessions	—	All relevant amendment pertaining to Banking Laws and Notification/Circulars issued thereunder upto 6 months prior to the date of examination.

(iv)

UPDATING SLIP

CAPITAL, COMMODITY AND MONEY MARKET

MODULE – III – ELECTIVE PAPER 9.2

<i>Examination Session</i>	<i>Question No.</i>	<i>Updation required in the answer</i>
All Previous Sessions	—	Amendments to SEBI Act, Securities Contract Regulations Act, Forwards Contract Regulation Act, Securities Contract Regulations Rules, various Rules/Regulations issued by SEBI from time to time. Master Circulars issued by RBI from time to time.

ADVANCED TAX LAWS AND PRACTICE

Time allowed : 3 hours

Maximum marks : 100

NOTE: 1. Answer ALL Questions.

2. All the references to sections mentioned in Part-A of the Question Paper relate to the Income-tax Act, 1961 and relevant Assessment Year 2015-16, unless stated otherwise.

PART A

Question 1

(a) Amar, an individual, resident of India, receives the following payments after TDS during the previous year 2014-15 :

	₹
(i) Professional fees on 17.08.2014	2,40,000
(ii) Professional fees on 04.03.2015	1,60,000

Both the above services were rendered in Pakistan on which TDS of ₹ 50,000 and ₹ 30,000 respectively has been deducted. He had incurred an expenditure of ₹ 2,40,000 for earning both these receipts/income. His income from other sources in India is ₹ 3,00,000 and he has made payment of ₹ 70,000 towards LIC.

Compute the tax liability of Amar and also the relief under section 91, if any, for assessment year 2015-16. (5 marks)

(b) Apple Industries Ltd. provides the following information for the financial year 2014-15 :

Net profit as per statement of profit and loss after debiting/crediting the following :	₹ 120 lakh
Proposed dividend	₹ 30 lakh
Profit from unit established in SEZ	₹ 20 lakh
Provision for income-tax	₹ 18 lakh
Provision for deferred tax	₹ 10 lakh
Provision for permanent diminution in value of investments	₹ 3 lakh

Depreciation debited to statement of profit and loss ₹ 10 lakh includes depreciation on revaluation of assets to the tune of ₹ 1 lakh

Brought forward losses and unabsorbed depreciation as per books of the company are as follows :

(₹ in lakh)

Previous Year	Brought Forward Losses	Unabsorbed Depreciation
2010 – 11	1	4
2011 – 12	1	1
2012 – 13	10	5

Compute the book profit of the company as per section 115JB for the assessment year 2015-16. (5 marks)

(c) Explain whether the benefit of exemption under section 54EC would be available in the case of 'capital gains arising on transfer of depreciable asset'. (5 marks)

Answer 1(a)

Computation of Tax Liability of Amar for Assessment Year 2015-16

<i>Particulars</i>	<i>Amount (Rs.)</i>	
Income under head business & Profession		
Gross fees for services rendered in Pakistan on 17.08.2014	2,90,000	
Gross fees for services rendered in Pakistan on 04.03.2015	1,90,000	
<i>Less: Expenditure incurred</i>	(2,40,000)	2,40,000
Income from other sources	3,00,000	3,00,000
Gross total income		5,40,000
Deduction u/s 80C		
Payment towards LIC	70,000	(70,000)
Total income		4,70,000
Tax Liability		
Tax on first 2,50,000	Nil	
Tax on remaining 2,20,000@10%	22,000	
Rebate u/s 87A	(2,000)	
Cess @2% of (22,000-2,000)	400	
SHEC@1% of (22,000-2,000)	200	20,600
Tax Relief	10,519	(10,519)
Tax Payable		10,081
Rounded off		10080

Note:

- Gross professional fee = Payment after TDS +TDS
Thus, professional fee on 17.08.2014 = Rs. (2,40,000 + 50,000)
Professional fees on 04.03.2015= Rs. (1,60,000+30,000)

2. Tax Relief u/s 91

Income for services rendered in Pakistan taxed in India = $((2,40,000 + 50,000 + 1,60,000 + 30,000) - 2,40,000) = \text{Rs. } 2,40,000$

Income assessed in Pakistan = $(2,40,000 + 50,000 + 1,60,000 + 30,000) = \text{Rs. } 4,80,000$

Tax paid in Pakistan = $(50,000 + 30,000) = \text{Rs. } 80,000$

(i) Tax on double taxed Income in India = $(20,600 \times 2,40,000 / 4,70,000) = \text{Rs. } 10,519$

(ii) Tax on double taxed income in Pakistan = $(80,000 \times 2,40,000 / 4,80,000) = \text{Rs. } 40,000$

Tax relief u/s 91 will be lower of (i) or (ii)

Tax relief = Rs. 10,519

Answer 1(b)**Computation of Book Profits of Apple Industries Ltd for FY 2014-15**

<i>Particulars</i>	<i>Amount (Rs. in lakhs)</i>	
Net profit as per P &L a/c	120	120
<i>Add:</i>		
Proposed dividend	30	
Provision for Income Tax	18	
Provision for deferred tax	10	
Provision for permanent diminution in value of investments	3	
Depreciation debited to P/L statement	10	71
<i>Less:</i>		
Depreciation (excluding dep on revaluation)	9	
Aggregate unabsorbed depreciation (4+1+5)	10	(19)
Book Profit U/s 115JB		172

Note:

Since, unabsorbed depreciation is less than brought forward losses, unabsorbed depreciation is taken.

Profit from unit established in SEZ is not deductible

Answer 1(c)

Yes, the benefit of exemption under Section 54EC would be available in the case of capital gains arising on transfer of depreciable asset.

The benefit under section 54EC of the Income Tax Act can be availed of only if there is an income from a capital asset, being long-term in nature. Further, as per section 54EC of the Income Tax act, 1961, capital gain arising to assessee, from the transfer of a long term capital asset shall be exempt to the extent such capital gain is invested within a period of 6 months after the date of such transfer in long term specified asset. Provided that the investment made in the long-term specified asset by an assessee during any financial year does not exceed Rs. 50,00,000.

In the case of transfer of a depreciable asset, section 50 is applicable and by virtue of it, capital gain on transfer of depreciable asset shall be treated as capital gain on transfer of short-term capital asset. In many cases, the department has sought to disallow exemption under section 54EC on the grounds that section 50 deems profits on sale of depreciable assets as short term capital profits, hence requirement of section 54EC, i.e. sale of a long term capital asset is not fulfilled. However, section 50 does not have an over-riding effect over section 54EC. Therefore, capital gain received by an assessee on the transfer of a depreciable asset (if conditions necessary under section 54EC are complied with by the assessee) is eligible for the benefit under section 54EC. The above proposition has been upheld in cases like *CIT v. Assam Petroleum Industries (P.) Ltd.* (2003).

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

- (a) What are the 'specified domestic transactions' which are subject to transfer pricing provisions ? (5 marks)
- (b) Comment on the following in the context of provisions contained in the Income-tax Act, 1961 :
- (i) The provisions of section 115JB are applicable in case of foreign companies. (2 marks)
- (ii) The provisions of dividend distribution tax are applicable to an undertaking or enterprise engaged in developing, operating and maintaining a special economic zone (SEZ). (3 marks)
- (c) Explain the meaning of 'eligible expenses' for the purposes of claiming benefit under section 35D. Also enumerate these eligible expenses. (5 marks)

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

- (i) (a) *Tinoo Ltd.* is eligible to claim deduction of ₹2 crore under section 80-IA. It has filed its return of income after the due date as specified in section 139(1). Discuss the allowability of deduction under section 80-IA. (2 marks)
- (b) *Sahil* sold a residential house on 15th March, 2015 to *Neeraj* for ₹30 lakh of which value applied by stamp valuation authority was ₹38 lakh. *Sahil*

purchased this house in March, 2004 for ₹12 lakh but the stamp duty value of the same was ₹15 lakh. In the context of these transactions, compute the following —

(i) Income out of this transaction, if any, in the hands of Neeraj.

(ii) Cost of acquisition to Neeraj. (2 marks)

(c) An HUF, resident in India, has a gross total income of ₹5,40,000 for the assessment year 2015-16. It made a payment of ₹50,000 for life insurance premium of one of its members. Whether the HUF is entitled to claim the rebate as per section 87A ? (1 mark)

(ii) In the context of transfer pricing provisions in relation to international transactions, what are the factors to be considered while selecting the most appropriate method? (5 marks)

(iii) Vijay is employed with Sunder Ltd., at a monthly salary of ₹45,000. He also receives ₹5,000 per month as house rent allowance. He deposited ₹40,000 in the PPF account. He also pays ₹30,000 as tuition fees of his two children.

Vijay's wife, Isha is employed with Chander Ltd., at a monthly salary of ₹25,000, where Vijay holds 21% of the shares of the company. Isha is not adequately qualified for the post held by her in Chander Ltd.

Isha owns a house used as self occupied house by the family. Municipal value of the house is ₹3,60,000. It was constructed with borrowed funds in 2013-14. Interest on loan is ₹1,80,000 p.a. Isha insured the house and paid insurance premium of ₹8,000 to United India Insurance Company. She also paid ₹20,000 as municipal taxes.

Suggest a scheme of tax planning for both Vijay and Isha to minimise their tax liability during the financial year 2014-15. (5 marks)

Answer 2(a)

Section 92BA, has been added in Transfer Price Code by Finance Act, 2012 which provides that "Specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:-

- (i) Any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;*
- (ii) Any transaction referred to in section 80A;*
- (iii) Any transfer of goods or services referred to in sub-section (8) of section 80-IA;*
- (iv) Any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;*
- (v) Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or*
- (vi) Any other transaction as may be prescribed,*

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees. Thus, a specified domestic transaction means a transaction which is covered by criteria as given in section 92BA and the aggregate value of such transactions exceed Rs. 5 crore in a year.

Answer 2(b)(i)

Section 115JB of the Income Tax Act, 1961, states that 'all companies having book profits under the Companies Act shall have to pay MAT at the rate of 18.5%'; there is no provision restricting its applicability to only domestic companies. Thus, MAT is applicable to all companies irrespective of it being a domestic company or a foreign company.

However, MAT is required to be computed with reference to book profits computed on the basis of profit and loss account prepared as per the Companies Act, and the Companies Act requires only foreign companies, having a place of business within India, to prepare and file its financial statements with the Registrar of Companies. Hence, the MAT provisions shall not apply to foreign companies, which do not have any presence in India.

Alternative Answer 2(b)(i)

The Authority for Advance Ruling has delivered the ruling in the case of the Timken Company holding that the provisions of section 115JB of the Income-tax Act, 1961 levying MAT on the book profit of a company would not apply to a foreign company not having any physical presence in India. Hence, provisions of Section 115JB are applicable only to those foreign companies which have physical presence in India.

Answer 2(b)(ii)

Finance Act, 2011 inserted a proviso to sub-section 6 of Section 115O of Income Tax Act, 1961 by which the provisions of Section 115O relating to dividend distribution tax (DDT) shall also be applicable on an enterprise or undertaking engaged in developing, operating and maintaining a SEZ. Thus, the exemption from DDT in the case of SEZ Developers under the Income-tax Act for dividends declared, distributed or paid is not available after 1st June, 2011.

Answer 2(c)

For the purpose of Section 35D of the Income Tax Act, 1961, eligible expenses are those which are incurred by an assessee, being an Indian company or a person (other than a company) who is resident in India:

- (i) before the commencement of his business, or
- (ii) after the commencement of his business, in connection with the extension of his undertaking or in connection with his setting up a new unit.

The assessee shall, be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the business commences or, as the case may be, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation.

These eligible expenses include expenses in connection with:

- (a) Preparation of feasibility report;
- (b) Conducting market survey or any other survey necessary for the business;
- (c) Preparation of Project report;
- (d) Engineering services relating to the business;
- (e) Legal charges for drafting an agreement relating to the setting up or conduct of the business;
- (f) Legal charges for drafting and printing of Memorandum of Association (MOA) and Articles of Association (AOA);
- (g) Registration fees of a company paid to Registrar of Companies;
- (h) Expenses and legal charges incurred in drafting, printing and advertising for prospectus;
- (i) Expenditure incurred on issue of shares or debentures like underwriting commission, brokerage.

Answer 2A(i)(a)

Facts : Tinoos Ltd. is eligible to claim deduction of Rs. 2 crore under section 80-IA, however, it has filed return after the due date specified in section 139(1).

Applicable Provisions: Section 80AC of the Income Tax Act, 1961 provides that where in computing the total income of an assessee of the previous year relevant to the assessment year, any deduction is admissible under section 80-IA or section 80-IAB or section 80-IB or section 80-IC or section 80-ID or section 80-IE, no such deduction shall be allowed to him unless he furnishes a return of his income for such assessment year on or before the due date specified under sub-section (1) of section 139.

Decision: Thus, Tinoos Ltd. shall not be allowed deduction under section 80-IA

Answer 2A(i)(b)

In order to prevent tax avoidance by transferring immovable property at prices significantly lower than the circle rates, section 56(2)(vii) has been amended with effect from Assessment Year 2014-15 to provide that where any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding fifty thousand rupees, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the individual or HUF as "Income from other sources".

- (i) In this case, Sahil has sold the residential house to Neeraj at Rs. 30 lakhs, whereas the stamp value was Rs. 38 lakhs, thus the difference amount i.e Rs. 8 lakhs would be chargeable as income from other sources in the hands of Neeraj.
- (ii) As per the provisions of section 49(4), the cost of acquisition of residential property in the hands of Neeraj shall be taken as Rs. 38 lakhs.

Answer 2A(i)(c)

As per the provisions of section 87A of Income Tax Act, the rebate under section 87A is available to an individual resident in India, whose total income does not exceed five hundred thousand rupees. Thus, it is not available to HUF and HUF is not entitled to claim the rebate under the said section.

Answer 2A(ii)

Rule 10C of the Indian Income Tax Rules, 1962 states that, in selecting a most appropriate method, the following factors shall be taken into account namely:-

- (a) The nature and class of the international transaction;
- (b) The class or classes of Associated Enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;
- (c) The availability, coverage and reliability of data necessary for application of the method;
- (d) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;
- (e) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions;
- (f) The nature, extent and reliability of assumptions required to be made in the application of a method.

Answer 2A(iii)

Some of the Tax planning measures for Vijay and Isha could be:

- (i) Vijay holds substantial interest (21%) in Chander Ltd. where Isha holds a post for which she is not adequately qualified. Thus, the remuneration received by Isha would be clubbed in the income of Vijay. To avoid this, Vijay may reduce his shareholding in Chander Ltd. to 19%.
- (ii) Vijay and Isha may request to their respective employers to restructure their salaries, as follows:
 - (a) Restructure salaries to break up the monthly salary into basic pay, conveyance allowance / car facility, leave travel facility, medical reimbursement and telephone reimbursement etc. This will reduce the amount of taxable salary.
 - (b) There are several employees' welfare schemes such as recognised provident fund, approved superannuation fund, gratuity fund. Payments made towards such schemes are eligible for deductions. So, Vijay and Isha may request their employer to include these welfare schemes and make contribution towards same.

- (iii) Currently Isha is treating the house as self occupied by the family; she may rent out this to Vijay against a rent receipt. This will enable Vijay in claiming deduction for House Rent Allowance.
- (iv) Isha may claim the deduction for the principal amount and the interest amount paid for the funds borrowed for construction of house. For principal amount, deduction, could be claimed for upto Rs. 1,50,000 and for interest amount deduction could be claimed upto Rs. 2,00,000.

PART B

Question 3

- (a) *AB Pipe Ltd. is engaged in the manufacture of water pipes. From the following details for the month of May, 2014, compute the amount of CENVAT credit available to them under the CENVAT Credit Rules, 2004 :*

CENVAT paid on purchases is detailed below —

<i>Particulars</i>	<i>₹</i>
<i>Raw steel</i>	<i>42,000</i>
<i>Water pipe making machine</i>	<i>16,000</i>
<i>Spare parts for the above machine</i>	<i>9,000</i>
<i>Grease & oil</i>	<i>3,000</i>
<i>Office equipment</i>	<i>42,560</i>
<i>Diesel</i>	<i>12,980</i>

Provide explanation for treatment of various items. (5 marks)

- (b) *Gold Ltd. is having a manufacturing unit at Ghaziabad. During the financial year 2013-14, the value of total clearances from the unit was ₹880 lakh as per the following details :*

	<i>(₹ in lakh)</i>
<i>(i) Clearances to 100% EOU</i>	<i>80</i>
<i>(ii) Clearances exempted vide Notification No.214/86-C.E. dated 25th March, 1986</i>	<i>125</i>
<i>(iii) Exports to USA</i>	<i>125</i>
<i>(iv) Exports to Nepal</i>	<i>50</i>
<i>(v) Clearance as loan licensee of goods carrying the brand name of another upon full payment</i>	<i>180</i>
<i>(vi) Balance clearance of goods in the normal course</i>	<i>320</i>

Find out whether the unit is entitled to benefit of exemption under Notification No.8/2003-C.E. dated 1st March, 2003 as amended for the financial year 2014-15. Explain with reasons. (5 marks)

- (c) Chandu Industries Ltd. imported some goods from USA. The details of the transactions are as under :

CIF value of goods	US \$1,44,000
Rate of basic duty	10%
Rate of education cess	2%
Rate of secondary & higher education cess	1%

If similar goods were manufactured in India, excise duty payable as per tariff plan would be 12%.

You are required to calculate the assessable value and total duty payable thereon as per provisions of customs law.

Note : Rate of exchange is as follows :

As per CBEC 1 US \$	= ₹63	
As per RBI 1 US \$	= ₹60	(5 marks)

- (d) Chikoo Constructions Ltd. is running real estate business. Following information relates to the services provided by them from January to March, 2014 :

	₹
Construction of residential complex meant for use of Members of Parliament	40,00,000
Repair and maintenance of a railway station	25,00,000
Repair services provided to State govt. relating to plant for sewerage treatment	16,00,000
Construction of roads in a factory	15,00,000
Construction services provided to International Labour Organisation	6,00,000

Assuming that Chikoo Constructions Ltd. has taxable services of ₹1.50 crore during financial year 2012-13, compute the value of taxable services and the service tax liability for the quarter ending March, 2014. Give working notes also. (5 marks)

- (e) Following information relates to purchases and sales of Kapil Ltd. for the month of September, 2014 :

	₹
Purchases for resale within the State	8,00,000
Purchases from registered dealers who opted for composition scheme	4,00,000

<i>Purchases to be used as consumable stores for manufacture of taxable goods</i>	6,00,000
<i>Purchases of goods where invoices do not show the amount of taxes separately</i>	5,00,000
<i>Purchases of goods for personal consumption</i>	2,00,000
<i>Purchases of capital goods (not eligible for input credit)</i>	5,50,000
<i>Purchases of capital goods (eligible for input credit)</i>	5,76,000

Sales made within the State during the month of September, 2014 was ₹450,00,000 on which VAT @ 4% was payable.

Assuming all purchases given above are exclusive of VAT @ 12.5%, calculate—

- (i) The amount of input tax credit available for the month of September, 2014.*
- (ii) VAT payable for the month of September, 2014.*
- (iii) Input tax credit carried forward.*

Assume that the input VAT credit on eligible capital goods is available in 24 equal monthly installments. Also make suitable assumptions wherever required and show the workings. (5 marks)

Answer 3(a)

Computation of CENVAT Credit available to AB Pipe Ltd.

<i>Particulars</i>	<i>Amount (Rs.)</i>	
CENVAT paid on:	CENVAT paid	Credit Admissible
Raw steel	42,000	42,000
Water pipe making machine (50% of Rs.16,000)	16,000	8,000
Spare parts for above machine (50% of Rs.9,000)	9,000	4,500
Grease & Oil	3,000	3,000
Diesel	12,980	Nil
Office equipment	42,560	Nil
Total CENVAT credit admissible		57,500

Note:

1. It is assumed that the assessee is not an SSI
2. For raw materials, grease & oil 100% CENVAT credit is admissible
3. Water pipe making machine and spare parts for machine are capital goods and so 50% of the credit will be admissible in the current financial year and the remaining in the successive financial year.
4. Rule 2(k)(i) of the CENVAT Credit rules, 2004, specifically excludes diesel from the definition of 'input', thus credit is not admissible.

Answer 3(b)**Computation of Value of Clearances by Gold Ltd.
During FY 2013-14**

<i>Particulars</i>	<i>Amount (Rs. in lakhs)</i>	
Gross value of Clearances	880	880
<i>Less:</i>		
Clearances to 100% EOU	80	
Clearances exempted vide Notification No. 214/86 CE	125	
Exports to USA	125	
Clearances as loan license of goods carrying brand name of others	180	(510)
Value of Clearances		370

Since the value of clearances doesn't exceed Rs. 400 lakhs during 2013-14, the unit is eligible for Small scale Industries Exemption under Notification No. 8/2003 for the financial year 2014-15

Note:

In order to determine whether the unit is eligible for SSI exemption, Exports to Nepal are included in the value of clearances.

Answer 3(c)

<i>Particulars</i>	<i>Value (Rs.)</i>	<i>Duty (Rs.)</i>
A CIF value of goods (1 US \$= Rs.63) (US \$1,44,000 x Rs.63)	90,72,000	
B Add: Landing charges @ 1%	90,720	
C Assessable Value (A+B)	91,62,720	
D Basic Custom Duty @10% of C (91,62,720 x 10%)		9,16,272
Value after BCD	100,78,992	
E Countervailing Duty @12% of (C+D) (1,00,78,992 x 12%)		12,09,479
Total after CVD	112,88,471	21,25,751
F Add : Education Cess @ 2% of (D+E) (21,25,751 x 2%) - rounded off to nearest rupee		42,515
G Add : SHEC @ 1% (21,25,751 x 1%) - rounded off to nearest rupee		21,258
Total Custom Duty Payable (D+E+F+G)		21,89,524

Notes:

1. The exchange rate as notified by CBEC would be applicable.
2. Rule 4 (2) provides that the costs and charges referred to in sub-rule (2) of rule 10 of these rules are to be included in the transaction value of identical goods. Thus, landing charges @ 1% of CIF are to be added to the CIF to arrive at the assessable value.
3. Where similar goods manufactured in India are liable to excise duty, the countervailing duty at the same rate is levied upon the imported goods.

Answer 3(d)

**Computation of Value of Taxable Services and Service Tax liability of Chikoo Ltd.
For quarter ending March, 2014**

<i>S.No.</i>	<i>Particulars</i>	<i>Amt. (Rs.)</i>	
Value of Taxable Services			
1	Construction of residential complex for the use of Member of Parliament	40,00,000	-
2	Repair & maintenance of railway station	25,00,000	25,00,000
3	Repair services provided to state Govt. relating to treatment of sewage plant	16,00,000	-
4	Construction of roads in factory	15,00,000	15,00,000
5	Construction services provided to International Labour Organisation	6,00,000	-
	Value of Taxable Services		40,00,000
	Service Tax Payable		
	Service tax @ 12% of value of taxable services (12% x 40,00,000)	4,80,000	
	Cess @ 2% of 4,80,000	9,600	
	SHEC @ 1% of 4,80,000	4,800	4,94,400
	Service Tax payable		4,94,400

Notes:

1. Construction of residential complex for Member of parliament is exempted vide Mega Notification dated 20-06-2012.
2. Services by way of construction, erection or installation of original works pertaining to railway are exempted vide Mega notification dated 20-06-2012. However, repairs and maintenance of railway will be liable to service tax.
3. Repair services provided to state Government are not liable to service tax.
4. Services by way of construction of roads for use of general public are exempted vide Mega notification dated 20-06-2012, however construction of road in a factory is taxable service.
5. Any services provided to International Labour Organisation are exempted.

