

PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 2009

COMPANY SECRETARIAL PRACTICE

Time allowed : 3 hours

Maximum marks : 100

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

Question 1

Draft any four specimen resolutions stating the authority who can pass it and also the type of resolution. Give reasons for passing the requisite resolution referring to the relevant section(s) of the Companies Act, 1956 :

- (i) Health Care Ltd. (HCL) wants to make investment of Rs.55 crore and loans of Rs.45 crore in other companies. Balance sheet as on 31st March, 2009 shows HCL's paid-up capital of Rs.35 crore and reserves of Rs.75 crore.*
- (ii) Buoyant Ltd., a loss incurring company, wants to appoint Jolly as Managing Director w.e.f. 15th March, 2009 on a total remuneration of Rs.10 lakh per month (all inclusive). Its paid-up capital is Rs.5 crore, reserves Rs.3 crore and term loans Rs.10 crore. The company has accounting year ending on 31st March every year.*
- (iii) Grow India Ltd. is sanctioned a credit facility of Rs.25 crore by the Union Bank of India, Kapurbavdi Branch, Thane, against its inventory and receivables. The company wants to enjoy the sanctioned credit facility.*
- (iv) Global Fashion Ltd. wants to appoint Amitabh as a director in place of Dharmendra who has resigned due to ill health.*
- (v) Neo Biotech (P) Ltd. wants to appoint the first auditors in the regular course within a fortnight of the registration of the company. (5 marks each)*

Answer 1(i)

Authority : Shareholders

Type of Resolution : Special Resolution

“RESOLVED THAT pursuant to Section 372A and other applicable provisions of Companies Act, 1956, consent of the company be and is hereby accorded to the Board of Directors of the company to make loans not exceeding an aggregate sum of Rs.45 crores and also to make investment not exceeding Rs.55 crores in other bodies corporate”.

Explanatory Statement

In the case of the aggregate amount of the investments in shares/debentures, loans and guarantee(s)/security(ies) proposed to be made by the company to other bodies corporate exceeds the limits provided in Section 372A of the Companies Act 1956 requires approval of the shareholders by Special Resolution at a General Meeting.

None of the directors save and except Shri..... and Shri..... who are also Directors on the Board of HCL (Ltd.) are concerned or interested in the resolution.

Note : As per the provisions of section 372A of the Companies Act, 1956, the Board of directors of a public company can make investments and give loans to the extent of 60% of its paid up capital and free reserves or 100% of its free reserves which is higher. If the company wants to exceed this limit then consent of the members at General Meeting is needed by passing a special resolution.

In the instant case, the company's aggregate of paid-up capital and free reserves is Rs. 110 crore. Therefore, a special resolution is required.

Answer 1(ii)

Authority : *Board/Shareholder with approval of the Central Government*

Types of Resolution : *Board Resolution subject to approval of the Central Government.*

“RESOLVED THAT, as per the provisions of section 198, 269 and 309 and subject to the approvals of the shareholders and the Central Government and subject to the compliance of the requirement of Schedule XIII of the Companies Act, 1956, Mr. Jolly be and is hereby appointed the managing director of the company with effect from 15th March, 2009 on a remuneration of Rs.10 (ten) lakhs per month or Rs.120 lakhs per annum inclusive all benefits and perquisites for a period of 3 years or lesser as may be approved by the Central Government and he shall not be liable to retire by rotation”.

Note : The board of directors of the company can appoint a managing director subject to approval of the members at the General Meeting by complying with the provisions of the various sections of the Companies Act read with Schedule XIII, Part III of the Act. Section 269 of the Act applies to this appointment as the company, a public company, is having paid-up capital of Rs.5 crore. When a student gives an ordinary resolution passed at a general meeting for appointment of managing director, he should also be fully awarded provided the body of the resolution is on.

Answer 1(iii)

Authority : *Board of Directors*

Type of Resolution : *Board Resolution*

“RESOLVED THAT in terms of section 292(1)(c) of Companies Act, 1956, the company do commence enjoying the credit facility of Rs.25 crore against its inventories and receivables sanctioned by Union Bank of India, Kapurbavdi Branch, Thane and do accept the terms and conditions of such sanction mentioned in the sanction letter No..... dated..... copy of which was tabled before the board and duly initialled by the Chairman for the sake of authentication.”

“RESOLVED FURTHER THAT, Mr. A, the Chairman or Mr. B, the Managing Director of the company, be and is hereby authorized to acknowledge the sanction letter by signing the duplicate copy thereof, on behalf of the company.”

“RESOLVED FURTHER THAT, Mr. B, the Managing Director of the company along with Mr. C, Director Finance be and are hereby authorized to sign and execute Promissory Note, Deed of Hypothecation and other documents, writings as deemed necessary by the said Union Bank of India, on behalf of the company, to avail the sanctioned credit facility”.

“RESOLVED FURTHER THAT, the Common Seal of the company be affixed to all such documents, deeds and other writings as required by the said Union Bank of India in the presence of Mr. B, Managing Director and Mr. C, Director Finance and counter signed by the Secretary of the company as per Article 72 of the Articles of Association of the company who shall sign the same in token thereof.”

Note : In terms of the section 292 (1)(c) of the Companies Act, 1956, the power to borrow moneys otherwise than debentures can be exercised by Board of Directors by means of resolution passed at the meeting of the Board. Further, to avail any credit facility sanctioned by a bank, first the same has to be acknowledged by signing the duplicate copy of the same. An authorization for signing of the documents has to be given to the director/s of the company and to affix common seal of the company as required by the Articles of Association of the company.

Answer 1(iv)

Authority : *Board of Directors*

Type of Resolution : *Board Resolution*

“RESOLVED THAT, in terms of the provisions of section 262 of the Companies Act, 1956 and Article 56 of the Articles of Association of the company Mr. Amitabh be and is hereby appointed as a Director of the company to fill up the casual vacancy resulted in the Board of Directors of the company due to the resignation by Mr. Dharmendra, due to his ill health, and he shall hold the office up to the remaining term of the said resigned director.”

Note : The section 262 of the Companies Act, 1956 empowers the company to fill in the casual vacancy resulted in the board of directors of the company. Such appointee shall hold the office until the director who resigned would have held such office of the director. The Articles of Association should contain a provision for such appointment, which normally most of the Articles do have.

Answer 1(v)

Authority : *Board of Directors*

Type of Resolution : *Board Resolution*

“RESOLVED THAT subject to compliance of section 224(1B) of the Act, consent of the Board of directors be and is hereby accorded to the appointment of M/s....., Chartered Accountants, who have given a certificate in writing of their eligibility, as First Auditors of the company to hold office up to the conclusion of the First AGM of the company at a remuneration of Rs..... in addition to the out of pocket expenses incurred by them plus service tax, if any applicable, in connection with audit of company accounts.

“RESOLVED FURTHER THAT the Secretary of the company be and is hereby directed to give intimation of the appointment to the Auditors so appointed within 7 days of the date of resolution.”

Note : As per section 224(5) of the Act, the First Auditor are expected to be appointed by the Board within one month of registration of the company. As the appointment is proposed within the fortnight of registration, the appointment is to be made by the Board

in the regular course, subject to compliance with Ceiling Rule contained in Section 224(1B) of the Act.

Question 2

- (a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :
- (i) Alteration to articles of association requires a _____ resolution under section _____ of the Companies Act, 1956.
 - (ii) Allotment of equity shares requires e-form _____ whereas increase in authorised capital needs e-form _____ .
 - (iii) Once a dividend is declared, it must be paid within _____, but unpaid dividend account balance needs to be transferred within 7 years to _____.
 - (iv) A Company Secretary in whole-time employment is to be appointed by every company whose paid-up capital is Rs. _____ and above under section _____ of the Companies Act, 1956. (1 mark each)
- (b) State, with reasons in brief, whether the following statements are correct or incorrect:
- (i) A public limited company can have equity share capital alone, but it cannot have preference share capital alone.
 - (ii) A company is not bound to close its register of members even for a single day.
 - (iii) Interim dividend can be declared out of reserves by a company which has even incurred a loss.
 - (iv) The annual general meeting of a company for the current year as also for the previous year can be held on the same day.
 - (v) A group of 44 members of a company limited by shares holding in aggregate 2% of the issued share capital of the company cannot under any circumstances apply to the Company Law Board alleging mismanagement of the company. The company has 550 members.
 - (vi) The expression 'free reserves' for the purpose of section 372A does not include the balance to the credit of 'securities premium account'. (2 marks each)

Answer 2(a)

- (i) Alteration to articles of association requires a **Special** resolution under section **31** of the Companies Act, 1956.
- (ii) Allotment of equity shares requires e-form **2**, whereas increase in authorised capital needs e-form **5** **duly stamped. (Stamping is not required in all the States)** .
- (iii) Once a dividend is declared, it must be paid within **30 days** , but unpaid dividend

account balance needs to be transferred within 7 years to **Investors Education & Protection Fund** .

- (iv) A Company Secretary in whole-time employment is to be appointed by every company whose paid-up capital is **Rs.5 crore** and above under section **383A** of the Companies Act, 1956.

Answer 2(b)(i)

True

Reason : By the very definition of 'preference share capital' in section 85, preference shareholders have certain preferential rights over the equity shareholders. So, in the absence of equity share capital, there cannot be preference share capital.

Answer 2(b)(ii)

True

Reason : Section 154 of the Companies Act has not made the closure of register mandatory. As per Secretarial Standard 4 (cl.4.2.1) issued by ICSI, a company is not bound to close its register even for a day, a company chooses to close its register so as to update it for reckoning entitlements to dividend, right bonus etc, such closure may be for any period or periods not exceeding in aggregate 45 days in a year, but not exceeding 30 days at any one time.

Answer 2(b)(iii)

False

Reason : Though section 205(1A) has empowered the Board to declare interim dividend, but such dividend cannot be declared out of reserves. According to Secretarial Standard 3 issued by ICSI (cl.1.2.2), while final Dividend may be paid out of Free Reserves subject to compliance of the rules, no Interim Dividend should be paid, in the event of a loss or inadequacy of profits, by transfers out of any reserves.

Answer 2(b)(iv)

True

Reason : Section 166 of the Companies Act, 1956 provides as under:

1. In every Calendar year there must be 1(one) AGM held.
2. The Time Gap between two consecutive AGM must not be more than 15 months, however, the ROC is authorized to extend this by 3 (three) months for valid reasons.
3. From the closure of the accounting year AGM must be held within 6 months under section 210.

However, there is no provision in the Act prohibiting the holding of two AGMs on the same day. The situations where two AGMs may be held on the same day :

1. The first and second AGM may be held on same day.

2. When the company changes financial year two AGMs may be held on the same day.

There should, however, be separate notices for each meeting, and they should be held at different timings on the same day after the conclusion of the 1st AGM.

Answer 2(b)(v)

False

Reason: The Central Government under section 399(4) of the Companies Act, 1956 may authorize such application alleging mismanagement, if it is satisfied that circumstances justify allowing such application.