Answer 3(e)**Calculation of VAT liability of Kapil Ltd. for the month of September, 2014**

<i>Particulars</i>	<i>Amount in Rs.</i>	
A Purchases eligible for Input tax credit		
1 Purchases for resale within state taxable	8,00,000	
2 Purchases from registered dealer opted for composition scheme	-	
3 Purchases to be used as consumable stores for manufacture of taxable goods	6,00,000	
4 Purchases of goods where invoices do not show the amount of taxes separately	-	
5 Purchase of goods for personal consumption	-	
6 Purchase of capital goods (not eligible for input credit)	-	
7 Purchase of capital goods (eligible for input credit)	5,76,000	
B Input Tax credit available for the month of September		
1 On goods other than Capital goods (14,00,000 x 12.5%)	1,75,000	
On Capital Goods ((5,76,000 x 12.5%) / 24)	3,000	1,78,000
C Net VAT Payable/ Input Tax credit Carried forward		
Output VAT payable during September, 2014 (50,00,000 x 4%)	2,00,000	
Less: Input tax credit available for September, 2014	(1,78,000)	22,000
D Tax Credit to be carried forward	-	
For Capital goods (Balance 23 installments of Rs. 3000 each)	69,000	
For other than capital goods	Nil	69,000

Notes:

1. Input tax credit is not available in the following cases:
 - a. Purchases from registered dealer who opted for composition scheme
 - b. Purchases of goods where invoices do not show the amount of taxes separately
 - c. Purchase of goods for personal consumption
2. Purchase of capital goods is eligible to input tax credit, however as given in the question, the same is deferred to 24 equal installments.

Attempt all parts of either Q.No. 4 or Q.No. 4A**Question 4**

- (a) *Baba Ltd. is a small scale unit manufacturing plastic name plates for motor vehicles as per specifications provided to them by their customers, who are*

vehicle manufacturers. For the purpose of classification under First Schedule to the Central Excise Tariff Act, 1985, the assessee has claimed that plastic name plates are 'parts and accessories of motor vehicles'. The Central Excise Department has proposed classification as 'other plastic products' in respect of these plastic name plates. The Department's view is that motor vehicle is complete without affixation of name plates and name plate cannot be treated as part of the motor vehicle. Whether the stand taken by the Department is legally correct? Briefly discuss with reference to relevant case law. (5 marks)

- (b) In a search conducted in the office premises of Zebra Ltd., large quantity of rough diamonds was recovered. It was found that these were imported without a license. After adjudication, penalty was imposed on Zebra Ltd. and goods were confiscated.

An option was given to the company to redeem goods on payment of redemption fine and customs duty at appropriate rate. During the relevant period, there was an exemption notification in respect of these goods. Zebra Ltd. claimed benefit of the exemption notification for payment of customs duty.

Discuss in the light of a decided case, whether Zebra Ltd.'s contention is correct. (5 marks)

- (c) Neem Infotech, while retaining the copyright with it, is selling information technology software as :
- (i) Shrink wrap software
 - (ii) Multiple user/paper license; and
 - (iii) Internet download.

In terms of end user license agreement (EULA), the contract is given for customised development of software, delivered online or downloaded on the internet.

The assessee is of the view that since it has been settled by the Supreme Court ruling in TCS case [2004(178)ELT22(SC)] that software (branded as well as unbranded) is 'goods', there is no element of service and hence service tax cannot be levied in this case.

Discuss, in the light of case law, if any, the following questions —

- (i) Whether the transaction may be called as 'sale' or 'deemed sale' ?
- (ii) Whether the transaction is liable to service tax? If yes, state the category of the service also. (5 marks)

OR (Alternate Question to Question No. 4)

Question 4A

- (i) (a) Mention the time-limit within which the CENVAT credit of duty paid on inputs and service tax paid on input services can be availed under the CENVAT Credit Rules, 2004. (3 marks)
- (b) Mention the circumstances under which a price less than the manufacturing cost and profit of excisable goods can be deemed to be the transaction value under section 4 of the Central Excise Act, 1944. (3 marks)

- (ii) (a) *Mention the rates of interest payable on delayed payment of service tax under section 75 of the Finance Act, 1994.* (3 marks)
- (b) *Discuss whether service tax is leviable on the monthly contribution collected from members to be used by residents welfare association for the purpose of making payments to the third parties in respect of commonly used services or goods?* (3 marks)
- (iii) *Mention the amount which is required to be deposited mandatorily before filing an appeal before the Commissioner (Appeals) and CESTAT under the Customs Act, 1962.* (3 marks)

Answer 4(a)

The facts of the case of *Baba Ltd.* are similar to that of *Pragati Silicons Ltd. v. CCEx Delhi* (2007), where the issue was whether the Name Plates, Labels, Emblems made from plastic for use on Motor Vehicles are classifiable under Chapter 87 of the Schedule to the Central Excise Tariff Act as parts of Motor Vehicle or Motor Cycles or as other articles of plastics.

In the case of *Pragati Silicons Ltd.* the Apex Court has applied the test laid down in *Mehra Bros.* case and observed that name plates add to the convenient use of the motor vehicle and serve a very useful purpose and gives an identity to the vehicle. Each vehicle comes with different brand name and in different models having distinct features. The manufacturers of different type of models of vehicles market them under a name and the vehicles are recognized and referred to by the name plate affixed on them. Name plates convey to the consumers the distinct features it carries. Undoubtedly they add effectiveness and value to the vehicle and are at the very least accessories of the vehicle. Thus, even if there was any difficulty in the inclusion of the plastic name plates as 'parts' of the motor vehicles, they would most certainly have been covered by the broader term 'accessory'. In this view the Supreme Court held that, 'plastic name plates' are 'parts and accessories' of motor vehicles.

Thus, in this case the contention of Department that name plate cannot be treated as part of motor vehicle is not valid.

Answer 4(b)

The facts of the case are similar to that of *M.Ambalal & Co. v. Commissioner of Customs* (2011) where it was observed that the wording of the exemption notification was clear that the benefit of the exemption envisaged is for those goods that are imported. According to Section 2(25) of the Customs Act 'imported goods' has been defined to mean "...any goods brought into India from a place outside India but does not include goods which have been cleared for home consumption."

It is necessary that the above definition is read along with Section 11, Section 111 and Section 112 of the Act, which provide for detection of illegally imported goods and prevention of the disposal thereof, confiscation of the goods and conveyances and imposition of penalties respectively. Under Section 111(d) of the Act, any goods which are imported contrary to any prohibition imposed by or under this Act or any other law for the time being in force shall be liable for confiscation.

In this case, the goods which have been seized cannot be imported into India without

a license under the Import Control Act and therefore goods so imported cannot, be treated to be lawfully "imported goods" within the definition of that term in Section 2(25) of the Act. Therefore, Zebra Ltd. shall not be entitled to the benefit of the notification. Thus, contention of Zebra Ltd. is not correct.

Answer 4(c)

The facts of the case of *Neem Infotech* are similar to the case of *Infotech Software Dealers Association v. Union of India* where it was held that although the software is goods, whether the transaction amounts to sale or service would depend upon the individual transaction and for the reason of that challenge, the amended provision cannot be held to be unconstitutional so long as the Parliament has the legislative competency to enact law in respect of tax on service in exercise of powers under Entry 97 of List I of Schedule VII.

- (i) Sale requires the transfer of goods as well as the right to use them. In the case of *Neem Infotech*, since the developer has retained the copyright of software, the dominant intention was to transfer to the subscribers or members, only the right to use the software. Thus, a license to use software which does not involve the transfer of 'right to use' would neither be a transfer of title to goods nor be a deemed sale of goods. Here, the activity would fall in the definition of 'service' under the declared service category specified in clause (f) of section 66E.
- (ii) As held in the case of *Infotech Software Dealers Association v. Union of India* that, when the transaction between the assessee and customer is such that the software is not sold, then such arrangement amounts to provision of service and therefore will be liable to service tax. The services are liable to service tax as declared service under clause (d) of section 66E of the Finance act, 1994.

Answer 4A(i)(a)

As per the provisions of Rule 4(1) and Rule 4(7) of the CENVAT Credit Rules, 2004 read with Notification No. 21/2014-CE (NT) dated 11.07.2014, time limit for availing CENVAT credit has been fixed as 6 months. Thus, the manufacturer or the service provider shall not take the CENVAT credit after six months of the date of the issue of invoice or any other document for input or input services. However, no time limit has been fixed for capital goods.

Answer 4A(i)(b)

In the case of *CCE v. Fiat India Pvt. Ltd.* (2012), it was held that if a price below cost is charged to have penetration into the market with a view to make profits in future; the price is not sole consideration. With a view to nullify the effect of this judgment, Rule 6 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 has been amended by Notification No. 20/2004 CE (NT) dated 11.07.2014. Proviso to Rule 6 provides that:

- (1) Where price is not the sole consideration for sale of excisable goods;
- (2) The excisable goods are sold by the assessee at a price less than the manufacturing cost and profit;
- (3) No additional consideration is flowing directly or indirectly from the buyer to assessee;
- (4) The value of excisable goods shall deem to be the transaction value.

Answer 4A(ii)(a)

As per section 75 of the Finance Act, 1994, every person, liable to pay the tax in accordance with the provisions of section 68 or rules made there-under, who fails to credit the tax or any part thereof to the account of the Central Government within the period prescribed, shall **pay simple interest at such rate not below 10% and not exceeding 36% per annum** as is for the time being fixed by the Central Government, by Notification in the Official Gazette for the period by which such crediting of the tax or any part thereof is delayed.

Provided that in the case of a service provider, whose **value of taxable services provided in a financial year does not exceed 60 lakh rupees during any of the financial years covered by the notice or during the last preceding financial year**, as the case may be, such rate of interest, **shall be reduced by 3% per annum**

In exercise of the powers conferred by section 75 of the Finance Act, 1994 and in supersession of the notification No.26/2004-Service Tax, dated 10th September, 2004, except as respects things done or omitted to be done before such supersession, the Central Government, vide Notification No. 12/2014 Service Tax fixed the certain rates of simple interest per annum for delayed payment of service tax, these rates are given in below Table:-

<i>Sr. No.</i>	<i>Period of delay</i>	<i>Rate of simple Interest</i>
1	Upto 6 months	18%
2	More than 6 months and upto 1 year	18% for the first 6 months of delay and 24% for the delay beyond 6 months.
3	More than 1 year	18 % for the first 6 months of delay; 24% for the period beyond 6 months up to 1 year ; 30% for any delay beyond 1 year

Answer 4A(ii)(b)

In a residential complex, monthly contributions collected from members, used by the Resident Welfare Association (RWA) for the purpose of making payments to the third parties, in respect of commonly used services or goods like, for providing security service for the residential complex, maintenance or upkeep of common area and common facilities like lift, water sump, health and fitness centre, swimming pool, payment of electricity bill for the common area and lift, etc are exempted from service tax.

This is vide Notification No. 25/2012-ST which specifically exempts service provided by an unincorporated body or a non-profit entity registered under any law for the time being in force such as RWAs, to its own members. However, a monetary ceiling has been prescribed for this exemption, calculated in the form of five thousand rupees per month per member contribution to the RWA, for sourcing of goods or services from third person for the common use of its members.

Answer 4A(iii)

As per section 129E of the Customs Act, the Tribunal or the Commissioner (Appeals), as the case may be, shall not entertain any appeal,-

- (i) Under section 128(1), unless the appellant has deposited 7.5% of the duty demanded or penalty imposed or both, in pursuance of a decision or an order passed by an officer of customs lower in rank than the Commissioner of Customs;
- (ii) against the decision or order referred to in section 129A(1)(a), unless the appellant has deposited 7.5% of the duty demanded or penalty imposed or both, in pursuance of the decision or order appealed against;
- (iii) against the decision or order referred to in section 129A(1)(b), unless the appellant has deposited 10% of the duty demanded or penalty imposed or both, in pursuance of the decision or order appealed against:

Provided that the amount required to be deposited under this section shall not exceed rupees ten crores. Further, the provisions of this section shall not apply to the stay applications and appeals pending before any appellate authority prior to the commencement of the Finance (No. 2) Act, 2014.

Question 5

(a) *Discuss the validity of the following statements with reference to the Central Excise Rules, 2002, as amended :*

- (i) *The general procedures prescribed for export under claim for rebate and export without payment of duty under bond do not apply to Nepal.*
- (ii) *In respect of goods received at concessional rate of duty, return is required to be filed on monthly basis.*
- (iii) *Submission of annual financial information statement in Form ER 4 is compulsory for all assessees. (2 marks each)*

(b) *Earth Ltd. is located in India and holding 51% of shares of Sun Ltd. Sun Ltd. provides business auxiliary services to Earth Ltd.*

From the following details, determine the point of taxation of Earth Ltd :

<i>Agreed consideration</i>	<i>US \$1,00,000</i>
<i>Date on which services were provided by Sun Ltd.</i>	<i>16th September, 2014</i>
<i>Date on which invoice is sent by Sun Ltd.</i>	<i>19th September, 2014</i>
<i>Date of debit in the books of account of Earth Ltd.</i>	<i>30th September, 2014</i>
<i>Date on which payment is made by Earth Ltd.</i>	<i>23rd December, 2014</i>

(3 marks)

- (c) *Explain how sales tax incentives cause problems for VAT system. (3 marks)*
- (d) *Is the transaction value under the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, acceptable even if goods are sold to related persons? Give reasons. (3 marks)*

Answer 5(a)(i)

Invalid. As specified in notification No. 42/2001-CE (N.T.) dated 26.6.2001. Procedures and conditions for export without payment of duty under bond applies to all countries except Bhutan. Thus, the procedures prescribed for export under claim for rebate and export without payment of duty under bond applies to Nepal.

Answer 5(a)(ii)

Invalid. Rule 5 of Central Excise (removal of goods at concessional rate of duty for manufacture of excisable goods) Rules, 2001 has been amended to provide inter-alia that the manufacturer receiving goods at concessional rate of duty will submit a quarterly return instead of a monthly return.

Answer 5(a)(iii)

Invalid. As per rule 12 (2) (a) of Central Excise Rules, for each financial year, Annual Financial Information Statement in ER-4 should be filed by all the assesses who are paying duty of Rs 1 crore or more per annum through (cash plus CENVAT credit).

Answer 5(b)

As per section 92A of the Income Tax act, 1961, Earth Ltd. and Sun Ltd. are “associated enterprises”, as Earth Ltd. holds 51% shares of Sun Ltd.

The question is silent about whether Sun Ltd. (service provider) is located in India or outside India. However it has been given that Earth Ltd. (service receiver) is situated in India and agreed consideration is in US \$, thus it has been assumed that Sun Ltd. is situated outside India. Now, as per Rule 7 of the Point of Taxation Rules, 2011, in case of associated enterprises, where the person providing service is located outside India, the point of taxation is the earlier of the following two dates:

- (i) Date of debit in the books of accounts of the service receiver; or
- (ii) Date of making the payment by the service receiver.

Here, date of debit in the books of Earth Ltd. is 30th September, 2014; and

Date on which payment was made by Earth Ltd. is 23rd December, 2014.

Thus, the point of taxation will be 30th September, 2014

Answer 5(c)

Value added tax (VAT) regime is based on the value addition to the goods. Under VAT, the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period. Thus, here the tax credit is passed at each stage through issuance of tax invoice. Sales tax incentives like fiscal exemption from tax or subsidy are against the principles of VAT as dealers effecting exempted sales are neither allowed to avail input tax credit nor allowed to pass on the credit because of which the VAT chain gets broken.

Answer 5(d)

As per Rule 3(3), of Customs Valuation (Determination of Value of Imported Goods)

Rules, 2007 in the following two cases the transaction value shall be acceptable even if goods are sold to related persons:

- (a) the examination of the circumstances of the sale of the imported goods indicate that the relationship did not influence the price.
- (b) whenever the importer demonstrates that the declared value of the goods being valued closely approximates to one of the following values ascertained at or about the same time:
 - the transaction value of identical goods, or of similar goods, in sales to unrelated buyers in India;
 - the deductive value for identical goods or similar goods;
 - the computed value for identical goods or similar goods.

Provided that in applying the values used for comparison, due account shall be taken of demonstrated difference in commercial levels, quantity levels, adjustments in accordance with the provisions of Rule 10 and cost incurred by the seller in sales in which he and the buyers are not related.

Question 6

- (a) *Mention the broad rates under the existing VAT regime.* (5 marks)
- (b) *Briefly explain the concept of goods and services tax (GST).* (5 marks)
- (c) *What do you understand by 'continuous supply of service'? Also mention the point of taxation in case of continuous supply of service.* (5 marks)

Answer 6(a)

VAT regime has following broad rates-

- 1) Exempted for unprocessed agricultural goods, and goods of social importance;
- 2) 1% for precious and semiprecious metals and stones;
- 3) 4% for inputs used for manufacturing and on declared goods, capital goods and other essential items;
- 4) 20% for demerit/luxury goods; and
- 5) the rest of the commodities will be taxed at a Revenue Neutral Rate of 12.5%.

Answer 6(b)

Concept of Goods and Service Tax (GST)

1. GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits from the producer's point and service provider's point upto the retailer's level.
2. The GST subsumes various central indirect taxes including the Central Excise Duty, Countervailing Duty, Service Tax, etc. It also subsumes state value added tax, octroi and entry tax, luxury tax, etc.

3. The Constitution (122 Amendment) Bill, 2014 was introduced in the Lok Sabha in December 2014 to amend the Constitution to introduce the goods and services tax (GST).
4. The bill proposes to give the central and state governments the concurrent power to make laws on the taxation of goods and services.
5. Alcoholic liquor for human consumption is exempted from the purview of the GST.
6. Further, the GST Council is to decide when GST would be levied on: (i) petroleum crude, (ii) high speed diesel, (iii) motor spirit (petrol), (iv) natural gas, and (v) aviation turbine fuel.

Answer 6(c)

“Continuous supply of service” means

- (i) any service provided or agreed to be provided continuously or on recurrent basis, under a contract, for a period exceeding three months with the obligation for payment periodically or from time to time. or
- (ii) where the Central Government, by a notification in the Official Gazette, prescribes provision of a particular service to be a continuous supply of service, whether or not subject to any condition.

Services notified by the Central Government: In this regard, the Central Government has prescribed the following services to be a continuous supply of service:-

- Telecommunication service; and
- Service portion in execution of a works contract

As per Rule 3, in case of continuous supply of service, the point of taxation shall be the date of completion of the events as specified in the contract or time when invoice for the service provided or to be provided is issued or the date on which payment is received whichever is earlier. Where any advance is received by the service provider the point of taxation shall be date of receipt of each such advance. Further, where the invoice is not issued within 30 days of completion of such event then point of taxation shall be the date of completion of such event.

DRAFTING, APPEARANCES AND PLEADINGS

Time allowed : 3 hours

Maximum marks : 100

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

Question 1

- (a) *“Drafting of documents is very important part of legal documentation. Documents are subject to interpretation when no clear meaning could be inferred by a simple reading of documents.”*

Explain this statement with reference to the rules relating to interpretation of formal legal documents. (10 marks)

- (b) *Explain in brief the essentials of a hypothecation agreement. Draft a specimen agreement on behalf of a firm Excel & Co. to hypothecate goods to execute fixed loan from Rich Bank. (10 marks)*

Answer 1(a)

The process of drafting operates in two planes: the conceptual and the verbal. Besides seeking the right words, the draftsman seeks the right concepts. Drafting, therefore, is first thinking and second composing. A proper understanding of drafting cannot be realized unless the nexus between the law, the facts, and the language is fully understood and accepted. There is no law in India on the interpretation of documents. On the subject of interpretation of statutes Maxwell's works published by Butterworth commands wide acceptance by the judiciary all over India. Based on the said work a set of principles has been evolved for the interpretation and construction of documents, assessing the language and assigning the exact meaning to the words and phrases to be used in the documents.

The object of all interpretation of a 'Written Document' is to discover the intention of the author, the written declaration of whose mind the document is always considered to be. Consequently, the construction must be as clear, to the minds and apparent intention of the parties, as possible and as the law will permit.

Where the agreement is formal and written, the following rules of the interpretation may be applied:

- (1) A deed constitutes the primary evidence of the terms of a contract, or of a grant, or of any other disposition of property (Section 91 of the Evidence Act). The law forbids any contradiction of, or any addition, subtraction or variation in a written document by any extrinsic evidence, though such evidence will be admissible to explain any ambiguity (Section 92 of the Evidence Act). The document should, therefore, contain all the terms and conditions, preceded by recital of all relevant and material facts.
- (2) In cases of uncertainty, the rules embodied in provisos 2 and 6 of Section 92 of the Evidence Act can be invoked for construing a deed. The sixth proviso enables the court to examine the facts and surrounding circumstances to which the language of the document may be related, while the second proviso permits

evidence of any separate oral agreement on which the document is silent and which is not inconsistent with its terms.

- (3) The cardinal rule is that clear and unambiguous words prevail over any hypothetical considerations or supposed intention. But if the words used are not clear and unambiguous the intention will have to be ascertained.
- (4) In case the terms are not unambiguous it is legitimate to take into account the surrounding circumstances for ascertaining the intention of the parties. The social milieu, the actual life situations and the prevailing conditions of the country are also relevant circumstances.
- (5) Sometimes a contract is completed in two parts. At first an executory contract is executed and later on an executed contract. In case of any difference between the preliminary contract and final contract, the terms of the latter must prevail.
- (6) If in a deed an earlier clause is followed by a later clause which destroys altogether the obligation created by the earlier clause, the latter clause is to be rejected as repugnant and the earlier clause prevails.
- (7) The court must interpret the words in their popular, natural and ordinary sense, subject to certain exceptions as,
 - (i) where the contract affords an interpretation different from the ordinary meaning of the words; or
 - (ii) where the conventional meanings are not the same with their legal sense.
- (8) Hardship to either party is not an element to be considered unless it amounts to a degree of inconvenience or absurdity so great as to afford judicial proof that such could not be the meaning of the parties.
- (9) All mercantile documents should receive a liberal construction.
- (10) No clause should be regarded as superfluous, since merchants are not in the habit of inserting stipulations to which they do not attach some value and importance. The construction adopted, should, as far as possible, give a meaning to every word and every part of the document.
- (11) Construction given to mercantile documents years ago, and accepted in the mercantile world should not be departed from, because documents may have been drafted in the faith thereof.
- (12) If certain words employed in business, or in a particular locality, have been used in particular sense, they must prima facie be construed in technical sense.
- (13) The ordinary grammatical interpretation is not to be followed, if it is repugnant to the general context.
- (14) Antecedent facts or correspondence, or words deleted before the conclusion of the contract cannot be considered relevant to ascertain the meaning.
- (15) Evidence of acts done under a deed can, in case of doubt as to its true meaning, be a guide to the intention of the parties, particularly when acts are done shortly after the date of the instrument.

- (16) If the main clause is clear and the contingency mentioned in the proviso does not arise, the proviso is not attracted at all and its language should not be referred to for construing the main clause in a manner contradictory to its import.
- (17) The fact that a clause in the deed is not binding on the ground that it is unauthorised cannot ipso facto render the whole deed void unless it forms such an integral part of the transaction as to render it impossible to sever the good from the bad.

Answer 1(b)

Hypothecation is a form of transfer of property in goods. Hypothecation agreement is a document by which legal property in goods passes to the person who lends money on them, but the possession does not pass. Hypothecation agreements usually cover moveable machinery, equipment, stocks of finished and semi-finished goods, raw materials, consumable stores, present and future available in factories and godowns of the borrower and also enroute to the borrower's factories and book debts. While these items as moveable assets remain in the possession of the borrower and he has absolute right to convert them, sell them and deal with them in any manner the borrower likes in the course of his business, the legal title vests in the lending institution by virtue of the hypothecation agreement.

A Specimen Agreement to Hypothecate Goods to Secure Fixed Loan

The Manager,

Rich Bank,

Sir,

In consideration of your Bank advancing to us on loan the sum of Rs.....
I/We hereby agree to hypothecate and hold under lien to the rich Bank(hereinafter called the one party) as security for the repayment as per Schedule hereto of the principal amount of the loan and payment of interest on demand at.....% per annum subject to a maximum of.....% per annum above Bank Rate.

The goods so to be held by us under lien to the Bank, We declare to be our absolute property, and to be stored in our godowns at..... We hereby agree to furnish you at the close of business on the last day of each English calendar month so long as any money remains due in respect of the said loan with a full and correct statement of particulars of all goods so held under lien to the Bank, with the market value thereof respectively on that day.

All goods from time to time held by us under lien to the Bank in terms of this agreement shall be kept separate and apart from all other goods in our possession.

It is understood that we are at liberty, from time to time in the ordinary course of business, to sell all or any of the goods from time to time held under lien to the Bank under this agreement.

We empower you or any one from time to time authorised by you on behalf of the Bank to enter the godowns in which the goods held under lien to the bank under this agreement shall be from time to time stored, for the purpose of inspecting and taking an account of the said goods.

We further empower you or anyone authorised by you as aforesaid so long as any money advanced by the bank under this agreement remains unpaid, to take possession of any goods from time to time held by us under lien to the Bank under this agreement.