Answer 2(b)(vi)

False

Section 372(A) of the Companies Act, 1956 while explaining the term “Free Reserves” has specifically included securities premium account balance in the term “Free Reserves”, which reads as follows:

“free reserves” means those reserves which, as per the latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

Question 3

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

(i) As per the Companies Act, 1956, the maximum number of directors a private limited company which is subsidiary of a public company, can have without approval of the Central Government is —

- (a) 10
- (b) 11
- (c) 12
- (d) 13.

(ii) The aggregate of the contributions to any political party or for any political purpose to any person by a company in any financial year shall not exceed—

- (a) 2 i% of its average net profits determined in accordance with the provisions of sections 349 and 350 during the five immediately preceding financial years
- (b) 5% of its average net profits determined in accordance with the provisions of sections 349 and 350 during the three immediately preceding financial years
- (c) 7 4-% of its average net profits determined in accordance with the provisions of section 349 during the five immediately preceding financial years

- (d) 10% of its average net profits determined in accordance with the provisions of section 349 read with section 350. The average profit is to be calculated by reference to preceding three financial years.
- (iii) The number of scrutineers to be appointed by the Chairman of a general meeting is —
- 3
 - 2
 - 1
 - 4.
- (iv) As per the rules framed under section 205A(3) relating to use of past reserves for payment of dividend, a company after drawal of the amount from the reserves for payment of dividend should retain in the reserves an amount not less than —
- 25% of the paid-up share capital of the company
 - 20% of the paid-up share capital of the company
 - 15% of the paid-up share capital of the company
 - 10% of the paid-up share capital of the company.
- (v) As per clause 49 of the listing agreement, the audit committee comprising of five directors must have a minimum of —
- 2 independent directors
 - 3 independent directors
 - 4 independent directors
 - 1 independent director.
- (vi) A special notice is required for —
- Removal of a member
 - Removal of the Company Secretary
 - Removal of a nominee director
 - None of the above. (1 mark each)
- (b) You are the Company Secretary of Alltime Favourites Ltd., a listed company, and the Managing Director of your company wants to know the procedure for shifting of registered office from Mumbai to Pune. Prepare a note for him. (10 marks)

Answer 3(a)(i)

- (c) 12

Answer 3(a)(ii)

- (b) 5%

Answer 3(a)(iii)

- (b) 2

Answer 3(a)(iv)

(c) 15%

Answer 3(a)(v)

(c) 4

Answer 3(a)(vi)

(d) (Note: A nominee director cannot be removed but his nomination is to be withdrawn). Hence (d) none of the above.

Answer 3(b)**Note for Managing Director**

MD Sir,

As desired by you, I am attaching herewith my note in detail for the procedure the company will have to follow for shifting of Regd. Office of the company from Mumbai to Pune.

According to Section 17A inserted by the Companies (Amendment) Act, 2000 a company can not change the place of its registered office from one place to another from the jurisdiction of one Registrar to another within the same State wherein more than one Registrars of Companies have jurisdiction, unless such change is confirmed by the concerned Regional Director.

Hence, a company, which needs to change its registered office within the same State but under the jurisdiction of another Registrar of Companies, shall have to take the following procedural steps in addition to the steps relating to shifting the Registered Office outside the local limits of any city, town or village where such registered office is situated -

1. After holding general meeting and having passed special resolution to this effect the company should make application to the Regional Director in the prescribed e-Form 1AD for confirmation along with a fee of Rs. 500/-.

The attachments prescribed alongwith e-form 1AD are :

- (a) Copy of the minutes of the meeting
 - (b) Copy of the newspaper advertisement
 - (c) Particulars of investor grievances, if any
 - (d) Any attachment to support the details of the prosecution filed against the company and its officers in default, if any
2. The Regional Director shall pass an order in writing confirming the change after giving necessary opportunity of being heard to the parties, within four weeks from the date of receipt of application.
 3. The company shall file with the concerned Registrar of Companies, a certified copy of the confirmation order of the Regional Director within two months from the date of confirmation order alongwith e-form 61.

4. The company should obtain a certificate of registration of the confirmation order from the Registrar of Companies who shall certify under his hand within one month from the date of filing of such confirmation order.
5. Such certificate shall be conclusive evidence that all the requirements of this Act for the alteration and confirmation have been complied with and henceforth the memorandum of association so altered shall be the memorandum of association of the company.
6. The Registrar shall make necessary changes in the register of companies and transfer the records to the Registrar of Companies, Pune under whose jurisdiction the company has shifted its registered office.

Regards,

Yours truly,

Sd/-A
Company Secretary

Question 4

- (a) *Swan Ltd. was sanctioned a term loan of Rs.15 crore by Fantastic Bank Ltd. with a stipulation of conversion of loan into equity. The company could not repay the loan as stipulated. As per one of the conditions of sanction, the bank now wants to exercise the right of conversion of Rs.5 crore loan into equity. State the procedure for the same. (8 marks)*
- (b) *Bipin is the Managing Director of Adarsh Ltd. and also of Bolder Ltd. Cleaner Ltd. decides to appoint Bipin as the Managing Director of the company. State the legal requirements under the Companies Act, 1956 to give effect to the proposed appointment and also draft a resolution for the appointment of Bipin as the Managing Director of Cleaner Ltd. (8 marks)*

Answer 4(a)

Fantastic Bank Ltd. had granted a term loan of Rs.15 crore to Swan Ltd. However, the borrowing company could not repay the term loan as stipulated. One of the conditions of the sanction provides a covenant that in the circumstances of non-repayment of the term loan as stipulated, the bank shall have right to get the loan converted into equity shares. The company therefore, on receipt of intimation from the bank will have to take steps for such conversion into equity shares by making allotment. Since the borrowing company is a public company it has to first offer shares to its existing shareholders on rights basis. However, the shares are required to be allotted to persons other than existing shareholders. This requires Special Resolution under section 81(1A) to be passed at a general meeting. Accordingly a general meeting has to be convened and the following special resolution is to be passed.

Draft Resolution:

To be passed at a General Meeting as a Special Resolution.

“RESOLVED THAT, in accordance with sub-section 1A of the section 81 of the

Companies Act, 1956 and Article 25 of the Articles of Association of the company, consent of the members be and is hereby accorded to the Board of directors to allot 50,00,000 (Fifty lakhs) Equity Shares of Rs.10(ten) each, at par to Fantastic Bank Ltd., by conversion of a part of the Term Loan of Rs.15 crore availed by the company, in terms of term loan agreement signed by the company, with the said Bank.”

Board Resolution/s at a Board Meeting:

“RESOLVED THAT, an allotment of 50,00,000 (Fifty lakhs) Equity Shares of Rs.10 each bearing distinctive No.100,00,001 to 150,00,000 be and is hereby made to Fantastic Bank Ltd.”

“RESOLVED FURTHER THAT, share certificates nos.....for respective 50 lakhs equity shares be issued by the company duly stamped and signed by any two directors of the company mechanically/manually/physically and by the Company Secretary, Mr. X, physically and by affixing the Common Seal of the company in their presence.”

“RESOLVED FURTHER THAT, necessary entries in the Register of Members of the company be made to record the said allotment of shares.”

“RESOLVED FURTHER THAT, the Secretary of the company Mr. X, be and is hereby authorized to file Form No.2, the Return of Allotment with the concerned Registrar of Companies, notifying this allotment to it.”

Answer 4(b)

As per Section 316 –

- (a) A person can act as a Managing Director in two or more than two companies, provided none of those companies is a public company.
- (b) A public company may appoint a person as its Managing Director, who is already a Managing Director in any other company, including a private company, only if such appointment is made by a unanimous resolution passed at a meeting of the Board of which specific notice has been given to all directors then in India.
- (c) A person can be appointed as Managing Director in more than two public companies only with the approval of the Central Government. The Central Government may permit a person to be appointed so if it is satisfied that it is necessary that the company should have a common Managing Director for their proper working and function as a single unit.

So Cleaner Ltd. can appoint Mr. Bipin as Managing Director of the company, subject to approval of the Central Government.

Draft Resolution:

“RESOLVED THAT, subject to the approval of the Central Government under sub-section (4) of Section 316, Mr. Bipin, who is already the Managing Director of two companies, namely M/s. Adarsh Ltd. and M/s. Bolder Ltd., be and is hereby appointed as Managing Director of the company by the directors present at the meeting and by specific notice in this regard was given to all directors then in India, on the terms and conditions in the draft agreement tabled before the meeting and initialed by the Chairman for the purpose of identification and that Mr. S, the Secretary of the company be and is hereby authorized to apply to the Central Government for seeking their approval.”

“RESOLVED FURTHER THAT, Shri D, Director and Shri S, the Secretary of the company be and is hereby authorized to execute the said agreement subject to such modifications/alterations made by the Central Government and to affix the common seal of the company thereon.”

Question 5

- (a) *What is a ‘foreign company’ and ‘foreign controlled company’? State the legal requirements a foreign company should comply with relating to delivery of documents to the Registrar of Companies, if it wishes to establish a place of business in India under the Companies Act, 1956. (8 marks)*
- (b) *Amar, Akbar and Anthony failed to pay the first call money of Rs.2.5 per equity share of Rs.10 each on 300, 500 and 1,000 equity shares held by them respectively in Good Prospects Ltd. The Board of directors wants to know what can be done in this situation. Guide the Board of directors by way of a note stating the steps involved and procedure to be followed by the company if it wants to forfeit the shares held by them. Also explain to the Board of directors whether the forfeiture will amount to reduction of share capital. (8 marks)*

Answer 5(a)

A foreign company means a company incorporated outside India and having a place of business in India, whatever be the pattern of their holding. However, as per section 591(2) of the Companies Act, 1956, where not less than 50% paid-up capital of foreign company is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in aggregate, such company shall comply with the provisions of the Companies Act, 1956, as if it were a company incorporated in India.

“A foreign controlled company”, however means a company in which the majority shareholding and voting power is in the hands of foreign individuals and/or bodies corporate.

Filing of returns and documents (sections 592 and 593): Foreign companies which establish a place of business in India must within one month from that date file with the ROC :

- (1) a certified copy of the charter, statutes or memorandum and articles of the company or other instrument defining its constitution with a certified translation of the documents in the English language if they are not in that language. Rule 16 of the Central Government’s General Rules, 1956 specifies the persons who are to certify the documents;
- (2) the full address of the Registered or principal office of the company;
- (3) a list of directors giving with respect to each of the directors who are individuals, his name and surname, former name and surname, usual residential address and nationality;
- (4) the present name and surname, former name and surname and usual residential address of the Secretary, if he is an individual and if a body corporate its corporate name and its registered office or principal office and if a firm, the partners of which are joint secretaries, the name and principal office of the firm;

- (5) the names, addresses of persons resident in India and authorized to accept service of documents, notices and processes on behalf of the company; and
- (6) the address of the principal place of business in India (section 592).

A foreign company should deliver to the ROC within the prescribed time, a return containing particulars of any changes or alterations in any of the particulars mentioned above (section 593).