We undertake to keep all held under lien to the Bank under this agreement, insured against fire to their full value, and to produce and deposit the policies with the Bank any time on demand and to hold all moneys which may become payable under any such policies in trust for the Bank so long as any money shall remain due in respect of our said loan.

It is understood that the Bank's lien on the goods, so held under this agreement shall extend to any other sum or sums of money for which we or any other of us either separately or jointly with any other person or persons may be or become indebted or liable to the bank on any account.

Schedule of securities referred to in the agreement.

.....

Schedule of instalments for the repayment of the loan amount.

.....

Yours faithfully,

For Excel & Co.

(.....)

Managing Partner,

New Delhi

Dated.....

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

Question 2

Explain the following :

- (a) *In a pleading, there is no scope for law and evidence as per Order 6 of the Code of Civil Procedure, 1908; yet, in practice, both are pleaded in higher courts, like High Courts and Tribunals.*
- (b) *An arbitration award is required to be registered.*
- (c) *A contract of counter guarantee is different from a contract of fidelity guarantee or performance guarantee.*
- (d) *All instruments are legal documents but all legal documents are not instruments.*
(4 marks each)

OR (Alternate question to Q.No. 2)

Question 2A

Distinguish between the following :

- (i) *A 'writ of mandamus' and a 'writ of certiorari'.*
- (ii) *'Privileged will' and 'unprivileged will'.*

(iii) *'Habendum' and 'reddendum'*.

(iv) *'Complaint' and 'plaint'*.

Answer 2(a)

“Pleading” shall mean plaint or written statement. In a pleading, there is no scope of pleading a provision of law or conclusion of law. It is the intention of the framers of the Code that a pleading should state facts, and the position as in law shall be inferred if such facts are capable of raising any legal inference. The pleading should present facts in such a way that those would irresistibly and spontaneously draw a legal inference. Herein lies the art of pleading. To find out the law is the duty of the court. Legal effects are not to be stated by the party. In India, as in England, the duty of a pleader is to set out the facts upon which he relies and not the legal inference to be drawn from them. Likewise the conclusion of law or a mixed question of law and fact should not be pleaded.

In like manner evidence has to be avoided in pleadings. We have noticed the wording of the rule of O. 6, R. 2, a statement in a concise form of the material facts on which the party pleading relies for his claim or defence as the case may be but not the evidence by which they are to be proved. A pleading should not contain facts which are merely evidence to prove the material facts.

Answer 2(b)

Arbitration Award is a determination on the merits by an arbitration tribunal in arbitration, and is analogous to the judgment in the Court of Law. The general requisites of an arbitration award are:

- (a) it must be consistent with the submission;
- (b) it must be certain;
- (c) it must be fair to the parties;
- (d) it must be final;
- (e) its implementation must be possible.

However, as per Arbitration and Conciliation Act, 1996 an arbitration award is not required to be registered. But The Registration Act, 1908 provides that if any non-testamentary document ‘purports or operates to create, declare, assign limit or extinguish..., any title, right or interest’ in any immovable property, the same is required to be registered and if it is not, it is invalid. Hence, if an award purports to impact any immovable property it is required to be registered.

Answer 2(c)

A “contract of guarantee” is a contract to perform the promise, or discharge the liability, of a third person in case of his default.

A guarantee, guaranteeing an employer against the misconduct of an employee or to answer for the debt or default of another, is called a “fidelity guarantee”.

A guarantee given by the principal debtor to the surety providing him continuing indemnity against any loss or damage that the surety may suffer on account of default on the part of the principal debtor is called “counter guarantee”.

A guarantee which ensures the contracted performance of another person and under which the surety undertakes to compensate the person in whose favour the guarantee is given, in the event of failure on the part of the person on whose behalf the guarantee is given, is known as “performance guarantee”.

Answer 2(d)

According to Black’s Law Dictionary an instrument is a written document; a formal or legal document in writing, such as a contract, agreements, deed, will, bond, or lease. Under Section 2(b) of the Notaries Act, 1952, and Section 2(14) of the Indian Stamp Act, 1899, the word “instrument” includes every document by which any right or liability is, or purports to be, created, transferred, modified, limited, extended, suspended, extinguished or recorded. In the context of the General Clauses Act, it has to be understood as including reference to a formal legal writing like an order made under constitutional or statutory authority.

Whereas legal documents includes contract, agreements, deed etc. which need not contain matters presumed or implied by law. It is better in such an agreement to specify even such matters and all other matters so as to make it a complete code, embodying the rights and duties of each party. Thus all instruments are legal documents but all legal documents are not instruments.

Answer 2A (i)

The writ of mandamus is a command issued to direct any person, corporation, inferior Court or Government authority requiring him to do a particular thing therein specified which pertains to his or their office and is further in the nature of a public duty. This writ is used when the inferior tribunal has declined to exercise jurisdiction. Mandamus can be issued against any public authority. The applicant must have a legal right to the performance of a legal duty by the person against whom the writ is prayed. Mandamus is not issued if the public authority has discretion. Mandamus can be issued by the Supreme Court and all the High Courts to all authorities. It is a discretionary remedy and the Court may refuse if alternative remedy exists except in case of infringement of Fundamental Rights.

The writ of certiorari is available to any person whenever any body of persons having legal authority to determine questions affecting the rights of subjects and having the duty to act judicially, acts in excess of its legal authority. The writ removes the proceedings from such body to the High Court in order to quash a decision that goes beyond the jurisdiction of the deciding authority.

Answer 2A(ii)

Any soldier being employed in an expedition or engaged in actual warfare, or an airman so employed or engaged, or any mariner being at sea, may, if he has completed the age of eighteen years, dispose of his property by a Will made in the manner provided in Section 6 of the Indian Succession Act. Such Wills are called privileged Wills. Privileged Wills may be made orally and may not always be in writing. If written in handwriting of testator, it need not be signed or attested. It is governed by sections 65 & 66 of the Indian Succession Act, 1925.

Wills made by the persons other than stated above are Unprivileged Will. Such Wills are required to be in writing, signed by testator and attested by the two witnesses (except

those made by Mohammedans). It is governed by section 63 of the Indian Succession Act, 1925.

Answer 2A(iii)

Habendum is a part of deed which states the interest, the purchaser is to take in the property. Habendum clause starts with the words "THE HAVE AND TO HOLD". The habendum limits the estate mentioned in the parcels. The parcels or the description of the property usually again included in the premises. If the property conveyed in encumbered, reference thereto should be made in the habendum.

Reddendum is peculiar to a deed of lease. Here is mentioned the mode and time fixed for payment. It begins with the word rendering or paying with reference to the reserved rent. Rent is payable during the term of the lease. Place where payable and instalments are mentioned. If there is apportionment of rent that is also mentioned.

Answer 2A(iv)

Complaint under section 2(d) of the Criminal Procedure Code means any allegation made orally or in writing to a Magistrate, with a view to his taking action under this Code that some person, whether known or unknown, has committed an offence, but it does not include a police report.

However, a report made by the police officer in a case which discloses after investigation, the commission of a non-cognizable offence shall be deemed to be a complaint, and the police officer making the report as a complainant.

A Complaint in a criminal case is what a Plaintiff is in a civil case. Order 6, R. 1 of Civil Procedure Code (C.P.C.) defines 'pleading'. It means either a plaint or a written statement. Plaintiff is the statement of claim, in writing and filed by the plaintiff, in which he sets out his cause of action with all necessary particulars.

Attempt all parts of either Q.No. 3 or Q.No. 3A

Question 3

In the light of judicial pronouncements, discuss the following :

- (a) *The court is entitled to put itself into the testator's arm chair.*
- (b) *A family arrangement can be enforced in a court of law.*
- (c) *In case of repugnancy in a will, last words shall prevail.*
- (d) *Goodwill of a business as an intangible asset.* (4 marks each)

OR (Alternate question to Q.No. 3)

Question 3A

- (i) *In what respect, if any, pleadings in the memorandum of appeals under sections 96 to 99, Order XLI, sections 100 to 103, 104 to 106, Order XLIII, Rules 1 and 2 and Appeals to Supreme Court under the Code of Civil Procedure, 1908, differ from the pleadings in appeals under Articles 132(1), 133 and 134 of the Constitution of India.* (8 marks)
- (ii) *Santosh and Swamy are the partners in a partnership firm 'Santswam'. In view*

of mounting losses in the business, they decided to wind-up the business and dissolve the said firm. They require you to provide a release deed for dissolution of the firm. Prepare the release deed. (8 marks)

Answer 3(a)

In construing the language of a Will, the Courts are entitled and bound to bear in mind other matters than merely the words used. They must consider the surrounding circumstances, the position of the testator, his family relationship, the probability that he would use words in a particular sense and many other things which are often summed up in somewhat picturesque figure. The Court is entitled to put itself into the testator's arm chair. [*Venkatanarasimha v. Parthasarthy*, 41 IA 51, 70 (PC) ; *Gnambal Ammal v. T. Raju Iyer*, AIR 1951 SC 103,106].

Answer 3(b)

No doubt, a family arrangement, which is for the benefit of the family generally, can be enforced in a court of law.

However, before the court would do so, it must be shown that there was an occasion for effecting a family arrangement and that it was acted upon. [*Lakshmi Perumallu v. Krishnavenamma*, AIR 1965 SC 825 : 1965 (1) SCR 261.]

Answer 3(c)

Later part or last words to prevail in case parts are irreconcilable or there is repugnancy.— If the several parts of the Will are absolutely irreconcilable, the part that is later has to prevail. [Section 88, Indian Succession Act, 1925; *Somasundera Mudaliar v. Ganga Bissen Soni*, 28 Mad 386].

In case of repugnancy, the last word in the Will shall prevail. [*CIT v. Indian Sugar Mills Association*, (1974) 97 ITR 486 SC].

Answer 3(d)

Supreme Court of India in *Khushall Khengar Shah v. Khorshedbanu*, AIR 1970 SC 1147, had opined Goodwill of a business as an intangible asset being the whole advantage of the reputation and connections formed with the customers together with the circumstances which make the connections durable. It is that component of the total value of the undertaking which is attributable to the ability of the concern to earn profits over a course of years because of its reputation, location and other features.

Answer 3A(i)

The Code of Civil Procedure, 1908 provides the following appeals:

Appeals from original decrees (Sections 96 to 99 and Order XLI) may be preferred from every decree passed by any Court exercising original jurisdiction to the Court authorised to hear appeals from the decisions of such Court on points of law as well as on facts. Second Appeals (Sections 100 to 103) lie to the High Court from every decree passed in appeal by any Court subordinate to the High Court, if the High Court is satisfied that the case involves a substantial question of law.

Appeals from Orders under Sections 104 to 106 would lie only on grounds of defect

or irregularity of law pertaining to (a) An Order under Section 35A of the Code allowing special costs; (b) An Order under Section 91 or Section 92 refusing leave to institute a suit; (c) An Order under Section 95 for compensation for obtaining arrest, attachment or injunction on insufficient ground; (d) An Order under the Code imposing a fine or directing the detention or arrest of any person except in execution of a decree; and (e) Appealable Orders as set out under Order XLIII, Rule 1 and Rule 2.

Constitution of India provides the following of appeals:

Article 132(1) of the Constitution provides that an appeal shall lie to the Supreme Court from any judgement, decree or final order of a High Court in the territory of India, whether in a civil, criminal or other proceedings, if the High Court certifies under Article 134A that the case involves a substantial question of law as to interpretation of the Constitution.

Article 133 deals with appeals to the Supreme Court from decisions of High Court in civil proceedings. A limited criminal appellate jurisdiction is conferred upon the Supreme Court by Article 134. It is limited in the sense that the Supreme Court has been constituted a Court of criminal appeal in exceptional cases where the demand of justice requires interference by the highest Court of the land.

Answer 3A(ii)

Deed of Release between two Partners on Dissolution of Partnership

THIS RELEASE is made on the.....:..... day of.....
BETWEEN Mr. Santosh of the first part AND Mr. Swamy of the second part.

WHEREAS the said Mr. Santosh and Mr. Swamy were carrying on in partnership the business of.....and the said business was wound up and the partnership dissolved by deed, dated.....executed by the said parties.

AND WHEREAS the winding up of the said business was entrusted to the arbitration of Mr. Soma of..... and he after realising the debts and calling in the property and assets of the said business and after paying all creditors and liquidating all the liabilities apportioned the shares of the parties, giving to the said Mr. Santosh a sum of Rs..... and to the said Mr. Swamy the sum of Rs..... .

AND WHEREAS the parties for mutual safety are desirous of executing this deed of release so that all future disputes in regard to the said partnership or the business may be set at rest.

NOW THEREFORE THIS DEED WITNESSES that in pursuance of the said mutual desire the said Mr. Santosh hereby releases the said Mr. Swamy and also that the said Mr. Swamy hereby releases the said Mr. Santosh from all sums of money, accounts, proceedings, claims and demands whatsoever which either of them at any time had or has up to the date of the said dissolution against the other, in respect of or in relation to the said partnership or the business of the said partnership.

IN WITNESS WHEREOF the said Mr. Santosh and the said Mr. Swamy have hereto at signed on the day and the year first above-mentioned.

Witnesses:

- 1.
- 2.

Mr. Santosh
Mr. Swamy

Question 4

- (a) 'B' has filed a title suit against 'A' in the court of City Civil Judge (S.D.) as a long-cause suit. Pending its hearing, 'B' executed a power of attorney in favour of 'D' and got it registered. Later on, without consulting 'D', 'B' signed a compromise deed with 'A'. 'D' challenged the compromise as it was entered into without informing him or obtaining his consent; and so it prejudiced his rights. Would 'D' succeed? Cite case law. (6 marks)
- (b) Rise Ltd. wants to engage Kapil as its managing director. The Chairman of the company wants you to prepare and submit to him a draft specimen agreement of service with Kapil as a managing director of the company. Draft the same and also mention the precautions you will take while drafting the above agreement. (10 marks)

Answer 4(a)

In the present case 'B' is principal and 'D' is attorney. D being an attorney cannot claim and independent capacity in the proceedings. When the principal B signed compromise petition, in the law it amounts to implied revocation of power of attorney in favour of D vide illustration to section 207 of the Indian Contract Act. The principal B is not bound to consult his attorney D before signing a compromise petition.

The above case is similar to the case of *Deb Ratan Biswas & Other v. Anand Moyi Devi & Other*, AIR 2011 SC page 1653 and the Hon'ble Supreme Court held that it is well settled that even after execution of a power of attorney the principal can act independently and does not have to take the consent of attorney. The attorney is after all only agent of the principal. Even after executing a power of attorney the principal can act on his own.

Answer 4(b)

While drafting a contract of appointment, the following points have to be taken care of:

- The person who is being appointed as managing director must be a director of the company; and
- He must be entrusted with substantial powers of management.

Being an agreement, such a contract must have all the other essential ingredients of a contract under the Indian Contract Act, 1872.

Specimen Agreement of Service as a Managing Director of a Company

THIS AGREEMENT is made on the..... day of..... 2015 between..... Ltd., a company incorporated under the Companies Act, 2013 and having its Registered Office at..... (hereinafter called "Company" of the one part and Mr..... son of Mr..... resident of..... (hereinafter called "the Managing Director" of the other part).

It is hereby agreed as follows:

1. The company hereby appoints under Section 203 of the Companies Act, 2013, Mr..... as Managing Director of the company for period of five years with

effect from..... and the Managing Director hereby agrees to serve the company in such capacity for a period of five years with effect from.....

2. The Managing Director shall exercise and perform such powers and duties as the Board of directors of the company shall, from time to time, determine, and subject to any directions and restrictions, from time to time, given and imposed by the Board and subject to the restrictions contained hereinafter, he shall have the general control, management and superintendence of the business of the company and to enter into contracts on behalf of the company in the ordinary course of business and to do and perform all other acts and things, which in the ordinary course of business he may consider necessary or proper or in the interest of the company.
3. Without prejudice to the generality of the powers vested in the Managing Director under the preceding clause hereof, the Managing Director shall be entitled to exercise the following powers—
 - (a) With Board's approval singly or together with other authorised officer(s) of the company, to open and operate on any banking or other account and to draw, make, accept, execute, endorse, discount, negotiate, retire, pay, satisfy and assign cheques, drafts, bills of exchange, promissory notes, hundis, interest and dividend warrants and other negotiable or transferable instruments or securities;
 - (b) Together with other authorised officer(s) of the company to borrow moneys with or without security, but not exceeding Rs. five lakhs at a time from one party;
 - (c) To incur capital expenditure up to a sum of Rs. five lakhs during any financial year;
 - (d) Together with other authorised officer(s) of the company, to invest funds of the company in approved securities (other than in shares of other companies) and on fixed deposit with the company's bankers provided that such investments in any one financial year shall not exceed Rs. twenty lakhs;
 - (e) To engage employees and other servants for the company at a basic salary not exceeding Rs. 10, 000/- per month within the budget sanctioned by the Board;
 - (f) To increase the salary or the remuneration of any employee or servant of the company whose basic salary does not exceed Rs. 5,000/- per month. General increments must be with the Board's approval;
 - (g) Together with other authorised officer(s) of the company, to enter into contracts for the purchase of goods and hiring of services for the company which contracts do not extend over a period of one year or exceed in value the sum of Rs. ten lakhs;
 - (h) To institute, prosecute, defend, oppose, appear or appeal, to compromise, refer to arbitration, abandon subject to judgment, proceed to judgment and execution or become non-suited in any legal proceedings relating to customs

or excise duties, tax on income, profits and capital and taxation generally or otherwise.

4. The Managing Director shall, throughout the said term, devote the whole of his time, attention and abilities to the business of the company, and shall obey the orders, from time to time, of the Board of Directors and in all respects conform to and comply with the directions and regulations made by the Board of Directors, and shall faithfully serve the company and use his utmost endeavour to promote the interest thereof.
5. The company shall pay to the Managing Director during the continuance of this agreement in consideration of the performance of his duties –
 - (a) a salary at the rate of Rs..... per month;
 - (b) the actual travelling expenses incurred by the Managing Director in or about the business of the company;
 - (c) the actual entertainment expenses and approved club membership fees reasonably incurred by the Managing Director in or about the business of the company;
 - (d) the actual hospital and medical expenses which have been incurred by the Managing Director for himself, his wife, dependent parents and his minor children, provided that such expenses during the three consecutive financial years shall not exceed Rs.....;
 - (e) The Managing Director shall be entitled to use the company's car, all the expenses for maintenance and running of the same including salary of the driver to be borne by the company;
 - (f) The company shall provide the Managing Director with rent free furnished accommodation and will pay electricity and water charges;
 - (g) He shall also be entitled to use the company's telephone at his residence, the charges whereof shall be borne by the company;
 - (h) The Managing Director shall be entitled to participate in any provident fund and gratuity fund or scheme for the employees which the company may establish;
 - (i) The Managing Director shall be entitled to such increments from time to time as the Board may in the discretion determine;
 - (j) The Managing Director shall be entitled to privilege annual leave on full salary for a period of one month, such leave to be taken at such time to be previously approved by the Board; Provided that the Board shall be entitled, at its sole and uncontrolled discretion, to permit the Managing Director to accumulate such leave for not more than three months; provided further that any leave not availed of by the Managing Director shall be encashable.
6. The Managing Director shall not during the period of his employment, and without the previous consent in writing of the Board, engage or interest himself either directly or indirectly in the business or affairs of any other person, firm, company,

body corporate or concern or in any undertaking or business of a nature similar to or competing with the company's business and further shall not, in any manner, whether directly or indirectly, use, apply or utilise his knowledge or experience for or in the interest of any such person, firm, company, body corporate or concern as aforesaid or any such competing undertaking or business as aforesaid.

7. The Managing Director shall not, during the continuance of his employment or any time thereafter, divulge or disclose to any person, firm, company, body corporate or concern, whatsoever or make any use whatever for his own or for whatever purpose of any confidential information or knowledge obtained by him during his employment of the business or affairs of the company or of any trade secrets or secret processes of the company and the Managing Director shall, during the continuance of his employment hereunder, also use his best endeavours to prevent any other person, firm, company, body corporate or concern from doing so.
8. Any property of the company or relating to the business of the company, including memoranda, notes, records, reports, plates, sketches, plans, or other documents which may be in the possession or under the control of the Managing Director or to which the Managing Director has at any time access, shall at the time of the termination of his employment be delivered by the Managing Director to the company or as it shall direct and the Managing Director shall not be entitled to the copyright in any such document which he hereby acknowledge to be vested in the company or its. assigns and binds himself not to retain copies of any of them.

The Managing Director shall, from time to time, during his employment hereunder, fully disclose to the company the progress of his investigation and any discoveries he may make himself or in conjunction with others and if at any time hereafter he shall make himself or in conjunction with others any improvement, invention or discovery arising out of or in connection with the said employment he shall forthwith disclose to the Company or any patent agent appointed by it a full and complete description of the nature of the said improvement, invention or discovery and the mode of performing the same.

9. The whole interest of the Managing Director in the said improvement, invention or discovery and in all future improvements thereon at any time discovered or invented by the Managing Director alone or in conjunction as aforesaid, shall be the sole and absolute property of the Company and the Managing Director, if and whenever required by the Company during the period of employment or after the termination thereof shall at the expense of the Company, join with the Company in applying for letters patent, design registration or other forms of protection in India and in such other countries as the Company may direct for the said improvement, invention or discovery or any such improvement thereon and shall, on the request by, and at the expense of the Company, execute, sign and do all applications, assignments, instruments and things necessary to vest the whole of his interest in the said improvements, invention or discovery or improvement thereon and any letters patent or other protection that may be obtained in respect thereof, in the Company or person or persons appointed by it.
10. If the Managing Director shall at any time be prevented by ill-health or accident

from performing his duties hereunder, he shall inform the Company and if he shall be unable by reason of ill-health or accident for a period of sixty days in any period of twelve consecutive calendar months to perform his duties hereunder, the Company may terminate his employment.

11. The Company shall be entitled to terminate this agreement in the event of the Managing Director being guilty of misconduct or such inattention to or negligence in the discharge of his duties or in the conduct of the Company's business or of any other act of omission or commission inconsistent with his duties as the Managing Director or any breach of his agreement.
12. If before the expiration of this agreement the tenure of office of the Managing Director shall be determined by reason of a reconstruction or amalgamation whether by the winding up of the Company or otherwise, the Managing Director shall have no claim against the Company for damages.
13. The Company shall be at liberty from time to time to appoint a person or persons to be Managing Director(s) jointly with the Managing Director.

The Managing Director hereby agrees that he will not, at any time, after the termination of this agreement, represent himself as being in any way connected with or interested in the business of the company.

IN WITNESS WHEREOF the parties hereto have set their hands the day, month and the year first above written.

Witnesses:

for and on behalf of the company

1.

2.

Managing Director

Question 5

- (a) *Ankush leased out his plot no. 111 in village Pilakhua, to Dinesh for three years from 1st June, 2012 for carrying out only nursery business therefrom. The plot has several Sheesham trees. A lease deed was signed by both the parties and registered as required by law. Dinesh has been doing nursery business but with effect from 1st October, 2014, he started digging earth from said plot for using it in his adjoining brick-kiln. A notice dated 5th October, 2014 served on him by Registered AD post asking him to stop digging earth from said plot, was ignored by Dinesh, the lessee. The plot continues to be damaged in this manner. It causes irreparable damage thus.*

Ankush intends to institute an injunction-cum-damages suit in a court of competent jurisdiction praying for restraining Dinesh from digging earth from said plot and damages pendente lite. Interests and costs are also to be claimed. Assuming supplementary data, draft a specimen plaint. (8 marks)

- (b) *State in brief the law regarding promoters' contract. Draft a specimen promoters' contract for the purchase of an industrial plot for setting-up an industrial unit of the proposed company PMQ Ltd. (8 marks)*

Answer 5(a)**In the Court of Civil Judge at****Original suit no.of**

Ankush s/o aged r/o Plaintiff

Versus

Dinesh s/o aged r/o Defendant

The above named plaintiff states as follows:

1. The plaintiff let plot no. 111 in villageto the defendant by a deed of lease, dated 01st June, 2012 for the purpose of a nursery for 3 years and the defendant agreed by the said deed of lease not to use the land for any other purpose.
2. The defendant has since 01st October, 2014 commenced to dig earth from the said plot for the purpose of his adjoining brick kiln.
3. The removal of earth from the land would make it unfit for cultivation for several years and would even otherwise reduce its quality and value and compensation in money would not afford adequate relief to the plaintiff.
4. The defendant threatens and intends unless restrained from so doing to continue to dig earth from the said plot.
5. That the said land is within the jurisdiction of this Hon'ble court hence this court has each and every jurisdiction to try and entertain this suit.
6. That the value of the suit for the purposes of jurisdiction has been fixed for Rs. ... and for the purposes of declaration and correct and authorized court fee stamp of Rs. __ has been affixed on the plaint.
7. That no suit has been instituted against the defendants on the same or similar cause of action in any other court.
8. It is, therefore, most respectfully prayed that a decree for Injunction restraining the defendant from digging the land over the suit plot comprising in Khata Khatauni No. _____, Khasara No. _____ measuring _____ Biswas situated in _____ which is against the Municipal Corporation Act and Bye-Laws and Town & Country Planning Act and Rules and also directing the defendant to remove illegal and unauthorized construction over the suit land owned and possessed by the plaintiff and also directing the defendants with costs of the suit. Such other reliefs as deemed fit and proper in the facts and circumstances of the case may also be passed in favour of the plaintiff and against the defendants in the interest of justice.

AND FOR THIS ACT OF KINDNESS, THE HUMBLE PLAINTIFF AS IN DUTY BOUND SHALL EVER PRAY.

The Plaintiff claims a perpetual injunction restraining the defendant his servants or

agents from digging earth from any portion of the said plot no. 111 and claims damages with interest and cost in the suit.

Place.....

Date

Plaintiff
Through
(Advocate)

Verification

I Ankush, plaintiff in above suit do hereby solemnly verified that the contents of above plaints in Para 1 to 5 are true to my knowledge and belief. Nothing material has been concealed.

Verified at Pilakhua this the _____.

Plaintiff

Answer 5(b)

Companies Act, 2013 does not contain any provisions about Promoter’s Contract. The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated; such contracts are called preliminary or pre-incorporation contracts. The promoters generally enter into such contracts as agents for the company about to be formed. When the company comes into existence, it is not bound by the pre-incorporation contracts even when it takes the benefit of the work done on its behalf. However, specific performance of a contract between a third party and the promoters may be successfully claimed by the third party against the company, when the company enters into possession of the property on the faith of the promoters’ contract.

A Specimen of Promoters’ Contract for the Purchase of an Industrial Plot for setting up Industrial Unit of the Proposed Company PMQ Ltd.

THE AGREEMENT made on..... day of.....between Mr. P, son of Mr.....resident of....., Mr. M, son of Mr.....resident of.....and Mr. Q, son of Mr....., resident of.....’(hereinafter referred to as “promoters”) of the one part which expression shall, unless repugnant to the context include their heirs, legal representatives and assigns and Mr. “V” son of Mr.....resident..... (hereinafter referred as “Vendor”) of the other part, which expression shall, unless repugnant to the context, include his heirs, legal representatives and assigns.

WHEREAS the promoters have been engaged for quite sometime in the past in promoting and forming a company to be known as PMQ Ltd., which name has been made available to the promoters by the Registrar of Companies....., consequent upon which they have filed with the Registrar memorandum of association and articles of association for registration of the company;

AND WHEREAS the memorandum and articles of association of the proposed PMQ

Ltd., empower the company and its directors to enter into agreements on its incorporation on the lines of the agreement entered into by the promoters for the purchase of land, plant, machinery, equipment and for hiring the services of persons required for and in connection with the formation and incorporation of the company;

AND WHEREAS the Vendor is the absolute owner of industrial plot of land measuring..... And situated at..... and is desirous of selling the same;

AND WHEREAS the promoters and desirous to buy the said plot of land for the proposed company PMQ Ltd. to set up an industrial unit on its incorporation.

NOW IT IS AGREED AND DECLARED BETWEEN AND BY THE PARTIES AS FOLLOWS:

That the said vendor shall sell and the promoters shall purchase the industrial Plot No.....Situated in the.....Industrial Area,bounded on North by....., on South by....., on East by....., and on West by..... in consideration of the payment, by the promoters on the date of this agreement, of the sum of Rs..... and the balance of Rs..... on the date of the appearance of the vendor and the promoters before the Sub- Registrar..... at the time of registration of the deed of sale to this agreement.

2. The vendor shall satisfy the promoters or PMQ Ltd., if incorporated by then, about the title of the vendor to the aforesaid piece of land within one month of the execution of this agreement.
3. The parties shall bear the expenses of sale equally. The purchaser shall pay to the vendor the expenses for purchase of stamp, a fortnight before the expiry of the period fixed for this agreement for completion of the sale and the promoters shall also at the same time deliver to the vendor a draft of the deed of sale.
4. The vendor shall deliver actual possession of the plot of land to the promoters or the company on the date of payment of the balance of the price aforementioned and shall do all other acts that may be necessary or requisite to effectually put the promoters or PMQ Ltd., as the case may be, in such possession.

IN WITNESS WHEREOF the parties aforementioned have signed this deed of acceptance of the terms thereof.

- | | |
|------------|---|
| 1. Witness | Vendor |
| 2. Witness | Purchasers/Promoters of the Company
PMQ Limited, under incorporation.
P
M
Q
(Schedule of Land) |

Question 6

(a) What are e-contracts ? Discuss important points with regard to drafting of e-contract. (8 marks)

(b) The complainant and the accused in a criminal case arrived at a settlement of

an offence which was not compoundable under the provisions of the Code of Criminal Procedure, 1973.

Answer the following questions citing relevant case laws —

- (i) *Whether the court can allow compounding of this offence in the interests of justice to both the parties ?*
- (ii) *What is the actual relevancy of such settlement ?* (4 marks each)

Answer 6(a)

E-contract is any kind of contract formed in the course of e-commerce by the interaction of two or more individuals using electronic means such as email, the interaction of any individual with an electronic agent such as computer programme or it is an interaction of at least two electronic agents that are programmed to recognize the existence of a contract. Traditional contract principles and remedies also apply to e-contracts. Electronic contracts are born out of the need for speed, convenience and efficiency.

Important points with regards to drafting e-contracts are as under:

1. The contract must specify that by using the Seller's website, the customer becomes subject to the terms of a legal agreement between the customer and Seller. Customers must be informed that they must be of legal age to enter into the contract.
2. Acceptance of the terms of the contract.
3. The contract should clearly state that all content included on the website, such as text, graphics, logos, button icons, images, audio clips, digital downloads, data compilations, and software, is the property of Seller.
4. The contract should clearly lay down the duties and obligations of the customer.
5. The contract must forbid the customer from the copying, modifying, in respect of the said software.
6. The contract should clearly mention that the reviews, comments, photos etc posted by customers should not be illegal, obscene, threatening, defamatory, invasive of privacy, infringing of intellectual property rights, or otherwise injurious to third parties.
7. The contract should clarify how the prices listed on the Seller's website are computed.
8. Seller's has a shipping contract with various courier companies to deliver the products to the customers. The contract should clearly state that once the products are handed over to the courier company, Seller's liability ends.
9. The contract should mention the city / state and country whose law will prevail in this contract. The courts having exclusive jurisdiction over the disputes should also be mentioned. Conditions relating to arbitration of disputes may also be mentioned.
10. The contract must clearly mention that the customer expressly understands

and agrees that his use of the services is at his sole risk and that the services are provided “as is” and “as available”.

11. The contract must expressly disclaim all warranties and conditions if any.

Answer 6(b)(i)

The Court cannot allow compounding an offence which is not compoundable. The Supreme Court made it clear that the Court has in a long line of decisions ruled that offence which are not compoundable under section 320 of the Cr.P.C. cannot be allowed to be compounded even if there is any settlement between the complainant on one hand and the accused on the other [*Ramlal & Anr v. State of J & K* (199) 2 SCC 213. *Ishwer Singh v. State of M.P.*, AIR 2012 SC 888]

Answer 6(b)(ii)

The settlement arrived at between the parties can be taken into consideration for the purpose of determining the quantum of sentence to be awarded to the accused. Thus the settlement is relevant for determining the quantum of sentence. (*Gulab Das v. State of M.P.*, AIR 2012 SC 888).

BANKING LAW AND PRACTICE
(Elective Paper 9.1)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

Following are the balance sheets and statements of profit and loss of XYZ Ltd. for the years ended 31st March, 2012 to 31st March, 2014 :

Balance sheets of XYZ Ltd. as at

Liabilities	31st March, 2014 (₹ in million)	31st March, 2013 (₹ in million)	31st March, 2012 (₹ in million)
Share capital	1,880.20	1,878.80	1,879.30
Reserves and surplus	58,282.00	47,398.50	39,647.80
Net worth	60,162.20	49,277.30	41,527.10
Secured loans	5,500.00	4,500.00	2,660.30
Unsecured loans	169.20	320.30	403.80
Total liabilities	<u>65,831.40</u>	<u>54,097.60</u>	<u>44,591.20</u>
Assets			
Gross block	68,262.70	58,356.70	54,640.70
(-) Acc. depreciation	26,679.80	23,659.70	21,493.50
Net block	41,582.90	34,697.00	33,147.20
Capital work in progress	21,562.10	16,028.60	6,491.90
Investments	14,756.40	6,790.80	8,448.10
Inventories	7,789.80	7,932.70	7,308.60
Trade receivables	2,037.00	3,101.70	2,892.90
Cash and bank	7,463.80	9,842.40	7,434.80
Loans and advances	7,145.50	7,797.60	5,443.10
Total current assets	24,436.10	28,674.40	23,079.40
Current liabilities	25,587.30	22,453.90	19,912.70
Provisions	10,918.80	9,639.30	6,662.70
Total current liabilities	36,506.10	32,093.20	26,575.40
Net current assets	(-)12,070.00	(-)3,418.80	(-)3,496.00
Total assets	<u>65,831.40</u>	<u>54,097.60</u>	<u>44,591.20</u>

Statements of profit and loss of XYZ Ltd. for the year ended

<i>Liabilities</i>	<i>31st March, 2014</i> <i>(₹ in million)</i>	<i>31st March, 2013</i> <i>(₹ in million)</i>	<i>31st March, 2012</i> <i>(₹ in million)</i>
<i>Sales</i>	80,215.90	72,299.70	68,947.90
<i>Other income</i>	1,361.70	2,115.90	1,422.40
<i>Total income</i>	81,577.60	74,415.60	70,370.30
<i>Raw material cost</i>	12,046.80	11,801.50	18,367.20
<i>Excise</i>	7,815.80	10,702.10	9,703.20
<i>Other expenses</i>	34,722.20	31,963.30	21,463.20
<i>Operating profit</i>	25,631.10	17,832.80	19,414.30
<i>Interest</i>	843.00	399.60	738.70
<i>Gross profit</i>	24,788.10	17,433.20	18,675.60
<i>Depreciation</i>	3,420.90	2,941.80	3,069.80
<i>Profit before tax</i>	22,728.90	16,607.30	17,028.20
<i>Tax</i>	6,889.30	5,246.00	4,917.00
<i>Net profit</i>	15,839.60	11,361.30	12,111.20
<i>Other non-recurring income</i>	227.70	766.40	2,269.50
<i>Reported profit</i>	16,067.30	12,127.70	14,380.70
<i>Equity dividend</i>	4,317.60	3,753.30	3,750.20

You are required to —

- (a) *Prepare summary of the balance sheet and profit and loss account for the years ended 31st March, 2012 to 31st March, 2014. (15 marks)*
- (b) *Compute the balance sheet and profit and loss ratios for the years 2012 to 2014 which the bank would ask XYZ Ltd. to submit for financial appraisal of the company. (15 marks)*
- (c) *Comment on the ratios as computed above. (10 marks)*
- (d) *Compute working capital requirement for the years 2012 to 2014. (10 marks)*

Answer 1(a)

Summary of Balance Sheet of XYZ Ltd.

(Rs. in millions)

<i>Particulars</i>	<i>As on</i> <i>31.03.2012</i>	<i>As on</i> <i>31.03.2013</i>	<i>As on</i> <i>31.3.2014</i>	<i>Remarks</i>
<i>Net Worth</i>	41,527.10	49,277.30	60,162.20	<i>Substantial increase in Net worth, primarily due to increase in reserve and surplus. Shows a good sign as the profit has been ploughed back in the business.</i>

<i>Particulars</i>	<i>As on 31.03.2012</i>	<i>As on 31.03.2013</i>	<i>As on 31.3.2014</i>	<i>Remarks</i>
Current Assets	23,079.40	28,674.40	24,436.10	Marginal increase in current asset in 2014 in comparison to 2012, but decrease in comparison to 2013.
Total Current Liabilities	26,575.40	32,093.20	36,506.10	Current liabilities and provisions have increased.
Working capital	-3,496	-3,418.8	-12,070	The working capital remained negative throughout the period. Increase in current liabilities was more than the increase in current asset, leading to further decline in working capital.
Long term Liabilities (unsecured + secured loan)	3,064.10	4,820.3	5,669.2	There is an overall increase in total long term liabilities; secured debts have been raised during the period and long term unsecured debts have been paid off during the period.

Summary of Profit & Loss statement of XYZ Ltd.

(Rs in millions)

<i>Particulars</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>	<i>Remarks</i>
Sales Revenue*	59,244.7	61,597.6	72,400.1	Revenue from sales has increased. This shows a steady progress in performance.
Raw Material Cost	18,367.20	11,801.50	12,046.80	The cost of raw material has decreased. Shows a satisfactory inventory management and cost control.

* Sales Revenue has been taken as (Sales-Excise), this is as per revised Schedule VI

<i>Particulars</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>	<i>Remarks</i>
Operating Profit	19,414.30	17,832.80	25,631.10	Due to increase in sales revenue and decrease in the cost of raw materials, operating profit has increased.
Profit Before Tax (PBT)	17,028.20	16,607.30	22,728.90	PBT has increased, primarily due to increase in sales revenue and decrease in cost of raw material.
Net profit	12,111.20	11,361.30	15,839.60	Net profit has increased.

Answer 1(b)

The Computation of the Balance Sheet and Profit and Loss related Ratios along with comments on the same (mentioned in Remarks column) is as under:

Ratio analysis for 2014**Balance Sheet Ratios**

<i>S.No.</i>	<i>Ratios</i>	<i>Particulars (Rs. in millions)</i>	<i>Values</i>
01.	Current Ratio = Current Assets / Current Liabilities	Current Assets = 24,436.10 Current Liabilities = 36,506.10	0.67
02.	Acid test or Quick ratio = Quick Assets/ Current Liabilities (Quick Asset = Trade receivable+ cash & bank + loans & advance)	Quick Assets = 16,646.3 Current Liabilities = 36,506.10	0.46
03.	Debt-Equity Ratio = Long term debt /Shareholders Equity	Long Term debt = 5,669.2 Shareholder Equity = 60,162.20	0.0942

Profit & Loss Statement Ratios

<i>S.No.</i>	<i>Ratios</i>	<i>Particulars (Rs. in millions)</i>	<i>Values</i>
01	Gross Profit margin = Gross Profit X 100/ Sales	Gross Profit = 24,788.10 Sales = 72,400.1	34.24%
02	Net Profit margin = Net Profit X 100 /Sales (Reported profit has been taken to calculate this ratio*)	Net Profit = 16,067.30 Sales = 72,400.1	22.19%
03	Return on Equity = Profit after tax X 100/Net Worth	Net profit =16,067.30 Net worth =60,162.20	26.71%
04	Return on Investments = Profit before Tax X100/Net Worth	Profit Before Tax = 22,728.90 Net Worth = 60,162.20	37.7 8%

S.No.	Ratios	Particulars (Rs. in millions)	Values
05	Interest coverage Ratio = Operating profit / Interest	Operating profit = 25,631.10 Interest = 843.00	30.40 times
06	Cost of Goods Sold Ratio = Cost of Goods Sold/Sales (Excise has not been added in COGS*)	Cost of goods sold = 12,046.80 Sales = 72,400.1	0.17
07	Operating profit margin = Operating profit X100/sales	Operating profit= 25,631.10 Sales= 72,400.1	35.40%

Note :

*Other non-recurring income is taken into account to arrive at actual Net Profit.

* Only raw material cost has been included in the COGS.

* Sales Revenue has been taken as (Sales-Excise), this is as per revised Schedule VI.

Ratio analysis for 2013**Balance Sheet Ratios**

S.No.	Ratios	Particulars (Rs. in millions)	Values
01.	Current Ratio = Current Assets / Current Liabilities	Current Assets =28,674.40 Current Liabilities =32,093.20	0.89
02.	Acid test or Quick ratio = Quick Assets/ Current Liabilities	Quick Assets = 20,741.70 Current Liabilities = 32,093.20	0.65
03.	Debt-Equity Ratio = Long term debt/ Shareholders Equity	Total debt = 4,820.30 Shareholder Equity = 49,277.30	0.0978

Profit and Loss Ratios

S.No.	Ratios	Particulars (Rs. in millions)	Values
01	Gross Profit margin = Gross Profit X 100/ Sales	Gross Profit = 17,433.20 Sales = 61,597.6	28.30%
02	Net Profit margin = Net Profit X 100 /Sales	Net Profit = 12,127.70 Sales = 61,597.6	19.69%
03	Return on Equity = Profit after tax X 100/ Net worth	Profit after tax = 12,127.70 Net worth= 49,277.30	24.61%
04	Interest coverage = Operating profit / Interest	Operating profit = 17,832.80 Interest = 399.60	44.63 times
05	Operating profit margin = Operating profit X 100/Sales	Operating Profit = 17,832.80 Sales = 61,597.6	28.96%

S.No.	Ratios	Particulars (Rs. in millions)	Values
06	Cost of Goods Sold Ratio = Cost of Goods Sold/ Sales	Cost of goods sold = 11,801.50 Sales =61,597.6	0.19
07	Return on Investments = Net Profit before Tax X 100/ Net worth	Profit Before Tax = 16,607.30 Net Worth = 49,277.30	33.70%

Note :

* Other non-recurring income is taken into account to arrive at actual Net Profit

* Only raw material cost has been included in the COGS.

* Sales Revenue has been taken as (Sales-Excise), this is as per revised Schedule VI

Ratio analysis for 2012**Balance Sheet Ratios**

S.No.	Ratios	Particulars (Rs. in millions)	Values
01.	Current Ratio = Current Assets/ Current Liabilities	Current Assets = 23,079.40 Current Liabilities =26575.40	0.87
02.	Acid test or Quick Ratio = Quick Assets/ Current Liabilities	Quick Assets = 15,770.8 Current Liabilities = 26,575.40	0.59
03.	Debt-Equity Ratio = Long term debt/ Shareholders Equity	Total debt = 3,064.1 Shareholder Equity =41,527.10	0.07

Profit and Loss Ratios

S. No.	Ratios	Particulars (Rs in millions)	Values
01.	Gross Profit margin = Gross Profit X 100 /Sales	Gross Profit = 18,675.60 Sales = 59,244.7	31.52%
02.	Net Profit margin = Net Profit X 100/ Sales	Net Profit = 14,380.70 Sales =59,244.7	24.27%
03.	Return on Equity = Profit after tax x 100 / Net worth	Profit after tax =14,380.70 Net worth = 41,527.10	34.63%
04.	Interest Coverage = Operating Profit/ Interest	Operating Profit =19,414.30 Interest= 738.70	26.28 times
05.	Operating profit margin = Operating profit X 100/ Sales	Operating Profit = 19,414.30 Sales =59,244.7	32.77%
06.	Goods Sold Ratio = Cost of Goods Sold / Sales	Cost of goods sold = 18,367.20 Sales = 59,244.7	0.31
07.	Return on Investments = Profit before Tax X 100/ Net Worth	Profit Before Tax = 17,028.20 Net Worth = 41,527.10	41.0%

Note:

* Other non-recurring income is taken into account to arrive at actual Net Profit.

* Only raw material cost has been included in the COGS.

* Sales Revenue has been taken as (Sales-Excise), this is as per revised Schedule VI.

Answer 1(c)

The Analysis of the Balance Sheet and Profit and loss Ratios along with comments on the same (mentioned in Remarks column) is as under:

Balance Sheet Ratios

S. No.	Ratios	2012	2013	2014	Overall
01.	Net Working Capital	Negative working capital	Working capital remained negative however, position was better than previous year.	Working capital has further reduced.	The working capital remained negative throughout the period. Thus, poor liquidity.
02.	Current Ratio	Ratio is 8.7, which is not a good indicator	The ratio has increased slightly, however, it remains below 1.	Lowest current ratio over the 3 years and is a poor indicator.	The ratio remained below 1, indicating difficulty in company's ability to meet short term debt obligation.
03.	Acid test or Quick ratio	The ratio is 0.59 which is not a good indicator of company's liquidity	The ratio has slightly improved over last year, but remains less than acceptable value.	Less than 0.5, showing inability of the company to meet its short-term obligations using its most liquid assets.	Normal value: no less than 1. However, in all the years the value remained less than 1.
04.	Debt-Equity Ratio	Ratio is 0.07, showing company is not having proper capital structure	Ratio has slightly improved, debts are nominal and shows Company has only 10% debt, the company should borrow more long term debts.	Fallen over the previous year. Company is not taking leverage of its borrowing capital.	Acceptable value is not more than 1.5 and optimum value is 0.43-1. The value remained less than 0.43 indicating under utilization of long term borrowing capacity.

Profit and Loss Ratios

S. No.	Ratios	2012	2013	2014	Overall
05.	Gross Profit margin	The Gross profit margin is 27.08%, it is acceptable.	It has fallen by 3% over the previous year.	It has improved by approx 6% over last year.	Overall, it is acceptable
06.	Net Profit margin	It remains above 20%, which is satisfactory.	The margin has reduced below 20% which is not a good sign.	It has increased over the last year. However, still lower than the year 2012.	It has shrunk slightly over the period.

07.	Return on Equity	The percentage of return on equity is 34.63% and is satisfactory.	The position has deteriorated over the previous year.	The position has slightly improved over the last year.	The return on equity on the overall is satisfactory.
08.	Return on Investments	41% is a satisfactory return on investment.	It has declined over the previous year due to decline in PBT and increase in net worth, however the position is still safe.	It has improved over previous year and shows company is trying to revive.	The overall position is satisfactory. However, position in 2012 was better than that in the successive years.
09.	Return on Net Worth	It is more than 30% and satisfactory.	It has fallen considerably and is not a good sign.	It has slightly improved over last year however, position is not satisfactory.	It was satisfactory in 2012, but not in 2013 or 2014. The decrease was due to increase in net worth which was not in proportion to profit.
10.	Interest Coverage	The coverage ratio is quite satisfactory.	The situation is better than previous year.	Though the situation has deteriorated over the last year, it is better than 2012.	The overall position is satisfactory.
11.	Operating profit margin	The ratio is satisfactory.	The position has deteriorated over the last year.	Satisfactory, as it improved over 2012 and 2013.	The position is quite satisfactory.
12.	Cost of Goods Sold	It is satisfactory. (COGS) Ratio.	It remains satisfactory.	It is still satisfactory.	The analysis shows that COGS is lowest in 2014.

Answer 1(d)*(Rupees in millions)***Computation of Working Capital Requirements**

<i>Particulars</i>	<i>Amount for 2012</i>	<i>Amount for 2013</i>	<i>Amount for 2014</i>
Total Current Assets	23,079.40	28,674.40	24,436.10
Current Liabilities	(19,912.70)	(22,453.90)	(24,587.30)
Working Capital Gap	3,166.70	6,220.50	-151.2
Working Capital Requirement	3,166.70	6,220.50	Nil

Note:

For the purpose of calculation of working capital requirements, provisions have not been included in the current liabilities.

Question 2

- (a) (i) *Is it compulsory to open the account in banks with initial deposit as cash only? Examine.*
- (ii) *Why the banks try to cover themselves for different transactions in different manner under the garb of different relationship?*
- (iii) *Banks freely negotiate cheques drawn by public i.e., individuals, firms, companies, etc. and not negotiate cheques issued by Government departments. Explain.*
- (iv) *Can an instrument be endorsed for the partial amount? Explain.*
- (v) *Why margins are maintained by the bank? (4 marks each)*
- (b) *Disaster recovery management plan (DRMP) and business continuity plan (BCP) are two important areas to mitigate the information technology risks in the banks. Explain. (10 marks)*

Answer 2(a)(i)

Customers offer initial deposit in cash and fulfill certain relative formalities which complete the relationship for opening the account in banks. Generally, banks require customers to deposit an initial amount in the bank. Legally it is not compulsory to open the account with cash only; the initial entry may be by collecting instrument payable to the customer. As per practice, the banks open the account by reflecting cash entry in the account. Further, certain banks allow opening of bank accounts without any minimum deposit. Example, there is no requirement for any initial deposit for opening a Basic Savings Bank Deposit Account under Pradhan Mantri Jan Dhan Yojana.