Rule 17 of the Central Government's General Rules, 1956 prescribes the time limit within which the particulars of alterations are to be filed.

Answer 5(b)

A brief note for the Board of Directors in respect with non-payment of call money and effect thereof.

To
The Board of Directors
Good Prospects Ltd.

As desired by you I furnish below the information required by you in respect with the matter of non-payment of call money by Mr. Amar, Mr. Akbar and Mr. Anthony for the shares held by them.

The shareholders are expected to make payment of call money due from them on the shares held by them in the time limit specified. In case of non-payment, the company has power to forfeit the shares held by them under Article 15 of the Articles of Association of the company. The provisions for forfeiture of shares are as under.

Procedure for forfeiture of shares

1. A forfeiture of any share must be done on the authority of the Board of Directors or, of a Committee of the Board if authorised by articles of association for the purpose, by its resolution. The resolution should provide for a notice to be given to the shareholder concerned before the forfeiture is actually effected in pursuance of the resolution, requiring payment of so much of the call as is unpaid, together with any interest which may have accrued.
2. The notice threatening forfeiture in pursuance of the Board resolution must be given in accordance with the provisions of the articles. The notice aforesaid shall
 - name a further day (not being earlier than the expiry of fourteen days from the date of service of the notice) on or before which the payment required by the notice is to be made; and
 - state that, in the event of non-payment on or before the day so named, the shares in respect of which the call was made will be liable to be forfeited.
3. The notice must:
 - specify clearly the amount payable on account of unpaid call money as well as interest accrued, if any, and other expenses.
 - mention the day on or before which the amount specified ought to be paid, not be earlier than 14 days from the date of service of the notice.

- contain an unambiguous clear statement to the effect that in the event of failure to pay the specified amount latest on the appointed day, the shares in respect of which the amount remains unpaid would be liable to be forfeited..
4. The notice threatening forfeiture as contemplated in regulation 29 of Table A must be served in accordance with the provisions of section 53 of the Companies Act, 1956.
 5. If the call money is not paid in response to such notice threatening forfeiture, the company may, at any time thereafter, before the payment required by the notice has been made, forfeit the shares by a resolution of the Board to that effect.
 6. It is common practice by widely held listed company to publish a notice of forfeiture in newspapers so that the members of the public are made aware of the forfeiture and cautioned not to deal in the forfeited shares.
 7. A further notice after the shares are forfeited is not necessary. However, it is advisable and a common practice to give a notice of the shares having been forfeited to the concerned shareholders by registered post.
 8. Regulation 34 of Table A provides for a verified declaration in writing to be issued under the signature of a director, manager or secretary of the company that a share in the company has been duly forfeited on a date stated in the declaration. The declaration so made shall be conclusive evidence of the facts stated therein as against all persons claiming to be entitled to the shares forfeited. The accidental non-receipt of notice of forfeiture by the defaulter is not a ground for relief against forfeiture regularly effected.
 9. The fact of the forfeiture will be entered in the Register of Members and the name of the concerned shareholder as a member of the company will be deleted from the register.

I hope the matter is clearly explained to you. Please advise if any action is to be initiated in this direction.

Regards,

Sd/-

Company Secretary

It may be noted that the forfeiture amounts to reduction of capital till the forfeited shares are re-issued.

Question 6

- (a) *Arnold is the elder son of John. John was holding 5,000 equity shares of Dreams Ltd. and died. As the Company Secretary of the company, how will you guide Arnold to claim the shares of John ? He has one brother, 2 sisters and mother. John had not made any nomination. (4 marks)*
- (b) *Article No.72 of the articles of association of the company requires 25 persons to be present personally and/or by proxy to constitute the quorum at a general meeting. The company now wants to have the lowest minimum quorum as*

provided in the Companies Act, 1956. As the Company Secretary of the company, how could this be achieved by you for your company ? (4 marks)

- (c) *A complaint has been made to the Registrar of Companies by 5 members asking him to direct the Timely Holdings Ltd. of which they are members to re-convene annual general meeting since they had not received the notice of the company for the annual general meeting held on 30th September, 2008. The Registrar of Companies issues notice as to show cause why such directions should not be issued. What would be your response as the Company Secretary of the aforesaid company ? (4 marks)*
- (d) *The Board of directors of Free Flow Ltd. registered in Chennai, proposes to hold the next meeting of Board of directors in the month of January, 2010. Advise with reference to the provisions of the Companies Act, 1956 and relevant Secretarial Standards in respect of the following matters :*
- (i) *Can the meeting of Board of directors be held in Kolkata, when all the directors of the company reside at Chennai ? (1 mark)*
- (ii) *Whether the meeting of Board of directors can be called on a public holiday and that too after business hours as the majority of the directors of the company have gone to Kolkata on vacation ? (1 mark)*
- (iii) *Is it necessary that the notice of the meeting of Board of directors should specify the nature of business to be transacted ? (2 marks)*

Answer 6(a)

From the details given in the question it is understood that the deceased member late Mr. John was holding 5000 shares of Dreams Ltd. and left behind him his wife two sons and two daughters.

As the company secretary I will have to advise Mr. Arnold as under:

Transmission of shares is a process by operation of law.

Secretarial Standard 6 (Clause 1.4) reads as follows with regard to transmission where there is no will and there are more than one legal heirs.

“Where a sole shareholder who has not appointed a Nominee, dies intestate, the company should on receipt of written request from the legal heir, accompanied by the certificate evidencing the death of the shareholder and the Succession Certificate or Letter of Administration, register the Shares in the name of the legal heir within a period of 30 days.