Answer 2(a)(ii)

Banks offer their services as debtor / creditor / licensor / bailee / trustee etc. These relationships are based on different enactments and mandates for different purposes and the intentions of the constituents. Thus, different transactions establish different relationships with its customers. This means that the relationship with the bank is based upon nature of transactions. Further, these also provide bankers with the protection under various enactments.

Answer 2(a)(iii)

The cheques issued by public are negotiable instruments as per Negotiable Instrument Act, 1881, whereas the cheques issued by the Government Departments are not covered under Negotiable Instrument Act, 1881. Thus, negotiability of private cheques by the banks covers the bank's rights to claim the amount from the drawer or endorsers as holders for value which is not in the case of the cheques issued by the Government Departments.

Answer 2(a)(iv)

As per the provision of Section 56 of the Negotiable Instruments Act, 1881, no writing

on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument. Thus, the instrument is to be endorsed for the full amount and it cannot be endorsed for the partial amount.

Answer 2(a)(v)

A banker always keeps adequate margin because of the following reasons:

- (a) The market value of the securities is liable to fluctuations in future with the result that the banker's secured loans may turn into partly secured ones.
- (b) The liability of the borrower towards the banker increases gradually as interest accrues and other charges become payable by him.

Hence, margins acts as a safety net which banker keeps cover the present debt and the future additions to them

Answer 2(b)

Disaster Recovery Management Plan (DRMP) : In a fully computerized bank branch, DRMP has acquired high importance. DRMP deals with the emergency action which the branch will take to deal with a situation of disaster. It covers three steps of action when a disaster strikes, viz.

- (a) Confronting the disaster by a Emergency Plan.
- (b) Procurement of required materials through a Back Up Plan; and
- (c) To restore the office normalcy for speeding up commencement of normal business transactions.

When a disaster strikes, the three teams goes into action. All information is made available in the Plan, i.e., persons who would be involved in confronting the disaster, their duties and areas of responsibilities. Information like Telephone / Cell Number, Address of Hardware / Software Personnel, Electrician etc., are also kept handy to facilitate contact in an emergency. Rigorous Training is provided to the team, including mock drills or simulated attacks to test DRMP drawn up by Bank Branches.

Business Continuity Plan (BCP) : Business Continuity Plan relates to resuming, maintaining and recovering business activity in the event of disruptions, disasters and calamities. The plan should accomplish the following objectives:

- (a) Provide for the safety and well-being of people on the premises at the time of disaster
- (b) Continue critical business operations
- (c) Minimize the duration of a serious disruption to operations and resources (both information processing and other resources)
- (d) Minimize immediate damage and losses
- (e) Establish management succession and emergency powers
- (f) Facilitate effective co-ordination of recovery tasks
- (g) Reduce the complexity of the recovery efforts

- (h) Identify critical lines of business and supporting functions

Information Technology, which drives the markets, should be given importance in managing the risks, especially the operational risks. The quality of software, hardware and the up gradation of IT support systems are very crucial for ensuring quick and correct transfer of financial transactions and funds across the international markets. Disaster Recovery Management Plan and Business Continuity Plan are two significant areas to handle risk and to ensure that better controls are exercised.

Question 3

Answer the following questions in brief :

- (a) What is 'net worth' and explain its significance ?
- (b) Illustrate the concept of 'window dressing' with a suitable example.
- (c) State any two exclusive rights of bankers.
- (d) State the types of letter of credit.
- (e) Name any four ratios that the management of every firm is interested in along with their significance ? (1 mark each)

Answer 3(a)

'Net Worth' represents the amount that belongs to the owners of the firm. In true sense, equity shareholders are the real owners of the firm. Paid up share capital, general reserves, capital reserves, share premium and balance lying in Profit and Loss Account, totally, constitute net worth. Preference share capital amount is also included in net worth. It also provides a cushion available to the outside creditors of the firm.

Answer 3(b)

'Window Dressing' is a situation of presenting a rosy picture instead of the real one. Such a situation is created, intentionally by manipulating the financial statements at the end of the year. For example, some firms try to present a higher current ratio than the actual to create better liquidity impression of the organization.

Answer 3(c)

1. *Right of Appropriation* : Under section 59 to 61 of the Indian Contract Act, 1872 the banker is given the rights of appropriation. Thus, if a customer has multiple loans and Deposit accounts and the customer deposits some funds without intimating the account where the money is deposited, the banker can on its own decides the account in which the said funds are to be credited.
2. *Right of General Lien* : Banker is also given a right of general lien. Under the general lien, the banker can unless there is a contract to the contrary, retain the goods/securities till all the debts granted to the customer are paid off.

Answer 3(d)

Types of Letters of Credit

1. Revocable and Irrevocable letter of Credit

2. Confirmed letter of Credit
3. Back to Back letter of Credits
4. Transferable letter of Credit
5. Revolving Letter of Credit
6. Sight letter of Credit
7. Time letter of Credit/ usance letter of credit.

Answer 3(e)

Every management is interested to maintain sufficient liquidity and utmost profitability of the firm, they manage. The ratios in which management is more interested are:

- Current ratio shows the liquidity strength of the firm.
- Net Profit Ratio gives the net profit margin of the firm that can be compared with the industry about its competitors. It is one of the important indicators of management's efficiency.
- Return on Equity ratio shows the earning capacity of proprietors' fund.
- Debt to Equity ratio is the key financial ratio and is used to assess the long – term financial solvency of a firm.

Question 4

Define 'customer' with special reference to banking and KYC policy/norms.

(5 marks)

Answer 4

Ordinarily, a person who has an account in a bank is considered as customer. The *Kerala High Court* observed in the case of *Central Bank of India Vs Gopinathan Nair and others* (AIR, 1979, Kerala (74)) "Broadly speaking, a customer is a person who has the habit of resorting to the same place or person to do business. So far as banking transactions are concerned, he is a person whose money has been accepted on the footing that banker will honor up to the amount standing to his credit, irrespective of his connection being of short or long standing."

For the purpose of K Y C policy /norms, a Customer is defined as:

- (1) A person or entity that maintains an account and/or has a business relationship with the bank
- (2) One on whose behalf the account is maintained (i e. The beneficial owner)
- (3) Beneficiaries of transactions conducted by professional intermediaries, such as stock brokers, Chartered Accountants, Solicitors etc.as permitted under the law and
- (4) Any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say a wire transfer or issue of a high value demand draft as a single transaction.

Question 5

Dhan Bank Ltd. erroneously credits the account of a customer. Explain the legal position in the following situations :

- (a) *The bank has to recover the said amount if the said customer has withdrawn the same.*
- (b) *The liability of the banker, if the customer has issued a cheque based on the entry and balance in the account.* (5 marks)

Answer 5

Facts of the Case : Dhan Bank Ltd. erroneously credits the amount to a Customer's account.

Related provisions : The fact that an entry is made in the account and is reflected in the passbook or statement does not give the right to the customer to the money reflected in the pass book or statement. In case the customer uses the amount wrongly credited, he will not get any title to the amount wrongly credited and is under the obligation to return the same. Similarly, if the banker wrongly debits any amount to the customer's account, the bank is under an obligation to rectify the error by crediting the amount to the customer's account. Thus, the banker has a right to reverse the incorrect debit/credit entry without recourse to the client. Considering the above:

- (a) If the customer has withdrawn the said amount, before reversal by the banker the banker can still reverse the same. Further, if the customer has insufficient balance in his account, the account will show a debit balance and the said debit balance would be treated as an unsecured advance (similar to a unsecured personal loan) to the customer and the banker could also file suit to recover the said advance.
- (b) In case a cheque is presented to the banker for payment, the banker has full right to return the said cheque. The customer whose account was wrongly credited and whose cheque was returned would have no recourse against the banker. The said customer cannot claim damages for the return of the cheque even if he proves that he has acted in good faith relying on the credit of the amount and balance reflected in the passbook or statement.

Question 6

Discuss the implication of the Limitation Act, 1963 on the rights of bankers and remedy available to a banker when limitation sets in. (5 marks)

Answer 6

The Limitation Act was enacted in 1963 with the intention of protecting borrowers and preventing lenders from misusing their position and acquiring assets of the borrower after a very long period of silence.

The Act specifies that if debt is not acknowledged within a time prescribed under the Act, it gets time barred. The provisions of the Limitation Act are also applicable to the Banking transactions and thus, the Banker has to ensure that the documents remain valid and are not time Barred. The limitation period for different type of documents as prescribed under Limitation Act are given under:

<i>S.No</i>	<i>Type of Document</i>	<i>Limitation Period</i>
1	Demand promissory Note	3 years from the date of the note
2	Bill of exchange payable at site or on presentation	3 Years from the date of presentation
3	Usance Bill of exchange	3 years from the due date
4	Clean loans	3 years from the date of the loan
5	Guarantee	3 Years from the date of invocation of the guarantee
6	Mortgage-Payment	12 years from the date the money sued becomes due
7	Mortgage -foreclosure	12 Years from the money secured by the mortgage becomes due
8	Mortgage-Possession of immoveable property	30 Years when the mortgagee becomes entitled for possession
9	Letter of credit	3 years from the date of payment of the amount of bills under the letter of credit

From the above, it is clear that the banker should recover the due amount within the limitation period. In case, they are unable to do so they should file a suit for recovery within the period. Banks are expected to hold valid legal documents as per the provisions of the Limitation Act. If the limitation period expires, then the bank should arrange to obtain fresh set of documents. A limitation period can be extended in the following manners.

- (a) Acknowledgement of debt
- (b) Part payment
- (c) Fresh set of documents

CAPITAL, COMMODITY AND MONEY MARKET
(Elective Paper 9.2)

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer **ALL** Questions.

Question 1

Fifteen weeks ago, Quick Ltd. listed 200 lakh equity shares of ₹10 each on Bombay Stock Exchange which is regulated by SEBI. The stock prices are stable in the range of ₹66 to ₹85 per share. Soon after listing, it was in need of additional funds for a new project which was not envisaged at the time of IPO and it was advised that the quickest way to raise funds at a short notice is the preferential issue route. Accordingly, the shareholders passed a resolution on 30th January, 2014 to allot 30 lakh equity shares at a price of ₹66 each to the following investors :

	No. of Shares
Michael Jackson	5 lakh
New York Investment LLP (FII)	10 lakh
India Asset Management Co. Ltd. (Indian MF)	10 lakh
Rohan-Sohan Works Ltd.	2 lakh
In & Out Share Trading Ltd.	3 lakh

All the above preferential allottees were also investors (non-promoter category) in the IPO when the shares were issued at a price of ₹90. Two of them, i.e. In & Out Share Trading Ltd. and Michael Jackson partly sold their holdings while the India Asset Management Co. Ltd. has sold off its entire holding. The average of the weekly high and low prices for the fifteen weeks prior to the relevant date is ₹76 while that of two weeks preceding the relevant date is ₹70. The company has filed its listing application with the stock exchange and it was rejected for non-compliance of the SEBI guidelines. The company filed an appeal and won the case with some additional conditionalities.

On hearing the verdict, the stock price further went-up and the average of weekly high and low for twenty-six weeks from the date of listing touched a high of ₹110.

In light of the above, answer the following questions :

- (a) What are the breaches observed in the preferential offer for which the stock exchange has rejected the listing application ? (20 marks)
- (b) What is meant by 'relevant date' ? What is the relevant date for Quick Ltd.'s preferential issue resolution ? (5 marks)
- (c) What is the appellate body for appeal against the decision of a stock exchange? Whether a professional Company Secretary can represent the case before such body ? Cite with relevant provisions of Acts/Regulations/Guidelines. (8 marks)

- (d) *What are the provisions/conditionalities governing the shareholding of the allottees pre and post allotment of preferential issue which are relevant for Quick Ltd. ?*
(10 marks)
- (e) *Out of three allottees who have sold their pre-preferential allotment, who are eligible and who are not eligible to receive the preferential offer as per the preferential issue guidelines ? What is the final price to be paid by all the preferential allottees ?*
(7 marks)

Answer 1(a)

There are two conditionalities that the company has failed to observe as per the SEBI (ICDR) regulations, 2009. They are related to:

- (a) Pricing norms and
- (b) Eligibility of allottees

As per the applicable pricing norms for Quick Ltd., issue of shares on preferential basis has to be made at a price not less than the higher of the following:

- (a) The price at which shares were issued by the company in its IPO

OR

- (b) The average of weekly high and low of the closing prices of the related shares quoted on the stock exchange during the period shares have been listed preceding the relevant date.

OR

- (c) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

- (d) In the case of QIB the price shall not be less than the average of the weekly high and low of the closing prices of the related shares quoted on the recognized Stock Exchange during two weeks preceding the relevant date.

In the instant case, the IPO was made only fifteen weeks ago at a price of Rs. 90. The average of weekly high-low for fifteen week since listing is 76 and while that of two weeks preceding the relevant date is Rs. 70.

Therefore, the price at which equity shares to be issued under preferential issue is Rs. 90. However, the company chose to issue at Rs. 66 which is in violation of pricing norms. However, for an FII who is one of the proposed allottees, the price can be lower than Rs. 90 but can't be lower than Rs. 70.

The second violation is w.r.t. eligibility of proposed allottees. As per the lock in norms, the shareholders who have sold their shares during the six months period prior to the relevant date shall not be eligible for allotment of shares on preferential basis.

In the instant case, two of the proposed allottees, namely, In & Out Share Trading Ltd. and Michael Jackson are not eligible for allotment as they have sold off partly their shareholding in the company which was allotted at the time of IPO.

Answer 1(b)

According to regulation 71 of SEBI (ICDR) regulations, 2009, “relevant date” means:

- (a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue.

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date.

- (b) in case of preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

Explanation : Where the relevant date falls on a Weekend/Holiday, the day preceding the Weekend/Holiday will be reckoned to be the relevant date.

In the given case, the general body meeting was held on January 30, 2014. Therefore, the relevant date is December 31, 2013.

Answer 1(c)

Securities Appellate Tribunal is the appellate body for appeal against the decision of a stock exchange. According to Section 22A (1) of Securities Contract (Regulation) Act 1956, where a recognised stock exchange, acting in pursuance of any power given to it by its bye-laws, refuses to list the securities of any company, the company shall be entitled to be furnished with reasons for such refusal, and may,— (a) within fifteen days from the date on which the reasons for such refusal are furnished to it, or (b) where the stock exchange has omitted or failed to dispose of, within the time specified in section 40 of the Companies Act, 2013, the application for permission for the shares or debentures to be dealt with on the stock exchange, within fifteen days from the date of expiry of the specified time or within such further period, not exceeding one month, as the Securities Appellate Tribunal may, on sufficient cause being shown, allow, appeal to the Securities Appellate Tribunal having jurisdiction in the matter against such refusal, omission or failure, as the case may be.

Under Section 22C of Securities Contract (Regulation) Act 1956, the appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal. Accordingly, a professional Company Secretary can represent the case before the Appellate Tribunal.

Answer 1(d)

The preferential issue made by Quick Ltd. is to persons other than promoters and promoter group. As per the SEBI (ICDR) Regulations, 2009, the following norms are applicable:

- (a) All shares issued under the preferential offer shall be locked in for a period of one year from the date of allotment.

- (b) The entire pre preferential allotment shareholding in the company be under lock in from the relevant date for six months after the date of allotment.
- (c) No part of the prior shareholding of the proposed allottees in the issuer company be sold six months prior to the relevant date.
- (d) The entire shareholding of the preferential allottees, both pre shareholding and post shareholding is held in dematerialized form.

Answer 1(e)

The three allottees who sold their pre preferential allotment are:

- In and out Share Trading Ltd.
- Michael Jackson
- India Asset Management Company Ltd.

As per the SEBI (ICDR) Regulations, 2009, shareholders who disposed off, partly or fully, their pre preferential issue allotment are not eligible for allotment of shares on preferential basis except Mutual Funds (MFs) registered with SEBI and insurance companies registered with IRDA. In the given case, In and Out Share Trading Ltd. and Michael Jackson are not eligible for allotment under preferential issue regulations while India Asset Management Company Ltd. being a MF, is eligible for allotment.

As per the pricing norms, if a company is listed on a stock exchange for less than 26 weeks, it shall recompute the preferential issue price upon completion of 26 weeks post listing. If such price is higher than the price at which it has allotted the shares on preferential basis, difference shall be paid by the allottees to the issuer. In the instant case, the average of high-low of 26 week price is Rs. 110. Therefore, the acquisition cost for all the four allottees is Rs. 110 per share with an exception to an FII which is a QIB where the price can be lesser than Rs. 110 but can't be less than Rs. 70.

Question 2

- (a) *Discuss the effect of changes in market interest rates on swap values with appropriate examples. (10 marks)*
- (b) *Evaluate the role of commodity exchanges for hedging and speculation with the help of appropriate examples. (10 marks)*
- (c) *"Bills discounting may be identified as an important instrument for business development." Comment on this statement and also elaborate its procedure. (10 marks)*

Answer 2(a)

An Interest Rate Swap is a financial contract between two parties exchanging or swapping a stream of interest payments for a 'notional principal' amount on multiple occasions during a specified period. Such contracts generally involve exchange of a 'fixed to floating' or 'floating to floating' rates of interest. Accordingly, on each payment date - that occurs during the swap period - cash payments based on fixed/ floating and floating rates, are made by the parties to one another.

For each party, the value of an interest rate swap lies in the net difference between the present value of the cash flows one party expects to receive and the present value of the payments the other party expects to make. At the origination of the contract, the value for both parties is usually zero because no cash flows are exchanged at that point. Over the life of the contract, it becomes a zero-sum game. As interest rates fluctuate, the value of the swap creates a profit on one counterparty's books, which results in a corresponding loss on the other's books.

The value of an interest rate swap changes with changes in interest rates. For the fixed rate payer (floating rate receiver) the value of the swap increases when interest rates increase.

In international market, LIBOR (London Inter-Bank Offered Rate) is the benchmark, or a reference rate in case of floating rate loans. LIBOR is the rate of interest offered by banks on deposits from other banks in EURO market. In India, there is Mumbai Inter-Bank Offered Rate (MIBOR), which can be used as a reference rate.

For better understanding let us consider an example:

A. Ltd. and B. Ltd., both want to borrow ₹10 crore for 5 years and following rates are offered :

	A. Ltd.	B. Ltd.
Fixed Rate	10%	11.20%
Floating Rate	LIBOR + .3%	LIBOR + 1%

B Ltd. wants to borrow at fixed rate while A Ltd., want to borrow at floating rate. How can they enter into a swap ? From the point of view of swap market, the difference in fixed rates is greater than the difference in floating rates, i.e., 1.20% and .7% respectively. B. Ltd. has a comparative advantage in floating rate borrowing while A Ltd. has a comparative advantage in fixed rate borrowing. This comparative advantage allow a swap to be negotiated.

A Ltd. should borrow at 10% fixed rate and B Ltd. borrows at LIBOR + 1% i.e., at floating rate and enter into a swap as follows :

In this case, A Ltd. pays LIBOR to B Ltd. and 10% to lenders. It receives 9.95% from B Ltd. The net burden of A Ltd. is LIBOR + .05%. On the other hand, B Ltd. pays 9.95% to A Ltd. and LIBOR + 1% to lenders. It receives LIBOR from A Ltd. The net burden of B Ltd. is 9.95% + 1% = 10.95%. So, A Ltd. is able to borrow at the lesser floating rate of LIBOR + .05% whereas B Ltd. is able to borrow at lesser fixed rate at 10.95%.

Answer 2(b)

Commodity Exchanges provide platforms to suit the varied requirements of customers. A commodity exchange acts as a portal or a common place where traders can buy and sell commodities. Such exchanges enable seamless trading, eliminate the need for middle men and allow the market to fix a price that is driven purely by demand and supply of the product. They help in price discovery as players get to set future prices which are also made available to all participants. Hence, a farmer in the southern part of India would be able to know the best price prevailing in the country which would enable him to take informed decisions.

Secondly, these exchanges enable actual users (farmers, agro processors, industry where the predominant cost is commodity input/output cost) to hedge their price risk given the uncertainty of the future - especially in agriculture where there is uncertainty regarding the monsoon and hence prices. This holds good also for non agro products like metals or energy products as well where global forces could exert considerable influence.

Purchasers are also assured of a fixed price which is determined in advance, thereby avoiding surprises to them. It must be borne in mind that commodity prices in India have always been woven firmly into the international fabric. Today, price fluctuations in all major commodities in the country mirror both national and international factors and not merely national factors.

Thirdly, Commodity Exchanges provide liquidity and buoyancy to the system by involving the group of Investors and Speculators.

Hedging in the futures market in general is a two-step process, depending upon the hedger's cash market situation.

First step : If the hedger is going to buy a commodity in the cash market at a later time, his first step is to buy futures contracts. Or if he is going to sell cash commodity at a later time, his first step in the hedging process is to sell futures contracts.

Second step : when the cash market transaction takes place, the futures position is no longer needed for price protection and should therefore be offset (closed out). Depending on the initial position taken long (long hedge) or short (short hedge), hedger would offset his position by selling or buying back the futures contract. Both the opening and closing positions must be for the same commodity, number of contracts, and delivery month.

Example :-

In June if a farmer expects an output of 100 tonnes of soyabean in October.

Soyabean prices in October are expected to rule relatively lower as it is harvesting season for soya bean.

In order to hedge against the price fall, the farmer/producer sells 100 contracts of one tonne each at 1347 on June 22. On a fall of price to 1216 per tonne in October he makes a profit of 131 per tonne.

Answer 2(c)

Bill Discounting is a short tenure financing instrument for companies willing to discount their purchase / sales bills to get funds for the short run and as for the investors, it is a good instrument to park their spare funds for a very short duration. It serves as a mean of working capital requirements for businesses.

The advantages of bills discounting to banks and finance companies which are as follows:

- *Safety of Funds*: The greatest security for a banker is that a bill of exchange is a negotiable instrument bearing signatures of two parties considered good for the amount of bill; so it can enforce its claim.

- *Certainty of payment:* A bill of exchange is a self liquidating asset with the banker knowing in advance the date of its maturity. Thus, bill finance obviates the need for maintaining large, unutilized, ideal cash balances as under the cash credit system. It also provides banks greater control over their drawals.
- *Profitability:* Since the discount on a bill is front ended the yield is much higher than in other loans and advances, where interest is paid quarterly or half yearly.
- *Evens out Inter-bank Liquidity Problems:* The development of healthy parallel bills discounting market would stabilize the violent fluctuations in the call money market as banks could buy and sell bills to even out their liquidity mismatches.

When an investor and the company agree to a particular bill discounting transaction, the following is what the company gives to the investor:

- The original copies of bills to be discounted;
- A hundi / promissory note;
- Post Dated Cheque (PDC).

The investor simply has to issue a cheque. The amount of cheque is arrived at after deducting the discount rate. The post-dated cheque that the company gives is of the full amount of the transaction. This can be better explained with an example as follows.

Company A wants to discount its purchase bill of Rs. 2,00,000 for a period of three months. Investor P agrees to do so at a discount rate of 21%. The deal is mutually agreed. Now, the investor will issue a cheque of Rs.1,89,500.

This figure is arrived at as follows:

$$= 2,00,000 - 2,00,000 \times 21\% \times 3/12$$

Thus the investor gets his/her interest before the end of the period on discounting. The company on its part will issue a post-dated cheque of Rs. 2,00,000 for three months period.

Here the investor benefits in two ways:

He gets the interest element at the first day of issuing the cheque. i.e. he does not include that part in his cheque amount. Thus he can earn interest on this interest for a three-month period. Even a simple bank fixed deposit on it will earn @5% p.a. By investing Rs.1,89,500 for three months, the investor earns Rs. 10,500 on it. A return of 22.16%.

Question 3

What are alternate investment funds ? What are the investment conditions imposed by regulations ? (5 marks)

Answer 3

Alternative investment funds (AIFs) are defined in Regulation 2(1)(b) of SEBI (Alternative Investment Funds) Regulations, 2012. It refers to any privately pooled investment fund, (whether from Indian or foreign sources), in the form of a trust or a

company or a body corporate or a Limited Liability Partnership (LLP) which are not presently covered by any Regulation of SEBI governing fund management (like, Regulations governing Mutual Fund or Collective Investment Scheme) nor coming under the direct regulation of any other sectoral regulators in India-IRDA, PFRDA, RBI. Hence, in India, AIFs are private funds which are otherwise not coming under the jurisdiction of any regulatory agency in India.

Investments by all categories of Alternative Investment Funds shall be subject to the following conditions:-

- a. Alternative Investment Fund may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time;
- b. Co-investment in an investee company by a Manager or Sponsor shall not be on terms more favourable than those offered to the Alternative Investment Fund;
- c. Category I and II Alternative Investment Funds shall invest not more than twenty five percent of the investible funds in one Investee Company;
- d. Category III Alternative Investment Fund shall invest not more than ten percent of the investible funds in one Investee Company;
- e. Alternative Investment Fund shall not invest in associates except with the approval of seventy five percent of investors by value of their investment in the Alternative Investment Fund;
- f. Un-invested portion of the investible funds may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, CBLOs, Commercial Papers, Certificates of Deposits, etc. till deployment of funds as per the investment objective;
- g. Alternative Investment Fund may act as Nominated Investor as specified in clause (b) of sub-regulation (1) of regulation 106N of the SEBI (ICDR) Regulations, 2009.

Question 4

Each player in the commodity market fulfills an economic activity. Justify.

(5 marks)

Answer 4

Broadly, the participants in commodity market can be classified as Hedgers, Arbitrageurs and Speculators. Each of the players has an economic function to fulfill as given under:

Hedger is the person who basically wants to avoid risk and enters into a contract with speculator. Hedger is a user of the market, who enters into futures contract to manage the risk of adverse price fluctuation in respect of his existing or future asset. Hedgers are those who have an underlying interest in the commodity and are using futures market to insure themselves against adverse price fluctuations. Examples could be stockists, exporters, producers, etc.

A speculator is one who enters the market to profit from the future price movements. He does not have any physical exposure. Speculators accept the risk that hedgers seek to avoid, giving the required liquidity to the market.

Arbitrageurs are traders who buy and sell to make money on price differentials across different markets. They simultaneously buy or sell the same commodities in different markets. Arbitrage keeps the prices in different markets in line with each other.

Question 5

What is the role of a Company Secretary in capital market ? Specify the areas for his/her services. (5 marks)

Answer 5

Company Secretary, over a period of time, have developed themselves as professionals having core competence in compliances and corporate governance, moving from their traditional role of Secretary of the Company. Under various securities laws such as Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996, Regulations and Guidelines issued by SEBI under SEBI Act, 1992 and the Listing Agreement of the Stock Exchanges for Equity, Debt listing, SMEs and IDRs, Company Secretaries have been recognized to verify compliances and to issue certificates.

A list of the services provided by Company Secretaries (both in employment and practice) in Capital Markets is given below:

Corporate Laws Advisory Services

Advising companies on Compliance of legal and procedural aspects, particularly under-

- SEBI Act, 1992
- Securities Contracts (Regulation) Act 1956 and Rules made thereunder
- SEBI Regulations and Guidelines
- Listing Agreement

Representation Services

Representing on behalf of a company and other persons before -

- Securities Appellate Tribunal

Public Issue, Listing and Securities Management

- Advisor/consultant in issue of shares and other securities in India and abroad
- Drafting of prospectus/offer for sale/ letter of offer/other documents related to issue of securities and obtaining approvals in association with lead managers
- Listing / delisting of securities
- Private placement of securities

- Buy-back of shares
- Raising of funds from international markets-ADR/GDR/ECB/FCCB
- Acting as Compliance Officer under various listing agreement(s)
- Compliance officer for various capital market intermediaries

Takeover Code and Insider Trading

- Compliance of the Takeover Regulations
- Compliance with SEBI (Prohibition of Insider Trading) Regulations, 2015.

Internal Audit and Certification Services

Compliance with rules and regulations in securities market particularly-

- Internal Audit of Depository Participants
- Internal Audit of Stock Brokers/Trading Members/Clearing Members
- Internal Audit of Portfolio Managers
- Internal Audit of Credit Rating Agencies
- Yearly Audit of Investment Advisers
- Yearly Audit of Research Analysts
- Certification in relation to Reconciliation of Share Capital Audit i.e. reconciliation of total issued capital, listed capital and Capital held by depositories in dematerialized form
- Concurrent Audit in case of Demat Account Opening, Control, Verification of Delivery Instruction Slips
- Certification that all transfers have been completed within stipulated time under clause 47 (c) of the Equity Listing Agreement and Clause 52 (ii) of SME Listing Agreement
- Certification regarding compliance of conditions of Corporate Governance under Clause 49 of the Equity Listing Agreement, Clause 24 of Listing Agreement for Indian Depository Receipts and Clause 50 of SME Listing Agreement
- Certification regarding maintenance of 100% Security covers under Listing Agreement for Debt Securities
- Various certifications for trading members of Stock Exchanges
- Certificate of Compliance for listing on BSE SME Platform through IPO.

Question 6

During the post-liberalisation process of the economy, significant reform measures have resulted the investors' grievances in many fold. How would you help them in the redressal of their grievances ?

(5 marks)

Answer 6

The following are the major initiatives available for grievance redressal of investors :

- Investors who are not satisfied with the response to their grievances received from the brokers/Depository Participants/listed companies, can lodge their grievances with the Stock Exchanges or Depositories. In case of unsatisfactory redressal, BSE/NSE has designated Investor Grievance Redressal Committees (IGRCs), or Regional Investor Complaints Resolution Committees (RICRC), this forum acts as a mediator to resolve the claims, disputes and differences between entities and complainants.
- In order to afford adequate protection to the investors, provisions have been incorporated in different legislations such as the Companies Act, Securities Contracts (Regulation) Act, Consumer Protection Act, Depositories Act, and Listing Agreement of the Stock Exchanges supplemented by many guidelines, circulars and press notes issued by the Ministry of Finance, Ministry of Company Affairs and SEBI from time to time.
- SEBI has constituted the Investor Education and Protection Fund (IPEF) under the aegis of SEBI (Investor Protection and Education Fund) Regulations, 2009. The fund shall be utilised for the purpose of protection of investors and promotion of investor education and awareness in accordance with these regulations.
- The Ministry of Corporate Affairs has established the Investor Education and Protection Fund (IEPF) under the Companies Act for promotion of investors' awareness and protection of the interests of investors. The Ministry of Corporate Affairs has also laid down rules for administration of IEPF.
- SEBI has commenced processing of investor grievances against the intermediaries in a centralized web-based complaints redressal system, SEBI Complaints Redress System (SCORES) at (<http://scores.gov.in>). This enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online.

INSURANCE LAW AND PRACTICE (Elective Paper 9.3)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

Nilesh, a businessman took a fire insurance policy to cover stocks of oil seeds, oil cakes, etc., in a godown of Class I construction located behind Vile Parle Market, Mumbai for a sum insured of ₹ 7 lakh against fire with riot and strike cover with ABC Insurance Company Ltd. for the period 15th May, 2014 to 16th May, 2015. The insured remitted ₹ 1,255 through account payee cheque to the insurer as premium for the coverage.

The cheque was acknowledged by the insurer and a cover note for the sum insured of ₹ 7 lakh was issued against fire with riot and strike coverage on 19th May, 2014 (17th and 18th May, 2014 being Saturday and Sunday). The cover note covering the risk in question was duly delivered to Nilesh on 20th May, 2014 by an authorised representative of the insurer. The cover note whilst describing the property in brief also indicated "Subject to terms, conditions and exceptions of the standard fire policy." The policy however was not released by the insurer.

Unfortunately, on 22nd June, 2014, a fire occurred in the godown and resulted in damage to a part of the oil seeds and oil cakes. The fire brigade was summoned and the fire was put out after considerable effort. But by that time, a substantial portion of the insured's stocks had suffered damages.

The insurance company upon receipt of intimation, deputed a senior fire surveyor to carry out inspection and assessment of damages. The surveyor after detailed inspection and verification of records assessed the damages to the tune of ₹3.40 lakh on account of 'spontaneous combustion'. The report was submitted to the insurer on 25th July, 2014.

The insured, Nilesh, took-up the matter with the insurance company for compensation. The ABC Insurance Company Ltd. however on the basis of surveyors findings informed the insured that spontaneous combustion was an excluded peril under the standard fire policy and hence the insurance company could not admit its liability under the claim. This decision of the insurance company was conveyed to the insured in writing on 6th August, 2014.

Being not satisfied with the decision of the insurance company, the insured, Nilesh took-up the matter with the 'consumer forum' for redressal stating that the cover note issued to him did not have a stipulation that 'spontaneous combustion' was an excluded peril under the standard fire policy and in the absence of such a condition, his rightful claim for compensation cannot be rejected by the insurer. Moreover, the policy too had not been released by the insurer even after a month and hence the claimant was completely in the dark with regard to terms, conditions and exclusions of a standard fire policy. The insured, therefore, cannot be penalised for 'no fault of his own'.

The insured further contended that there was 'deficiency in service' on the part of the insurer in not releasing the policy document in time and in keeping the insured fully informed of the coverage.

The consumer forum heard arguments from both the parties including those advanced by the respective advocates on both sides. They also questioned the surveyor at length who had carried out loss assessment of the damages sustained by the insured.

The consumer forum after due deliberation amongst its members, directed the insurance company to pay the claim to the insured to the tune of ₹ 3.40 lakh as assessed by the surveyor.

The consumer forum further directed the insurance company to pay an additional amount of ₹ 30,000 for 'deficiency in service' in not releasing the fire policy within a reasonable period of 30 days.

Answer the following questions —

- (a) Discuss in detail how far the award of the consumer forum is justified in the light of the terms and conditions of the standard fire policy. (15 marks)*
- (b) Was the penalty for 'deficiency in service' imposed on the insurer justified in the light of existing guidelines in the market wherein there is no stipulation on issuance of a policy by the insurer within a reasonable period of 30 days ? (10 marks)*
- (c) What are the additional perils that can be covered under a standard fire policy ? (5 marks)*
- (d) What do you understand by 'condition of average' in a fire insurance contract ? (5 marks)*
- (e) Name the 'excluded perils' under a fire policy. (5 marks)*
- (f) Can a fire policy be issued providing coverage for more than one year ? Name the subject matter along with the period for which such cover can be granted ? (5 marks)*
- (g) Mention the 'implied conditions' in a fire insurance contract. (5 marks)*

Answer 1(a)

Fire insurance contracts are contracts of utmost good faith. Utmost good faith implies that there should be good faith on both sides – not only on the side of the insured but also the insurer should observe it strictly. The facts of the case are clear. A policy was taken against fire and riot. Strike risks for sum insured of ₹ 7 lakhs. The commodity insured was stocks of oil cakes and oil seeds in a class I godown located behind parle market, Mumbai for ₹ 7 lakh. The cover note was issued by ABC Insurance Company covering the risk from May 15, 2014 to May 16, 2015. A representative of the insured delivered the cover note personally on May 20, 2014. He should have advised the insured that the commodity is susceptible to spontaneous combustion and hence this risk too should be taken. But he did not do so. The policy too was not released within a reasonable period of a month. On June 22, 2014, a fire occurred and damages were assessed by a senior surveyor to the tune of ₹3.40 lakhs. The cause of loss was spontaneous combustion.

The insured took the matter with the insurance company. The company denied its liability stating that spontaneous combustion was an excluded risk. The matter thereafter went to the consumer forum which gave an award against the insurance company for ₹3.40 lakh.

On a review of the entire facts, it becomes clear that the insurer was neither proactive nor sensitive to the needs of his client. Had he been a real friend and advisor, he would have advised the insured to take spontaneous combustion risk on May 20, 2014 itself when his representative met the insured and handed him the cover note. He did not do so, nor released the policy document timely so that the insured may take precaution even belatedly. He just acted as an insurer forgetting that insurance is peoples business. You are dealing with the people and hence you have to be proactive and sensitive to their needs. Since, insurance is the subject matter of solicitation, the representative should have advised the client with regards to the coverage. However, in this case, although a cover note is binding on the insured, since there is a lapse on the side of the insurer, the consumer forum's award is timely, fair and justified.

Alternate Answer 1(a)

The operative clause of the cover note of fire insurance generally reads as follows.

"In consideration of the proposer named in the schedule hereto having, proposed to effect an insurance against fire for the period therein, on the usual terms and conditions of this company and having paid the premium stated in the schedule is hereby insured to the extent of the sum insured mentioned therein".

The cover note is made subject to the terms and conditions of the fire policy by the following clause.

"The Cover Note is issued pending preparation and issue of a duly stamped policy of insurance and should the terms and conditions of this Company's policy be unknown to the proposer, it shall be incumbent upon him to make application to the company for a copy of such terms and conditions. Failure to comply with policy terms and conditions though the insured being unacquainted with them shall not excuse his failure to act in accordance therewith and by the acceptance of this Cover Note, the proposer binds himself by the terms and conditions of this company's policy."

The operative clause of the fire policy provides coverage in respect of fire but excludes damages caused to the insured property by "its own fermentation, natural heating or spontaneous combustion."

However extension endorsement in the fire policy covering spontaneous combustion can be obtained by the insured on payment of additional premium.

In the given case the insured failed to make an application to the Insurance Company for a copy of the terms and conditions of the policy. So, it is a failure on the part of the insured and not the insurance company. Ignorance of the terms and conditions of the policy on the part of insured is not an excuse. Moreover, extension endorsement and add on cover for spontaneous combustion is available to the insured only on payment of additional premium by the insured before coverage of the risk. But in this case no such additional premium was paid by the insured to the insurance company. So the insurance company is not liable to pay for the loss due to spontaneous combustion.

In view of the above, the award of the Consumer Forum for payment of claim to the insured to the tune of ₹3.40 lakh as assessed by surveyor is not justified.

Answer 1(b)

Cover Note is a temporary document evidencing the receipt of premium and acceptance of the risk by the insurer, pending preparation and issuance of fully worded insurance policy. Usually the cover note is issued for a temporary period of 30 days and beyond this period the cover note becomes invalid and has to be replaced by a fully worded policy document. For the insured, the Cover Note is the evidence that the risk he proposed for insurance is covered against the peril he desired. The insurer issues the fully worded policy once he receives the full details required for underwriting the risk, including documents like completed proposal form and all other relevant information required in documentary form like inspection reports etc.

If the issuance of fully worded insurance policy by the insurance company (even after receipt of all necessary documents from the insured) is delayed beyond the reasonable period of 30 days, then the insurance company will be liable for deficiency of service.

Hence the decision of the consumer forum in awarding a penalty for deficiency in service is fully justified.

Answer 1(c)

The additional perils or add on covers are extension of fire policy which can be covered on payment of additional premium and by attachment of endorsements.

These add on covers include:

1. Spontaneous combustion
2. Earthquake (Fire and shock)
3. Forest fire
4. Architect, etc. fees (in excess of 3%)
5. Debris removal (in excess of 1% of claim amount)
6. Terrorism
7. Temporary removal of stocks
8. Leakage and contamination cover
9. Spoilage material damage cover
10. Deterioration of stocks in cold storage premises due to power failure following damage due to an insured peril.
11. Impact damage due to insured's own vehicles, Forklifts and the like and the articles dropped therefrom.
12. Loss of rent
13. Insurance of additional expenses of rent for alternative accommodation
14. Start up expenses.

Answer 1(d)

Fire insurance contracts are strict contracts of indemnity. In other words, the insurer is supposed to indemnify the insured to the extent of loss suffered by him and not more than the loss. Indemnity implies making good of actual loss. The aim of the principle of indemnity is to place the insured in his pre-loss financial position and not to make a gain out of a loss. For example, if a property is insured for a certain amount and later on it transpired that the market value of the property was much on the higher side and in case an accidental fire occurs, then the insured will be his own insurer for the accidental partial loss suffered by him. This is also called as underinsurance or self-insurance. The formula that will be applicable would be as under:

$$= \frac{\text{Sum insured}}{\text{Market value}} \times \text{loss}$$

For example, if sum insured is Rs. 2 lakh and the value of the property on the day of loss was Rs. 2.75 lakh. If the loss assessed for partial damages is Rs. 1.25 lakh, then the liability of the insurance company would be as under:

$$= \frac{2,00,000}{2,75,000} \times 1,25,000$$

$$= \text{Loss payable ₹90,909}$$

The insured would be his own insurer for the balance amount of loss. In other words, he has to bear a loss of ₹34,091 out of his pocket.

Answer 1(e)

The excluded perils under a Fire Policy are as under:

1. Loss or damage caused by war and war like operation
2. Nuclear perils
3. Pollution or contamination
4. Electrical / mechanical breakdown
5. Burglary and house breaking
6. 5% of each and every claim – Subject to a minimum of Rs. 10,000 in Act of God (AOG) Perils, Rs. 10,000 for each and every loss out of other perils
7. Loss, destruction or damage caused to bullion, precious stones, works of art exceeding Rs. 10000, books of accounts, paper money, explosives etc.
8. Stocks in cold storage
9. Any electrical / electronic machinery
10. Loss of earnings, loss by delay, consequential loss etc.
11. Loss / damage by spoilage, interruption/ cessation of any process
12. Loss by theft during or after the peril
13. Loss by natural calamity

14. Loss due to temporary shifting of machinery for repairs, cleaning, renovation for a period not exceeding 60 days
15. Expenses in excess of - 3% of Architects, surveyors, engineers fees, &1% of claim amount for debris removal

Answer 1(e)

Fire insurance policies are normally issued for one year only. Only in the case of residential dwellings, the policy may be issued for a longer term. In such an eventuality, the policy may be issued for a minimum period of 3 years, however with payment of premium in advance.

Answer 1(f)

Conditions are of two types (i) Express condition (ii) Implied condition. While express conditions, are those that are generally specified on the face of the contract, and printed on the policy document, implied conditions are those, which are so basic and material that their existence forms the very basis of the policy. In the absence of express conditions, the insurance contract is subject to implied conditions, which relate to:

1. Utmost good faith
2. Insurable interest
3. Indemnity
4. Subrogation
5. Contribution
6. Proximate cause

Question 2

- (a) *Anil, an individual, has taken with Urban Insurance Co. Ltd, a fire policy against his residential property, for a sum assured of ₹ 3,00,000. The cover lasts till the end of September, 2015. On 20th May, 2015, an accidental fire takes place and the entire building is gutted and damaged. Anil prefers a claim with the insurance company. The claim is rejected on the ground of negligence on Anil's part. Representations made by Anil to the insurer against such a rejection were not successful.*

What options are left to Anil to proceed further in this regard ? Discuss.

(15 marks)

- (b) *Southern Ltd. carries a large volume of stock. It has secured fire policies to cover the stocks from three general insurers, the details of which are as under :*

<i>Insurer</i>	<i>Sum Assured</i>
<i>M Insurance Co. Ltd.</i>	<i>— ₹ 75,00,000</i>
<i>N Insurance Co. Ltd.</i>	<i>— ₹ 50,00,000</i>
<i>S Insurance Co. Ltd.</i>	<i>— ₹ 25,00,000</i>

On 31st January, 2015, when a fire took place the value of the actual stocks in

the godown, on the basis of the company's accounts was ₹ 1,60,00,000. Salvage gained was ₹ 1,50,000 which the company recovered and realised by way of sales.

Determine the individual liability of each of the insurers on the premise that the claim was admitted by the companies. (15 marks)

Answer 2(a)

This question deals with dispute resolution between an insured and insurer. It is a case where an individual has insured a non-commercial building against fire losses for ₹3,00,000. A fire takes place and the building is completely gutted and destroyed. In other words, the property is completely lost and there is a total loss. The insurer, on receiving a claim has denied it on the ground of negligence on the part of the insured. The avenues open to Mr. Anil to resolve the disputes are discussed below:

- (i) He can approach the Consumer Disputes Redressal Forum established by a State Government in each district of a State. These forums deal with cases of a value of upto 20,00,000 rupees. However, the complaint has to be filed within two years from the date of cause of action arising. State Consumer Forums entertain claims upto ₹1 crore and national forum of more than ₹1 crore.
- (ii) The forum has the power of a civil court. The forum can order and provide relief to the complainant.
- (iii) For insurance related claims, an additional separate window has been provided in the shape of insurance ombudsman who has been empowered to look into insurance related cases from non-corporate persons when the claim amount does not exceed ₹20 lakhs. A person who wants to approach the ombudsman must have approached first the insurance company and must have gone through the procedure regarding complaint redressal mechanism in house by the company. The IRDAI has provided a gateway of IGMS (Integrated Grievance Management System) in its website which provides an opportunity to any individual to log in the details of the complaint or grievance and thereby is informed on the follow up action taken by the Regulator and the company. Thereafter, the insured can approach the ombudsman if either the insurance company rejects the grievance or complaint or the insured is not satisfied with the decision of the insurer or the insurer fails to respond the complaint within one month of the submission of the grievance. No complaint can be filed with the ombudsman after one year from the date of rejection or the receipt of a final letter from the insurer. The insured should not have also filed complaint seeking legal remedies in alternate forum and those proceedings were not disposed off.

After hearing both the insurer and the insured, the ombudsman will make his recommendation within one month from the date of receipt of the complaint. This will be followed by a trial order within three months. The ombudsman's order will be binding on the insurer but if the insured was not satisfied with the order he can choose to appeal against it. The insurer, within 15 days of the ombudsman order shall comply with it. The individual can also appeal against the award pronounced by the Ombudsman if he is not satisfied with the judgment in the Consumer forums.

In the present case, the fire accident took place on May 20, 2015 and on the insured

reporting to in-house grievance facility, the insurer rejected the claim. Anil has now two choices before him. Since the loss is less than ₹20 lakh, he can either approach the District Consumer Forum or go to the insurance ombudsman. The claim before the Consumer Forum will be civil litigation and will be time consuming. If Anil approaches the insurance ombudsman, the settlement process is quick around three or four months and if Anil at the end of the proceedings is not satisfied with the ombudsman's award, he can seek alternative remedies, like Consumer Forum, High Court, etc. Hence, it will be prudent for Anil to go to insurance ombudsman with the complaint. The cost of litigation will also be very low before the ombudsman.

Answer 2(b)

This question calls for an inter-say allocation of liabilities amount different insures have insured. The main idea of an insurance contract is to indemnify the insured, against losses. The insured cannot gain out of a loss and hence the claim will have to be settled on pro-rata basis by all the three insurers collectively as per their sum insured liability ratios.

Since there are three insurers, the liability to settled claims has to be distributed ratably. The claim amount has to be calculated applying the 'SUE' clause in the order namely:

- S – Salvage
- U – Under-insurance
- E – Excess

The distribution will be as under:

The actual stocks at the time of loss were ₹1,60,00,000.

Insurance covers available are ₹75 lakh + ₹25 lakh + ₹50 lakh = 1.50 crore.

There is under insurance.

Loss	₹ 1,60,00,000
Less salvage	₹ 1,50,000
	₹ 1,58,50,000

The loss has therefore to be limited to the maximum of the same assured under the policies.

Loss limited to	₹ 1,50,00,000
Less 'Salvage'	₹ 1,50,000

Maximum Allowable ₹ 1,48,50,000 to be distributed among M, N & S in the ratio of 3:2:1 viz. after adjusting for underinsurance clause.

The stocks were insured only to the value of ₹1,50,00,000 i.e. upto a value of 93.75%. Hence, the amount payable is to be adjusted for underinsurance after adjustment of salvage, and Excess of ₹10,000.

Hence 93.75% of ₹1,48,50,000 = 1,39,21,875 which is to be divided amongst the three insurers in rateable proportion after excess adjustment.

Actual Total Loss	=	₹ 1,60,00,000
Loss limited to	=	₹ 1,50,00,000
Less (-) 'Salvage'	=	₹ 1,50,000
		₹ 1,48,50,000
Less (-) Underinsurance (6.25%)	=	₹ 9,28,125
		₹ 1,39,21,875
Less (-) Mandatory Excess*	=	₹ 10,000

(* 5% of every claim subject to a minimum of ₹10,000 is taken as mandatory excess)

Balance Amount of loss payable = ₹ 1,39,11,875

Loss Payable ₹ 1,39,11,875 to be distributed among M, N & S in the ratio of 3:2:1

(Based on the respective contribution of M, N and S in the Sum Assured)

M Insurance Co. Ltd., 3/6 of 1,39,11,875 or ₹ 69,55,938

N Insurance Co. Ltd., 2/6 of 1,39,11,875 or ₹ 46,37,292

S Insurance Co. Ltd., 1/6 of 1,39,11,875 or ₹ 23,18,645

Question 3

Life insurance business is a long-term business and to ensure that resources are available to an insurer for meeting the claims, there must be an efficient system of investment of the funds.