In case the transmission is requested in favour of one or more but not all the legal heirs, the company may require a No Objection Certificate relinquishing their right on the said Shares or Deed of Relinquishment from other legal heir(s) for such transmission.”

After compliance procedure as prescribed above by Mr. Arnold, the Secretary will place the matter for the approval of the transmission of 5000 shares in his name by the board of directors by passing appropriate resolution. After such approval by the board, necessary change in the entries will be made in the Register of Members. Then the share certificate shall be endorsed in the name of Mr. Arnold and sent to him by registered post.

Answer 6(b)

The Article No.72 of the Articles of Association of the company requires 25 persons to be present personally and/or by proxy to constitute the quorum of a general meeting. The Company now wants to have the lowest minimum quorum as mentioned in the Companies Act, 1956. The said Act under section 174 states that at least 5 members to be present personally in case of public company and two members personally in case of private company, to constitute the quorum at a General Meeting to commence and transacting the business thereat.

The proposed action amounts to an alteration to the Articles of Association of the Company which could be done by passing a Special Resolution under section 31 of the Companies Act, 1956. To do this following steps would be undertaken:

1. To hold a board meeting to consider the matter of alteration of the Article No.72.
2. At the same board meeting fix date of holding an extra-ordinary General Meeting and approve the draft notice of General Meeting and authorize to issue the same to the members under the signature of the Director or Secretary of the Company. Despatch the notice at least 21 clear days before the General Meeting. Also approve the Explanatory Statement under section 173.
3. Hold General Meeting and pass a Special Resolution incorporating the desired number to be the quorum.
4. File form no.23 along with the certified copies of the Special Resolution and Explanatory Statement. (This will go as an attachment to e-form 23).
5. Also copy of the Altered Articles be sent as an attachment to the said e-form 23.
6. After approval of e-form 23 the Articles stand altered from the date of passing the special resolution.
7. If the company is a listed public company then 3 copies of notice be sent to the Stock Exchange(s) and also after passing the resolution copies of such resolution be sent along with copy of Altered Articles.

Answer 6(c)

Five members of Timely Holdings Ltd., claimed and complained to the Registrar of Companies, that they have not received any Notice of Annual General Meeting and therefore any proceedings took place thereat be treated as null and void.

One of the fundamental and basic rights of a shareholder/member of a company is to receive a Notice of General Meeting, attend and vote thereat.

The response to the Registrar will be on the following lines by the Company Secretary to submit that :

1. The Notice was sent to the complainants on their registered address with the company as per Register of Members.
2. The Notice was sent through post.

3. Besides this a Public Notice under section 154 of the Companies Act, 1956 was published in two news papers one in English and other in Vernacular having largest circulation in the district of the Regd. Office of the company.
4. Since the company has strictly followed and complied with all the provisions of the Companies Act, 1956 in respect with issue of Notice there is no question of reconvening the Annual General Meeting held on 30th September, 2008.

Answer 6(d)(i)

Yes. There is no prohibition in Companies Act, 1956 regarding time, day, venue of the Board meetings.

As per clause 1.2.2 of Secretarial Standard-1, a Board meeting may held at any time, any day including a public holiday and at any place.

Answer 6(d)(ii)

Yes, there is no prohibition in the Companies Act, 1956 regarding time, day, venue of the Board meetings. As per clause 1.2.2 of Secretarial Standard-1, a Board meeting may held at any time, any day including a public holiday and at any place.

Answer 6(d)(iii)

Section 286 of the Companies Act, 1956 does not make it mandatory to specify the nature of business to be transacted along with notice of the meeting. If the Articles of Association are silent, the notice of the Board Meeting is not required to specify the nature of business to be transacted. However, Secretarial Standard-1 has specified that agenda for the meeting should be provided, along with the notes on agenda atleast 7 days before the date of the meeting.

Question 7

- (a) *Enumerate the search facilities in MCA-21.* (6 marks)
- (b) *Enumerate the contents of Management Discussion and Analysis Report (MDAR) which forms part of the Board of directors' report.* (6 marks)
- (c) *Discuss directors' remuneration report in the light of Companies Act, 2006 of the United Kingdom.* (4 marks)

Answer 7(a)

The following search facilities are available to locate the requisite information:

- (a) *Search for viewing public document* : Public documents are those documents that are available for viewing, by anyone, on payment of requisite fees. Users may need to see public documents of any company registered with MCA for various purposes. Similarly, banks and financial institutions may also need to view these documents while sanctioning loan.

The following are the categories of public documents:

- (i) Incorporation documents
- (ii) Charge documents

- (iii) Annual Return & Balance Sheet
 - (iv) Change in directors
 - (v) Other documents.
- (b) *Search for getting certified copy*: The user selects one or more document(s) for viewing and clicks the “Get Certified copy” button. User has the option to choose more than one document at a time. This is a paid service. User will have the facility to add the documents to his cart and make the payment collectively. The user has the option to mention the number of pages in the document for which he wants a certified copy as well as the number of copies.
- Once the request reaches to the pending work list of the concerned MCA official, the official will take the printouts of the documents and sign it with seal and deliver to the requester. The certified copy will be delivered in the physical form.
- (c) Finding the Corporate Identity Number (CIN).
 - (d) Checking Company Name.

Answer 7(b)

The MDAR should either form a part of the Board’s Report or to be given as an addition thereto in the annual report to the shareholders. The MDAR should include a discussion on the following matters within the limits set by the company’s competitive position:

- (1) Industry structure and developments.
- (2) Opportunities and threats.
- (3) Segment wise or product wise performance.
- (4) Outlook.
- (5) Risks and area of concern.
- (6) Internal control systems and their adequacy.
- (7) Discussion on financial performance with respect to operational performance.
- (8) Material developments in human resources/industrial relations front including number of people employed.