State how the IRDAI has ensured that this happens in the Indian market.

(5 marks)

Answer 3

Life Insurance is a long term contract and hence it is essential that the Life insurance Company should be able to meet its future obligations and commitments in the form of claims that may arise. In other words it means that the company should have resources available anytime and hence must have a strong Investment policy so that all the premiums received are amicably invested in safe investments so that the company remains solvent and sustainable at the same time. Therefore, in a bid to direct long term savings, the recently amended investment regulations of the Insurance Regulatory Development Authority (IRDA) provide the IRDA (Investment) Regulations, 2000 as amended from time to time for Insurance companies with regards to the investments. As per Regulation 3, a life insurer, for the purposes of these regulations, shall invest and at all times keep invested, the Investment Assets forming part of the Controlled Fund as defined in section 27 of the Act as under :

- all funds of Life Insurance business and One Year Renewal pure Group Term Assurance Business (OYRGTA), and non-unit reserves of all categories of Unit linked life insurance business, as per regulation 4;

- (b) all funds of Pension, Annuity and Group Business [as defined under Regulation 2(d) of [IRDA (Actuarial Report and Abstract) Regulations, 2000] as per Regulation 5;
- (c) the unit reserves portion of all categories of Unit linked funds, as per regulation 6.

Question 4

Loss control is an important method in handling risk. What are its major objectives? Describe them briefly. (5 marks)

Answer 4

Loss control is an important method for handling risk. It has two major objects :

(a) *Loss prevention*

Loss prevention aims at reducing the probability of loss so that frequency of losses are reduced, e.g. if you follow good health habits, watch your weight and give up smoking, the chances of heart attacks are minimized. Loss prevention is important for business of the enterprises as loss frequency can be reduced by enforcement of strong safety measures.

(b) *Loss reduction*

Loss reduction involves reduction in severity of loss. This can be achieved by installing sprinkler system in a warehouse which would help in speedy extinguishment of fire, installing perfect partition wall between two highly inflammable commodities, practicing segregation and construction of fire resistant materials to minimize losses.

Question 5

Which section of the Marine Insurance Act, 1963 talks of a 'valued policy' ? Define. (5 marks)

Answer 5

Section 29 of the Marine Insurance Act, 1963 talks of a valued policy.

- A Valued Policy is a policy which specifies the agreed value of the subject matter insured.
- Subject to the provisions of this Act and in the absence of fraud, the value fixed by the Policy is, as between the Insurer and the Assured conclusive of the insurable value of the subject intended to be insured, whether the loss be total or partial.
- Unless the policy otherwise provides, the value fixed by the policy is not conclusive for the purpose of determining whether there has been a constructive total loss.

U/S 30 an unvalued policy is a policy which does not specify the value of the subject matter insured but subject to the limit of the sum insured leaves the insurable value to be subsequently ascertained.

Question 6

*Which section of the Motor Vehicles Act, 1988 talks about 'hit and run accident' ?
What is the payment of compensation provided under this section ? (5 marks)*

Answer 6

Section 161 of Motor Vehicles Act, 1988 talks about compensation in case of "Hit and Run" Motor Accident. Section 161(b) has defined 'Hit and Run Motor Accident' as an accident arising out of the use of a Motor Vehicle or Motor Vehicles, the identify whereof cannot be ascertained in spite of reasonable efforts for the purpose. The compensation (solarium) payable under this section is as under:

- Fixed sum of ₹ 50000 (earlier it was ₹ 25000) in respect of death of any person resulting from Hit and Run Accident.
- A fixed sum of ₹ 25000 (earlier it was ₹12500) in respect of grievous hurt to any person resulting from Hit and Run Motor Accident.
- Compensation known as solarium is payable out of solarium fund established by Central government with effect from 1st October 1982.

The Indian insurers would now pay compensation as per the scheme framed by the central government.

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

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer **ALL** Questions.

Question 1

Read the Novartis case on patenting law of Gleevec and answer the questions that follow : Novartis vs. Union of India & Others is a landmark decision by a two-judge bench of the Supreme Court of India on the issue of whether Novartis could patent Gleevec in India, and was the culmination of a seven-year-long litigation fought by Novartis. The Supreme Court upheld the Indian Patent Office's rejection of the patent application.

The patent application claimed the final form of Gleevec (the beta crystalline form of imatinib mesylate). In 1993, during the time India did not allow patents on products, Novartis had patented imatinib, with salts vaguely specified, in many countries but could not patent it in India. The key differences between the two patent applications, were that the 1998 patent application specified the counterion (Gleevec is a specific salt imatinib mesylate) while the 1993 patent application did not claim any specific salts nor did it mention mesylate, and the 1998 patent application specified the solid form of Gleevec the way the individual molecules are packed together into a solid when the drug itself is manufactured (this is separate from processes by which the drug itself is formulated into pills or capsules) while the 1993 patent application did not. The solid form of imatinib mesylate in Gleevec is beta crystalline.

In 2000, the United States Food and Drug Administration (FDA) approved imatinib mesylate in its beta crystalline form, sold by Novartis as Gleevec (U.S.) or Glivec (Europe/Australia/ Latin America). TIME magazine hailed Gleevec in 2001 as the 'magic bullet' to cure cancer. Both Novartis patents on the freebase form of imatinib, and on the beta crystalline form of imatinib mesylate are listed by Novartis in the FDA's Orange Book entry for Gleevec.

As provided under the TRIPS agreement, Novartis applied for exclusive marketing rights (EMR) for Gleevec from the Indian Patent Office and the EMR was granted in November, 2003. Novartis made use of the EMR to obtain orders against some generic manufacturers who had already launched Gleevec in India. Novartis set the price of Gleevec at USD 2,666 per patient per month; while the generic companies were selling their versions at USD 177 to 266 per patient per month. Novartis also initiated a programme to assist patients who could not afford its version of the drug, concurrent with its product launch.

The Intellectual Property Appellate Board (IPAB) was formed and in 2007 the case was transferred before the IPAB in line with section 117G of the Patents Act, 1970. The IPAB on 26th June, 2009 modified the decision of the Assistant Controller of Patents and Designs stating that ingredients for grant of patent novelty and non

obviousness to person skilled in the art were present in the application but rejected the application on the ground that the drug is not a new substance but an amended version of a known compound and that Novartis was unable to show any significant increase in the efficacy of the drug and it, therefore, failed the test laid down by section 3(d) of the Patents Act, 1970.

When examination of Novartis' patent application began in 2005, it came under immediate attack from oppositions initiated by generic companies that were already selling Gleevec in India and by advocacy groups. The application was rejected by the Patent Office and by an Appeal Board. The key basis for the rejection was the part of Indian patent law that was created by amendment in 2005, describing the patentability of new uses for known drugs and modifications of known drugs. That section, Paragraph 3d, specified that such inventions are patentable only if "they differ significantly in properties with regard to efficacy." At one point, Novartis went to court to try to invalidate Paragraph 3d; it argued that the provision was unconstitutionally vague and that it violated TRIPS. Novartis lost that case and did not appeal. However, Novartis did appeal the rejection by the Patent Office to India's Supreme Court, which took the case.

The Supreme Court case hinged on the interpretation of Paragraph 3d. The Supreme Court decided that the substance that Novartis sought to patent was indeed a modification of a known drug (the raw form of imatinib, which was publicly disclosed in the 1993 patent application and in scientific articles), that Novartis did not present evidence of a difference in therapeutic efficacy between the final form of Gleevec and the raw form of imatinib, and that therefore the patent application was properly rejected by the patent office and lower courts.

Although the court ruled narrowly, and took care to note that the subject application was filed during a time of transition in Indian patent law, the decision generated widespread global news coverage and reignited debates on balancing public good with monopolistic pricing and innovation with affordability. Had Novartis won and gotten its patent issued, it could not have prevented generics companies in India from continuing to sell generic Gleevec, but it could have obligated them to pay a reasonable royalty under a 'grandfather clause' included in India's patent law.

Questions —

- (a) *Why did Novartis file the case in Supreme Court only after India signed TRIPS?*
(15 marks)
- (b) *Gleevec patent is already granted in 45 other countries including China. What will Indian industry gain/loss in the rejection of the patent in India ?* (15 marks)
- (c) *What is your opinion on Novartis' claim that the beta crystalline packing in solid form is a 'novelty' and is thus patentable ?* (10 marks)
- (d) *What do you understand by 'grandfather clause' of the Novartis patent developed when India did not have product patents ?* (10 marks)

Answer 1(a)

India accepted products patents as part of the World Trade Organisation (WTO) deal hence Gleevec patent could be registered and enforced by the Indian Courts. The patent

application at the center of the case was filed by Novartis in India in 1998, after India had agreed to enter the World Trade Organization and to abide by worldwide intellectual property standards under the TRIPS agreement. As part of this agreement, India made changes to its patent law; the biggest of which was that prior to these changes, patents on products were not allowed, while afterwards they were, albeit with restrictions. These changes came into effect in 2005, so Novartis' patent application waited in a "mailbox" with others until then, under procedures that India instituted to manage the transition. India also passed certain amendments to its patent law in 2005, just before the laws came into effect, which played a key role in the rejection of the patent application.

Answer 1(b)

Indian industry gains in the rejection of the patents:

- Savings in outward remittance of foreign exchange
- Dumping shall be restricted
- Generic Medicines shall be available at cheaper rates
- Growth of Indian Pharma Companies
- Enhancement of innovation by Indian Pharma Companies

Indian industry Losses in the rejection of the patents:

- Multinational Companies will invest less money in research in India
- Hinders medical progress
- Indian industry will lose credibility
- Multinational Companies will not do R&D in India
- Better technology transfer from outside not possible

Answer 1(c)

A novel invention is one, which has not been disclosed; in the prior art where prior art means everything that has been published, presented or otherwise disclosed to the public includes documents in foreign languages disclosed in any format in any country of the world on the date of patent. For an invention to be judged as novel, the disclosed information should not be available in the 'prior art'. This means that there should not be any prior disclosure of any information contained in the application for patent anywhere in the public domain, either written or in any other form, or in any language before the date on which the application is first filed.

The "beta crystalline form" of the molecule is a specific polymorph of imatinib mesylate; a specific way that the individual molecules pack together to form a solid. This is the actual form of the drug sold as Gleevec; a salt (imatinib mesylate) as opposed to a free base, and the beta crystalline form as opposed to the alpha or other form.

Thus, by going through the concept of novelty, the process of "beta crystalline packing in solid form" pass the test of novelty, since, this process is not disclosed anywhere in the prior art.

But, if anything to be patentable, then the sole test of novelty is not sufficient. By the virtue of Section 3 (d) (as amended), we also have to test that whether the same is differ significantly in properties with regard to efficacy.

Section 3(d) of Indian Patent Act, 1970 (as amended) reads as follows: "The mere discovery of a new form of a known substance which does not result in the enhancement of the known efficacy of that substance or the mere discovery of any new property or new use for a known substance or of the mere use of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant.

Explanation : For the purposes of this clause, salts, esters, ethers, polymorphs, metabolites, pure form, particle size isomers, mixtures of isomers, complexes, combinations and other derivatives of known substance shall be considered to be the same substance, unless they differ significantly in properties with regard to efficacy."

Since, the beta crystalline form of Imatinib Mesylate being a pharmaceutical substance and moreover a polymorph of Imatinib Mesylate, it directly runs into explanation to section 3(d) of the Act.

Since, Novartis was unable to show any significant increase in the efficacy of the drugs, hence it failed in the test laid down by explanation to section 3(d) of the Act. Thus, the same is not patentable.

Answer 1(d)

Section 11A (7) of The Patents Act, 1970 provides that on or from the date of publication of the application for patent and until the date of grant of a patent in respect of such application, the applicant shall have the like privileges and rights as if a patent for invention had been granted on the date of publication of application. However, the applicant shall have no right to institute any proceedings for infringement until the patent has been granted. Additionally, the rights of a patentee in respect of applications made under Section 5(2) of the Patents Act before January 1, 2005 shall accrue from the date of grant of patent.

Moreover, after the patent is granted in respect of applications made under Section 5(2), the patent holder shall only be entitled to receive reasonable royalty from such enterprises which have made significant investment and were producing and marketing concerned product prior to January 1, 2005 and which continue to manufacture the product covered by the patent on the date of grant of the patent and no infringement proceedings shall be instituted against such enterprises.

The above provision is termed as "grandfather clause" in common parlance.

The above grandfather clause created "a special regime for generic versions of medicines if the initial patent application was made between the 1st of January 1995 and the 31st of December 2004 and if these medicines were already on the Indian market before the 1st of January 2005. Generics that enter into this category can stay on the Indian market even if their pharmaceutical substance is patented. However, the Indian law requires that the producers of those generics then pay a "reasonable royalty" to the patent holder.

If Novartis won the case and got the patent, then also the Indian companies could

have continue to sell generic Gleevec, but they have to enter a grandfather clause with Novartis and shall be obligated to pay a reasonable royalty to the patent holder.

Question 2

- (a) *'Passing off' is a common tactics to use a similar trade mark.*
- (i) *Describe the typical actions and trade mark violation in 'passing off' an action of publicising a body called 'University of Universal Learning'.*
 - (ii) *Is it possible to resort to 'passing off' petition in unregistered trade mark ?*
 - (iii) *Does the Trade Marks Act, 1999 govern an act of 'passing off' ? If yes, why and if no, why not ?* (5 marks each)
- (b) *Microsoft develops software applications. Thus, it is the 'author' with the copyrights. When you buy the Microsoft software, what is purchased, is it the software or is it licence to use the software ?*
- (i) *What are the rights of the user ? Can they be transferred ?*
 - (ii) *Does the user have right to free update versions of the software ?*
 - (iii) *If the price of a particular application is too high for the Indian consumers, what is the recourse with the Indian government to help the users in getting it at low price ?* (5 marks each)

Answer 2(a)(i)

A cause of action for passing off is a form of intellectual property enforcement against the unauthorised use of a mark which is considered to be similar to another party's registered or unregistered trademarks, particularly where an action for trademark infringement based on a registered trade mark is unlikely to be successful (due to the differences between the registered trademark and the unregistered mark). Passing off is a form of common law, whereas statutory law as such provides for enforcement of registered trademarks through infringement proceedings.

Passing off and the law of registered trademarks deal with overlapping factual situations, but deal with them in different ways. Passing off does not confer monopoly rights to any names, marks, get-up. It does not recognize them as property in its own right. Instead, the law of passing off is designed to prevent misrepresentation in the course of trade to the public.

A civil suit can be initiated under the law of passing off in respect of unregistered trade mark. The suit for passing off 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.

Section 135 of the Trade Marks Act expressly stipulates that the relief which a Court may grant in any suit for infringement or for passing off referred to in Section 134 includes injunction (subject to such terms, if any, as the court thinks fit) and at the option of the plaintiff, either damages or an account of profits, together with or without any order for the delivery up of the infringing labels and marks for destruction or erasure.

In view of the above, a civil suit can be initiated against the University of Universal Learning for an action of passing off.

Answer 2(a)(ii)

The Indian trademark law statutorily protects trademarks as per the Trade Marks Act, 1999 and also under the common law remedy of passing off. The passing off is a common law of tort which can be used to enforce unregistered trade mark rights. Passing off action arises when an unregistered trademark is used by a person who is not the proprietor of the said trademark in relation to the goods or services of the trade mark owner. It is a tort and actionable under common law.

Section 27 of the Trade Mark, 1999 provides that no infringement action will lie in respect of an unregistered trade mark but recognises the common law rights of the trade mark owner to take action against any person for passing off their goods/ services as the goods of another person or as services provided by another person.

Section 134 of the Trade Marks Act, 1999 provides that no suit for passing off arising out of the use by the defendant of any trade mark which is identical with or deceptively similar to the plaintiff's trade mark, whether registered or unregistered shall be instituted in any court inferior to a District Court having jurisdiction to try the suit.

Answer 2(a)(iii)

As per Section 11(3) of the Trade Marks Act, 1999, a trade mark shall not be registered if, or to the extent that, its use in India is liable to be prevented —

- (a) by virtue of any law in particular the law of passing off protecting an unregistered trade mark used in the course of trade: or
- (b) by virtue of law of copyright.

Section 134 of the Trade Marks Act, 1999 provides that no suit for passing off arising out of the use by the defendant of any trade mark which is identical with or deceptively similar to the plaintiff's trade mark, whether registered or unregistered shall be instituted in any court inferior to a District Court having jurisdiction to try the suit.

Further Section 135 states that the relief which a court may grant in any suit for infringement or for passing off referred to in section 134 includes injunction (subject to such terms, if any, as the court thinks fit) and at the option of the plaintiff, either damages or an account of profits, together with or without any order for the delivery up of the infringing labels and marks for destruction or erasure.

With the above provisions, it can be clearly understood that the action of passing off has been taken care in the provisions of Trade Marks Act, 1999. Since, there is very minute difference between passing off and infringement and in the common parlance the passing off and infringement is supposed to be one and the same thing. Therefore, the Act has to take care the provisions of passing off. The difference between action in passing and action in infringement had been clearly explained by the Hon'ble Supreme Court in the case of *Kaviraj Pandit Durga Dull Sharma v. Navratna Pharmaceutical Laboratories*, AIR 1965 SC 980.

Answer 2(b)(i)

The user has a right / license to use the software and user has rights only as a licensee of the copy right holder. These types of software are known as proprietary Software. These rights are defined in the sale agreement or end-user license agreement or software license agreement. The right to use the software can be transferred from one person to another as per the sale agreement or end-user license agreement or software license agreement.

Answer 2(b)(ii)

Normally, a licensee is not allowed free updates of the software. He may be given updates at a concessional rate but it is not a matter of right.

Answer 2(b)(iii)

Government of India can ask for compulsory licence if the price is too high for the Indian consumer. Royalty must, however, be paid to Microsoft in the case of Compulsory licence.

Question 3

What is the meaning of 'appeal to the eye' in the definition of a design ? A book designer prepares a jacket of a hard copy book. Will his work be covered under the Designs Act, 2000 or will it be a subject matter of the Copyright Act, 1957 ? Discuss. (5 marks)

Answer 3

As per Section 2(d) of the Designs Act, 2000 design means only the features of shape, configuration, pattern, ornament or composition of lines or colours applied to any article whether in 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 of construction or anything which is in substance a mere mechanical device, and does not include any trade mark or property mark (as defined in Section 479 of the Indian Penal Code) or artistic work (as defined in clause (c) of section 2 of the Copyright Act, 1957).

Section 2(d) of the Designs Act, 2000 contains a positive requirement for registrability: there must be features which in the finished article appeal to and are judged solely by the eye. Designs apply to nothing but that which the eye can tell entirely.

The design will therefore be calculated to attract the attention of the beholder regardless of whether or not it makes a favourable appeal to him. The requirement of appealing to the eye is therefore really a preliminary test of novelty, as compared to the fundamental form of the article". (*Amp. v. Utilux (1972) RPC 103, pp 107*).

Jacket will be covered under Copyright Act, 1957 not under Designs Act, 2000 which is usually a three dimension structure or object with "appeal to the eye".

Question 4

What are the essential requirements for the registration of a design ? (5 marks)

Answer 4

The essential requirements for the registration of a design are as under :

- The design should be new or original, not previously published or used in any country before the date of application for registration. The novelty may reside in the application of a known shape or pattern to new subject matter.
- The design should relate to features of shape, configuration, pattern or ornamentation applied or applicable to an article.
- The design should be applied or applicable to any article by any industrial process.
- The features of the design in the finished article should appeal to and are judged solely by the eye.
- Any mode or principle of construction or operation or any thing which is in substance a mere mechanical device, would not be registrable design.
- The design should not include any Trade Mark or property mark or artistic works as define under the Copyright Act, 1957.

Question 5

What are the factors to be reckoned while defining technology in the licensing agreement ? (5 marks)

Answer 5

Certain factors to be considered while defining the technology in the licensing agreement include:

- Type of the technology i.e. product, process, facility, software, formula, etc.;
- Need for additional license for practicing the technology;
- Industrial standards or specifications associated with the technology; and
- Details required practicing the technology.

Other factors that need to be considered for a successful technology licensing are:

- Owner/s of the technology;
- Nature of ownership;
- Other non-exclusive or exclusive licensing associated with the technology;
- Assistance required from the licensor to further develop or practice the technology;
- Other IPRs such as trademark, copyright, trade secret, etc. associated with the technology;
- Terms and value of royalty, etc.

Question 6

Who are the beneficiaries of registration of geographical indications ? (5 marks)

Answer 6

As per Section 11 of the Geographical Indications of Goods (Registration & Protection) Act, 1999, registered proprietors of geographical indication like any association of persons, producers, organization or authority established by or under the law are the beneficiaries of geographical indications.

The Applicant has to be a legal entity and should be representing the interest of producers of the goods applied for. Any such organisation or association being not that of the producers may have to prove that they represent the interest of producers. Any Applicant Authority also has to prove that they represent the interest of producers.

INTERNATIONAL BUSINESS LAWS AND PRACTICES (Elective Paper 9.5)

Time allowed : 3 hours

Maximum marks : 100

NOTE: Answer **ALL** Questions.

Question 1

There is no telling how different our streets and highways would look had Japanese car companies not been able to sell their cars in the U.S. market when they first came to the United States in the 1960s and 1970s. Since the days of the ultra-compact Honda Civics which could barely make it up the hilly roads in California, U.S. consumers have had the opportunity to choose from a wide variety of high-quality Japanese cars and parts. In fact, in the last twenty-five years, Japan has sent 40 million cars to the United States.

This competition from Japan has helped to ensure that U.S. auto and auto parts companies remain topnotch, world-class competitors. Not only are the U.S. auto and auto parts companies facing fierce competitors in the United States, they also compete aggressively all over the world.

In Japan the U.S. companies have taken specific steps to tailor their products specifically to Japanese consumers. Today, American auto manufacturers sell 101 products in the Japanese market, sixty of which are right-hand drive vehicles. These include the Jeep Cherokee, Ford Probe and Mondeo and GM Opel. More are on the way. But in the last twenty-five years, the United States has only shipped 4,00,000 cars to Japan.

In the recently concluded automobile negotiations with Japan, all the United States asked was that Japan provide the same free access to its market that we provide to their companies here. Denial of this access has cost substantial loss of jobs and business opportunities in the United States and other countries.

Ford, GM, Chrysler and U.S. parts manufacturers have had great success in markets all over the world from Europe to other Asian markets. But, when they have tried to sell their products in Japan, they confronted a web of unnecessary and burdensome regulations, informal and artificial barriers, and business practices that made it extremely difficult to sell their products in Japan.

After a significant investment of time and resources trying to crack the Japanese market, these companies turned to the U.S. Government for help in trying to weed through some of the burdensome regulations, break-up some of the exclusive business relationships, and create an environment which would allow them to sell their autos and auto parts in Japan.

The Clinton Administration was eager to take on the challenge. After all, autos and auto parts represent nearly 60 percent of our trade deficit with Japan. These industries support about 2.5 million U.S. jobs in sectors from semiconductors to rubber and glass.

The Agreement

After twenty-two months of intensive negotiations with Japan, a negotiating team led by Under Secretary of Commerce for International Trade Jeffrey E. Garten and Ambassador Ira Shapiro from United States Trade Representatives (USTR), reached a historic, market-opening agreement on autos and auto parts on 28th June, 1995.

This agreement will increase access to Japanese dealerships for U.S. auto manufacturers, help deregulate Japan's repair parts market and lead to increased Japanese purchases of U.S. parts both here and in Japan. Accomplishments in these three areas should go a long way in helping U.S. auto and auto parts companies substantially increase their sales to Japanese companies.

Dealerships

One key problem for U.S. auto companies trying to sell their products in Japan is that they were effectively blocked from getting their cars to Japanese showrooms. This was because Japanese dealers were afraid that their primary Japanese suppliers would retaliate against them if they entered into independent franchise agreements with foreign vehicle manufacturers. As a result of the agreement, the Japanese Government has promised to vigorously enforce its antitrust laws, and to take actions to assure Japanese dealers that they are free to carry foreign cars, without risking business relationships with their primary suppliers.

As a result of this agreement, we expect U.S. auto companies to open an additional 200 outlets in Japan by 1996 and 1,000 new outlets by the year 2000.

Deregulation of After Market for Parts

U.S. parts suppliers also faced great difficulties trying to sell their replacement parts in the Japanese after market. To deal with this problem, the United States sought to substantially reduce the number of Japanese regulations that greatly constrain consumer choice and the ability of foreign suppliers to have their products reach the end-user. The multi-billion-dollar Japanese market for replacement auto parts is restricted by a complex system of regulations that go well beyond what is needed for safety or environmental protection. These regulations involve a complex car inspection system that forces Japanese consumers to have their cars repaired in 'certified garages' that tend to only carry Japanese parts. The regulations also stipulate that any repair to 'critical' parts must be done at special garages, and that any modifications made to cars must be reinspected.

One American expert on this system recently said in a Japan Digest article, "It's a no-brainer to say that \$1 U.S. made spark plugs should have long since captured 100 percent of a market in which Japanese plugs sell for \$8 a piece. They haven't because inspection laws compel drivers to use 'authorised' parts. Toyotas can only use pure Toyota parts, Nissans pure Nissan parts, etc."

Spark plugs are just one example. Because of Japan's closed market and the lack of competition, prices for auto parts far exceed prices in the United States. An alternator which sells for \$120 in the United States sells for \$600 in Japan. Shock absorbers that sell in the United States for \$228 sell for \$605 in Japan. As a result of the automotive agreement, Japanese consumers should now be able to save over \$300 when they need new shocker for their cars by purchasing high quality U.S. products.

The agreement cuts through some of the burdensome after market regulations, and allows market forces a greater chance to work properly in ensuring that the best quality and lowest priced products reach the Japanese consumer. The agreement specifically reduces the number of parts on the 'critical parts' list, reduces the number of modifications subject to inspection, and makes it easier to establish garages that can sell foreign auto parts.

Original Equipment Parts Purchases

In the area of original equipment parts sales to Japanese manufacturers in Japan as well as the United States, the U.S. addressed a very real problem: the closed 'keiretsu' purchasing relationships between Japanese manufacturers and their key suppliers. Despite the world-class competitiveness and strong price advantages of U.S. parts suppliers, Japanese manufacturers have simply not been responding to market forces.

To help address this situation, the five major Japanese auto manufacturers have released business plans which will lead to increased parts purchases by Japanese transplants in the United States, increased auto production in the United States, and increased imports of foreign auto parts into Japan. We expect that the transplants will purchase \$6.75 billion more in parts from U.S. suppliers by 1998, Japanese car makers will increase auto production in the U.S. to 2.65 million in 1998, and Japan will import \$6 billion worth of foreign parts by 1997.

Many agencies in the U.S. Government contributed to bringing about an agreement in this sector so critical to our nation's economy. The Commerce Department, which played a key role throughout the nearly two years of talks, succeeded in working with other governmental agencies and industry groups to avoid a serious trade conflict with Japan, and in reaching a meaningful agreement. International Economic Policy's Office of Japan led the negotiations within the Department, along with Trade Development's Office of Automotive Affairs. Ambassador Mickey Kantor, USTR, acknowledged this fact when he stressed in a recent letter to Senator Bob Dole, "... the Commerce Department provides essential analytic support and in-depth knowledge of foreign trade practices that have been invaluable to USTR and other agencies involved in negotiation and implementing trade agreements ... the Commerce Department's detailed knowledge of the Japanese automotive sector has been essential to our efforts to open the Japanese auto and auto parts markets to foreign competition."

Of course, an international trade agreement is only as good as its implementation. The Commerce Department will be responsible for carefully monitoring and implementing this agreement. Martina Bradford, Vice President for government affairs at AT&T Corporation, recently said in a Washington Post article, "trade agreements only yield results through vigorous monitoring, enforcement and measurement of results." The Department of Commerce will implement this agreement with the vigor and energy it demonstrated in helping to negotiate it.

As former Secretary of Commerce Ron Brown noted, "The Commerce Department is proud to have played such a critical role in negotiating an agreement which deals with many of the very real and specific problems U.S. businesses face in trying to penetrate the Japanese market." The level of cooperation demonstrated by the Department of Commerce, USTR and the U.S. auto and auto parts industries in

developing an agreement which deals with such complex and technical barriers and regulations in Japan should set a new standard for future negotiations in other areas.

US-Japan Auto and Auto Parts Agreement Fact Sheet

The United States and Japan on June 28 reached a historic agreement which will result in significantly increased market access for autos and auto parts, and structural change in the Japanese automotive sector. This is the sixteenth trade agreement the Clinton Administration has completed with Japan in the past twenty-eight months – an unprecedented rate of success. These agreements have opened major trade sectors.

The missing piece has been the autos and auto parts sector. This area represents \$37 billion of our \$66 billion trade deficit with Japan, nearly 60 percent of our Japan deficit and 25 percent of our overall trade deficit.

Since auto negotiations began in October 1993, the Administration has emphasised three overriding goals for opening the auto and auto parts sector. This agreement meets our goals in each of the following area :

Deregulation of the Replacement Parts Market in Japan: A thicket of bureaucratic regulations have blocked competitive U.S. auto parts from Japan's multi billion-dollar market for replacement parts. This agreement clears away layers of needless regulations, introducing new competition and opening a market previously reserved for Japanese suppliers.

Access to Dealerships: This agreement will give U.S. auto companies increased access to Japanese dealership networks. U.S. auto companies will be able to sell through more dealerships in Japan. Japanese consumers will have the option to buy our reasonably priced, high-quality cars. We expect U.S. auto companies to open an additional 200 outlets by 1996 and 1,000 new outlets by 2000, to support the U.S. industry's objective of exporting 3,00,000 vehicles by the year 2000.

Increased Purchases of Original Equipment Parts: In Japanese companies, the original equipment auto parts market is dominated by 'keiretsu', unique interlocking relationships between manufacturers, suppliers, distributors and financial institutions. The keiretsu act unfairly to block foreign access to the market.

Japan's five largest auto companies are announcing plans to increase their parts purchases in North America, including diversification into high-value components such as transmissions and engines; to increase their vehicle production in North America by \$6.7 billion; and to purchase \$6 billion of foreign parts by 1998 for production use in Japan.

Answer the following questions :

- (a) Does Japan's trade success owe more to its manufacturing superiority or its mercantilistic trading philosophy (i.e., import barriers) ?*
- (b) Does the Japanese government use non-tariff barriers unreasonably to restrict imports ?*
- (c) Some claim that U.S. trade deficits are caused by U.S. adoption of a free-trade philosophy. Do you think that the United States has fewer import barriers than its trading partners ?*
- (d) Will protectionist measures adopted by the U.S. government be effective in*

increasing employment in the United States ? Do you think that the U.S. government's use of open market access against Japanese auto imports benefits the United States ?

- (e) *What can U.S. firms (including automakers) do to overcome Japanese trade barriers and improve their performance ?* (10 marks each)

Answer 1(a)

There are two situations in this case-

- *Manufacturing Superiority* - In 1960s and 1970s, there was the influx of variety of Japanese cars in the US due to easy trade and industry policy of the host nation. These cars offered a wide variety of the options to the US customers with a very high quality. This phase was very lucrative and beneficial to the Japanese car trade.
- *Mercantilist philosophy* - The US auto firms faced restrictions in accessing the Japanese markets. The variety of trade regulations existed in Japanese markets for foreign companies. There was a thicket of bureaucratic regulations that have blocked competitive US auto parts from accessing Japanese market.

The success of Japanese automobile trade was mainly due to the quality of Japanese automobiles as well as large variety and the US's relative trade deficit in automobile trade was due to restrictions on entry in Japan.

Answer 1(b)

American Auto companies such as Ford, GM, Chrysler and US parts manufacturers have had great success in markets all over the world, but they faced a number of problems in Japanese markets.

- Japan had officially 'opened' its market but Japanese government perfected the art of using non-tariff barriers as huge obstacles for all foreign companies trying to do business in Japan to keep imports to a minimum.
- Japan had a web of unnecessary and burdensome regulations, informal and artificial barriers and business practices.
- Japan had complex system of regulations for safety and environmental protection.
- These regulations involved a complex car inspection system that forced Japanese consumers to get their cars repaired at 'certified' garages.
- The regulations also stipulated that any repair to 'critical' parts be done at be done at special garages.
- Japan's exclusive 'keiretsu' arrangements between government and Japanese automakers prevented US and other foreign auto companies from doing business in Japan;
- Japan has used automotive technical regulations as a means to protect local markets by creating excessively difficult and costly regulatory and certification requirements, with little or no safety or emissions benefits;
- The tax system in Japan was designed to benefit domestic over imported motor vehicle types;

Thus, we can say that Japanese government used non-tariff barriers unreasonably to restrict imports.

Answer 1(c)

US had adopted free trade policy with Japan. The auto sector accounted for more than half of the US deficit with Japan. US attributed trade deficits to Japan's unfair trade practices and also to its very open policy towards Japanese automobile influx.

Following points clarify that US had fewer import barriers than its trading partners-

- The US trade policy of the 1980s had tremendous economic effects on Japan and other East Asian economies. For example, many Japanese manufacturers invested in the US in the early 1980s.
- Japan had extensive access to the US market while US exporters lacked access to the Japanese markets.
- According to the case, in last twenty five years, Japan has sent 40 million cars to the US whereas US has shipped only 4 lakh cars to Japan.
- Only autos and auto parts represent nearly 60% of the trade deficit with Japan.
- US had to face overall lack of access to Japan's automotive market. For example, US automakers seeking to introduce automobiles using new technology had to face a lack of transparency and other barriers to certify these new products in a timely and efficient manner.

Answer 1(d)

At the time of this case, autos and auto parts industries supported about 2.5 million US jobs in sectors from semiconductors to rubber and glass. The protectionist measures, if adopted by US government would not have been effective in increasing the employment in US as auto and auto parts industry would have suffered.

In fact the US government's use of open market access against Japanese auto imports had benefitted US in following ways.

- The competition from Japan has helped to ensure that US auto and auto parts companies remain topnotch, world class competitors.
- US auto and auto parts industry compete aggressively all over the world.
- US consumers had the opportunity to choose from a wide variety of high quality Japanese cars and parts.
- Autos and auto parts industries have provided more employment opportunities in US.
- There were increased parts purchases by Japanese transplants in the US and increased auto production in the US.

Answer 1(e)

Since the US Auto companies were facing difficulty in penetrating Japanese market due to the non tariff trade barriers and strong legal formalities imposed by the Japanese

Government, US Commerce Department negotiated and signed various agreements with Japanese counterpart. Under the agreement, the US auto companies known for good quality and low priced products entered the replacement parts market in Japan. Under the agreement on access to dealership, the US auto companies were able to sell more through dealership in Japan.

US firms including automakers can do following to overcome Japanese trade barriers and improve their business-

- Improve quality of their products.
- Provide high quality products at competitive prices.
- Search for new potential markets.
- Make pressure on Government to use diplomatic pressure on the Japanese counterpart to reduce the non tariff barriers and monitor the implementation of the same by Japan.
- Emphasizing on the importance of reciprocation in business utility to both the countries.

Question 2

- (a) *An Indian company is running hotel chain in India but now it is planning to internationalise its operations in European countries. Explain why the company should adopt franchising as entry mode on licensing.*
- (b) *Analyse the impact of Government of India's decision to increase foreign direct investment in insurance sector from 26% to 49% by using Michael Porter's Force 'threat of new entry'.*
- (c) *Explain the MNCs taxation issues and government decision to defer General Anti Avoidance Rule (GAAR) for two years.*
- (d) *Explain the purpose of introducing duty exemption & remission schemes and export promotion of capital goods (EPCG).*
- (e) *Distinguish between 'economic union' and 'monetary union'.*
- (f) *Why was International Monetary Fund (IMF) created in 1945 and what was the purpose of introducing special drawing rights (SDRs) by IMF ? Why SDRs is called paper gold ?* (5 marks each)

Answer 2(a)

Licensing is the method of foreign operation whereby a firm in one country agrees to permit a firm in another country to use the manufacturing, processing, trademark, know-how or some other skill provided by licensor. The licensor has minimum involvement in day to day functions and the returns are also comparatively low.

In Franchising, the franchise provides an established product or service which may already enjoy widespread brand-name recognition. This gives the franchisee the benefits of selling proven products and services to a pre-sold customer base which would ordinarily takes years to establish. This is so because a defined level of quality and consistency

are assured to the customers in this model. Franchising model offers important pre-opening support as well as ongoing support in the form of training, national and regional advertising, operating procedures and operational assistance, ongoing supervision and management support, etc. which are not available in licensing.

Franchising model will be more suitable for this Indian hotel over licensing as franchising is more apt for service industries than licensing which is more suitable for manufacturing industries. Franchising will provide following advantages to the Indian company-

- (i) It will provide access to venture investment capital without the need to give up control of the operation of the chain in the process.
- (ii) Once the brand and formula are designed and properly executed, franchisor will be able to sell franchises and expand rapidly across countries and continents using the capital and resources of their franchisees, and can earn profits commensurate with their contribution.
- (iii) It will provide access to European markets at greatly reduced risk and expense.
- (iv) The Indian company/franchisor will be relieved of many of the legal formalities involved in starting a new outlet, such as obtaining the necessary licenses and permits.
- (v) In some jurisdictions, certain permits (especially alcohol licenses) are more easily obtained by locally based, owner-operator type applicants while companies based outside the jurisdiction. Therefore, hotel and restaurant chains that sell alcohol often go for franchisee mode of international entry.
- (vi) The need of franchisors to closely scrutinize the day to day operations of franchisees will be greatly reduced.

Answer 2(b)

Michael Porter's five forces model is an analysis tool that uses five forces to determine the profitability of an industry and shape a firm's competitive strategy. As per Michael Porter, profitable markets that yield high returns attract new firms. This results in many new entrants, which eventually decreases profitability for all firms in the industry. This is called threat of new entry.

The Government of India has decided to increase foreign direct investment in Insurance sector from 26% to 49%.

As far as Michael Porter's five forces model applicability for threat from new entrants is concerned, India is a country having very low insurance penetration (3%) and this market share is further declining due to lack of satisfactory service on the part of existing players in the market. Reports reveal that there is a need to infuse capital in this sector. Therefore, low penetration indicates the threat of new entrants will not have much adverse affect on market share of the present players, as 97% market is still uninsured.

Secondly, private players in insurance are also facing problem of meeting Capital Adequacy norms. Increased FDI limit will strengthen the capital base of existing private sector companies entering into joint ventures with foreign players. This will lead to offering

of new products that will attract larger population to come under insurance cover. Though FDI in insurance will be the threat for the public sector companies, this will lead to a healthy competition leading to introduction of new products which in turn lead to increase in their existing customer base.

Answer 2(c)

MNCs Taxation issues: An MNC operates with different companies located in different countries under same management group. They transfer finished and semi-finished goods, raw materials, spares and services among the group companies. 40% of the international trade consists of transfers between related business companies which involve transfer pricing. In many cases, there are charges against MNCs on the usage of transfer pricing for dubious activities. Hence, it becomes a source of conflict between the MNC and the host government. However, the adverse effects of transfer pricing can be checked to a great extent by indirect regulations which may be applied in different forms like-

- Harmonization of tax and tariff between home and host country,
- Compensation for the loss of corporate tax revenues on account of transfer pricing,
- Apportionment of the consolidated profit of the MNC among the relevant units on the basis of total assets, sales and labour and capital employed. etc

General Anti-Avoidance Rule (GAAR) is an anti-tax avoidance regulation of India. This regulation allows tax officials to deny tax benefits, if a deal is found without any commercial purpose other than tax avoidance. It allows tax officials to target participatory notes. Under GAAR, the investor has to prove that the participatory note was not set to avoid taxes. It also allows officials to deny double taxation avoidance benefits, if deals made in tax havens like Mauritius are found to be avoiding taxes. It has provisions to seek taxes from past overseas deals involving local assets retrospectively, because of which it has been postponed by two years to April 2017.

Answer 2(d)

Duty exemption schemes enable duty free import of inputs required for export production. Duty Exemption Schemes consist of -

- (i) *Advance Authorisation scheme* - An Advance Authorisation is issued to allow duty free import of inputs, which are physically incorporated in export product (making normal allowance for wastage).
- (ii) *Duty Free Import Authorisation (DFIA) scheme* - A Duty Free Import Authorisation is issued to allow duty free import of inputs which are used in the manufacture of the export product (making normal allowance for wastage), and fuel, energy, catalyst etc. which are consumed or utilised in the course of their use to obtain the export product.

Duty Remission schemes enable post export replenishment / remission of duty on inputs used in export product. Duty Remission Schemes consist of Duty Drawback (DBK) Scheme.

Export Promotion Capital Goods Scheme - EPCG scheme allows import of capital goods for pre production, production and post production at 3% Customs Duty, subject to an export obligation equivalent to 8 times of duty saved on capital goods imported under EPCG scheme, to be fulfilled in 8 years reckoned from Authorisation issue-date. In case of agro units, and units in cottage or tiny sector, import of capital goods at 3% Customs duty shall be allowed subject to fulfilment of export obligation equivalent to 6 times of duty saved on capital goods imported, in 12 years from Authorisation issue-date.

Answer 2(e)

Economic union is created when countries enter into an economic agreement to remove barriers to trade and adopt common economic policies. An example is the European Union (EU).

Monetary union is a group of countries that share single money. When two or more countries share common currency or decide to peg their exchange rates in order to keep the value of their currency at a certain level it is called monetary union. Monetary union is established through a currency-related trade pact. Economic and Monetary Union of the European Union with the Euro for the Euro-zone members is the example of monetary union.

Answer 2(f)

The International Monetary Fund (IMF) was created in 1945 to foster international monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. The IMF's primary purpose is to ensure the stability of the international monetary system—the system of exchange rates and international balance of payments that enables countries (and their citizens) to transact with one other. This system is essential for promoting sustainable economic growth, increasing living standards, and reducing poverty.

The SDR was created by the IMF in 1969 to support the Bretton Woods fixed exchange rate system. A country participating in this system needed official reserves, government or central bank holdings of gold and widely accepted foreign currencies that could be used to purchase the domestic currency in foreign exchange markets, to maintain its exchange rate. But the international supply of two key reserve assets—gold and the US dollar—proved inadequate for supporting the expansion of world trade and financial development. Therefore, the international community decided to create a new international reserve asset SDR under the IMF.

Originally, the value of the SDR was equivalent to 0.888671 grams of fine gold—which, at the time, was also equivalent to one US dollar. But when the dollar was devalued against gold and against other major currencies, the SDR retained its nominal gold value, hence it was referred to as “paper gold.”

Question 3

Anti-dumping duty is imposed by the countries to protect the domestic industries and market. Analyse the recent anti-dumping cases in India and give your argument that why India should impose anti-dumping duty. (5 marks)

Answer 3

Anti-dumping is a measure to rectify the situation arising out of the dumping of goods and its trade distortive effect. It provides relief to the domestic industry against the injury caused by dumping. It is imposed to protect the domestic industries and market. Some of the recent cases justifying why India should impose anti-dumping duty are given below-

- (i) India has recently imposed anti-dumping duty for certain stainless steel products imported from China, Malaysia and South Korea, as the domestic steel industry was battling sluggish market sentiments and strained margins. The duty was imposed on hot rolled (HR) flat products of stainless steel grade with all its variants originating from China at \$309 per tonne, \$316 a tonne from Malaysia and from Korea at \$180 a tonne as the home-grown stainless steel industry had sustained material injury due to such dumped imports and anti dumping measure was required to stop it.
- (ii) The Finance Ministry has imposed a definitive anti-dumping duty on 'USB Flash Drives' imported from China and Taiwan. For 'USB Flash Drives' imported from China, the revenue department has imposed an anti-dumping duty of \$ 3.12 per unit. In the case of pen drives imported from Taiwan, the anti-dumping duty has been pegged at \$ 3.06 per unit. The anti-dumping duty will be valid for a period of five years. Storage Media Products Manufacturers & Marketers Welfare Association had filed the application on behalf of the domestic producers represented by Moser Baer India Ltd. which is the sole producer of 'USB Flash Drives' in India to protect the domestic industry.
- (iii) The Finance Ministry has imposed definitive anti-dumping duty on 'poly vinyl chloride paste/emulsion resin' imports from Norway and Mexico. The anti-dumping duty ranged from \$309-\$429 per tonne depending on the exporter and the country of export.

Question 4

Why are India and other developing countries concerned about Doha agenda ? Analyse the Doha Development Round ? (5 marks)

Answer 4

The Doha Development Round or Doha Development Agenda (DDA) is the current trade-negotiation round of the World Trade Organization (WTO) which commenced in November 2001. Its objective is to lower trade barriers around the world, which will help facilitate the increase of global trade. As of today, talks have stalled over a divide on major issues, such as agriculture, industrial tariffs and non-tariff barriers, services, and trade remedies.

Concerns of India and other developing countries regarding Doha Agenda:

- India and other developing countries claim that they have had problems with the implementation of the agreements reached in the earlier Uruguay Round because of limited capacity or lack of technical assistance.
- Agriculture has become the key issue of India and developing and developed countries.

- India was also concerned about compulsory licensing of medicines and patent protection.
- Another issue is related to a review of provisions giving special and differential treatment to developing countries.
- India and other developing countries were also concerned about problems faced in implementing current trade obligations.

At the Doha meeting, the Ministerial Declaration directed a two-path approach for the large number of remaining issues: (a) where a specific negotiating mandate is provided, the relevant implementation issues will be addressed under that mandate; and (b) the other outstanding implementation issues will be addressed as a matter of priority by the relevant WTO bodies.

Question 5

Explain how Paul Krugman trade theory is different from Heckscher-Ohlin Model and also explain the recent trends in global trade. (5 marks)

Answer 5

The Heckscher-Ohlin theory is formulated with labor and capital as the two factors of production. According to the Heckscher-Ohlin theory, what determine trade are differences in factor endowments. Some countries have much capital, others have much labor. The theory says that countries that are rich in capital will export capital-intensive goods, and countries that have more labor will export labor-intensive goods. However, in the 20th century, an ever larger share of trade occurred between countries with similar characteristics, which were difficult to explain by comparative advantage. Krugman's explanation of trade between similar countries involves two key assumptions: that consumers prefer a diverse choice of brands, and that production favours economies of scale. He explained that each country may specialize in producing a few brands of any given type of product, instead of specializing in different types of products.

Recent Trends in global trade

The global trade in the year 2014 was disappointing. Developing countries saw an uptick in growth this year, boosted in part by soft oil prices, a stronger US economy, continued low global interest rates, and receding domestic headwinds in several large emerging markets. After growing by an estimated 2.6 percent in 2014, the global economy is projected to expand by 3 percent in the year 2015, 3.3 percent in 2016 and 3.2 percent in 2017. Activity in the US and the UK is gathering momentum as labor markets heal and monetary policy remains extremely accommodative. But the recovery has been sputtering in the Euro Area and Japan as legacies of the financial crisis linger. China, meanwhile, is undergoing a slowdown.

Question 6

Justify —

Logistics = Supply + Material Management + Distribution

Why a large scale steel manufacturing company should use third party logistics (3PL) ? (5 marks)

Answer 6

Logistics = Supply + Material Management + Distribution. This is so because; the purpose of logistics is to make the product available to the customer at the right place and at the right time. The operating responsibility of logistics is the geographical repositioning of raw materials, work in process, and finished inventories where required at the lowest cost possible. Logistics is concerned with proper movement of materials from the source of supply to the place of production and movement of finished product from the factory to the customer.

Third-party logistics (3PL) refers to outsourcing transportation, warehousing and other logistics related activities that were originally performed in-house to a 3PL service provider. A large scale steel manufacturing company should use third party logistics (3PL) for following advantages-

- The company can focus to its core business operations.
 - The company can gain immediate access to intelligent IT infrastructure.
 - The company need not invest or block funds in facilities like warehouses, trans-shipment centers or equipment vehicles etc.
 - To reduce costs / expenses as costs are based on the transported volumes and distances by 3PL service providers.
 - To gain the advantage of economies of scale.
 - To get the flexibility in market penetration.
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