It is desirable that MDAR is signed in the same manner as in the case of the Board’s Report.

Answer 7(c)

Duty to prepare directors’ remuneration report under UK Companies Act, 2006 (Section 420 & 422)

The directors of a quoted company shall for each financial year prepare a directors’ remuneration report which shall contain the information specified in the Schedule to Act and comply with any requirement of that Schedule as to how the information is to be set out in the report. The directors’ remuneration report shall be approved by the Board of directors and signed on behalf of the Board by a director or the secretary of the company. Every copy of said report which is laid before the company in general meeting or which

is otherwise circulated, published or issued, shall state the name of the person who signed it on behalf of the Board. The copy of the directors' remuneration report which is delivered to the registrar shall be signed on behalf of the Board by a director or the secretary of the company.

Question 8

Write notes on any four of the following :

- (i) One person company*
- (ii) Independent director*
- (iii) Share warrants*
- (iv) Nominee director*
- (v) Secretarial Standards.*

(4 marks each)

Answer 8(i)**One person company**

One person company is totally a new concept for India but in United Kingdom and other developed countries this is already in existence. In the proposed Companies Bill, 2009 this concept is being brought in and introduced. It is alike a proprietorship firm but with limited liability of the company. Dr. J J Irani Committee has made recommendations for this concept. This company will have at least one director. The last words in the name must indicate the word "OPC" to distinguish it with others. The company will function more or less on the broad principles of company type of organization in India with total independence. All the compliances and regulations as applicable to other companies shall be also applicable to this OPC.

Answer 8(ii)**Independent director**

Independent director has gained great importance in the present functioning of the boards of Indian companies. The meaning of the word 'independent' means having no pecuniary interest whether directly or indirectly in the company in which such person is appointed. International Corporate Governance norms require constitution of various committees on which independent director is being appointed as the Chairman to have total transparency of working of the company. The SEBI guidelines on Corporate Governance has directed that every public listed company will have composition of its board as under.

If the chairman is executive director, there should be atleast 50% directors as independent.

If the chairman is non-executive then such strength should be atleast 1/3rd of the total strength.

The purpose behind this direction is to have control over the core promoters actions to decide various matters of the company so that shareholders interest not being jeopardized.

Answer 8(iii)**Share warrants**

Share warrants are bearer instruments as such very easy to sell or buy as it does not require any procedure for getting them transferred in the name of the buyer. The warrant holder however does not have any right to attend and vote at the General Meetings of the Company.

Share warrants can be issued only by a public company if its Articles of Association permits. A special resolution is required to be passed to issue share warrants. Also prior approval of the Central Government is required if the shares are to be converted into warrants. Share warrants are quasi negotiable instruments. On conversion of the shares into warrants the names of such shareholders is removed from the Register of Members of the company.

Answer 8(iv)**Nominee director**

Nominee director is a person who is an individual appointed by third party to protect its interest in the company and have participation in the decision making process of the board. Usually, the Banks or Financial Institutions or others who have large stake in the company nominates their representatives on the board in terms of the conditions of sanctioning of the credit facilities, term loans or financial investments. The Articles of Association must contain provisions for appointment of such nominee director/s. Such appointed director will be on the board until the continuation of the credit exposure to the company or withdrawal of nomination by the nominating entity. As soon as the company liquidates its dues to the bank/financial institution etc. the nominee director normally is withdrawn from the board. He is not liable to retire by rotation. Also he is not considered as an independent director for the purpose of deciding the retiring director every year.

Answer 8(v)**Secretarial Standards**

The Institute of Company Secretaries of India, (ICSI), recognising the need for integration, harmonisation and standardisation of diverse secretarial practices, has constituted the Secretarial Standards Board (SSB) with the objective of formulating Secretarial Standards.

The Secretarial Standards do not seek to substitute or supplant any existing laws or the rules and regulations framed thereunder but, in fact, seek to supplement such laws, rules and regulations.

Secretarial Standards that are issued will be in conformity with the provisions of the applicable laws. However, if, due to subsequent changes in the law, a particular Standard or any part thereof becomes inconsistent with such law, the provisions of the said law shall prevail.

DRAFTING, APPEARANCES AND PLEADINGS

Time allowed : 3 hours

Maximum marks : 100

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

Question 1

Attempt any four of the following :

- (a) Anand sells a property to Karan. After completion of the conveyance, Karan discovers that under a decree for partition, a portion of the property had been allotted to Chandan and Anand's omission to disclose the decree is fraudulent. Discuss the rights and course of action available to Karan. (5 marks)
- (b) Define 'deed'. What are the components of a deed in general ? (5 marks)
- (c) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :
- (i) _____, in legal sense, means an act of preparing legal documents.
 - (ii) _____ are those deeds in which there are two or more parties.
 - (iii) _____ is a special type of agency, which combines agency with guarantee.
 - (iv) _____ is a method of acquiring the right to use equipment or real property for consideration.
 - (v) Pleadings filed by a defendant/respondent in answer to the claim set-out by the plaintiff/petitioner in the form of affidavit and/or supported by an affidavit are referred to as _____. (1 mark each)
- (d) State, with reasons in brief, whether the following statements are true or false :
- (i) 'Drafting' and 'conveyancing' provide the same meaning although these terms are not inter-changeable.
 - (ii) Consideration is very important in a document and must be expressed. But, non-mention of consideration does not invalidate the document.
 - (iii) Agreements not relating to immovable property and agreements not creating an interest in immovable property are not compulsorily registrable.
 - (iv) "I promise to pay Balram Rs.2,000 and all other sums which shall be due to him" is a promissory note.
 - (v) A private trust will fail, if the object is uncertain or incapable of application. (1 mark each)
- (e) Choose the most appropriate answer from the given options in respect of the following :
- (i) If a power of attorney is executed in favour of more than one person and is silent on the mode of execution by attorneys, the attorneys will be entitled to act only —
 - (a) Jointly
 - (b) Severally

- (c) *Both (a) and (b)*
(d) *None of the above.*
- (ii) *The notices issued by a company under the Companies Act, 1956 may be—*
(a) *Contingent*
(b) *Conditional*
(c) *Both (a) and (b)*
(d) *None of the above.*
- (iii) *The Code of Civil Procedure, 1908 prescribes that dates, sums and numbers expressed in pleading shall be in —*
(a) *Figures*
(b) *Words*
(c) *Both (a) and (b)*
(d) *None of the above.*
- (iv) *The writ that is available to any person, whenever any body of persons having legal authority to determine questions affecting rights of subjects and having the duty to act judicially acts in excess of its legal jurisdiction, is —*
(a) *Mandamus*
(b) *Certiorari*
(c) *Both (a) and (b)*
(d) *None of the above.*
- (v) *The power of registered proprietor of a trade mark to assign his rights in the trade mark is dealt under section 37 of —*
(a) *The Copyright Act, 1957*
(b) *The Trade Marks Act, 1999*
(c) *The Trade and Merchandise Marks Act, 1958*
(d) *None of the above.* (1 mark each)

Answer 1(a)

This is a case of non – disclosure of material defect in title. Section 55 of the Transfer of Property Act, 1882 prescribes the rights and liabilities of buyer and seller which can be modified by the parties to a contract by mutual consent and contract to the contrary of these provisions. One of the liabilities of the seller under section 55(1) of the Act is that he is bound to disclose to the buyer any material defect in the property or in his title to such property before the completion of the execution of the sale deed.

In other words, seller is liable to disclose latent defects in the property or in his title known to him before the completion of the execution of the sale deed. Such a latent defect should be material i.e. it should be such as would influence the buyer's decision if he knew about it. A latent defect is one which a purchaser would not be able to discover by ordinary diligence. If it could be, then it is a patent defect and there is no obligation on the part of the seller to disclose it.

Allotment of property to another co-owner under a partition deed not known to the purchaser is one of the examples in defects in the title. If A agreed to sell a property to B and puts B in possession, but B discovers defect in A's title before the sale deed is executed, in such a case B may sue for damages for breach.

In the given problem also there is non –disclosure of material defect in title. Karan i.e, the buyer has accepted the title and he discovers the fraud. He may sue to set aside the sale and claim damages. [*Gajapathi v. Alagia* (1886)ILR9 Mad 89]

Answer 1(b)

A deed is a writing —

- (a) on paper, vellum or parchment,
- (b) sealed, and
- (c) delivered, whereby an interest, right or property passes, or an obligation binding on some persons is created or which is in affirmance of some act whereby an interest, right or property has been passed.

In *Halsbury's Laws of England*, a deed has been defined as “an instrument written on parchment or paper expressing the intention or consent of some person or corporation named therein to make (otherwise than by way of testamentary disposition, confirm or concur in some assurance of some interest in property or of some legal or equitable right, title or claim, or to undertake or enter into some obligation, duty or agreement enforceable at law or in equity or to do, or concur in some other act affecting the legal relations or position of a party to the instrument or of some other person or corporation, sealed with the seal of the party, so expressing such intention or consent and delivered as that party's act and deed to the person or corporation intended to be affected thereby.

A deed is a present grant rather than a mere promise to be performed in the future.

Deeds are in writing, signed, sealed and delivered.

Deeds are instruments, but all instruments are not deeds.

A deed is divided into different paragraphs. Under each part relevant and related information is put in paragraph in simple and intelligible language. The usual parts or components or clauses of deeds in general are mentioned as follows:

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

- (9) Description of property
- (10) Parcels Clause
- (11) Exceptions and Reservations
- (12) Premises and Habendum
- (13) Covenants and undertakings
- (14) Testimonium Clause
- (15) Signature and attestation
- (16) Endorsements and supplemental Deeds
- (17) Annexures or Schedules.

Answer 1(c)

- (i) **Drafting**, in legal sense, means an act of preparing legal documents.
- (ii) **Indenture** are those deeds in which there are two or more parties.
- (iii) **Del Credere Agency** is a special type of agency, which combines agency with guarantee.
- (iv) **Lease** is a method of acquiring the right to use equipment or real property for consideration.
- (v) Pleadings filed by a defendant/respondent in answer to the claim set-out by the plaintiff/petitioner in the form of affidavit and/or supported by an affidavit are referred to as **Counter Affidavit** .

Answer 1(d)

- (i) True
- (ii) True
- (iii) True
- (iv) False
- (v) True

Answer 1(e)(i)

- (a) Jointly

Answer 1(e)(ii)

- (d) None of the above

Answer 1(e)(iii)

- (c) Both (a) & (b)

Answer 1(e)(iv)

- (b) Certiorari

Answer 1(e)(v)

- (b) The Trade Marks Act, 1999

Question 2

- (a) *Discuss the requirements of section 13 of the Companies Act, 1956 with regard to 'objects clause' of the memorandum of association of a company. What are the precautions which must be taken in drafting the objects clause ?*
(4 marks)
- (b) *Explain mortgage by deposit of title deeds.* (4 marks)
- (c) *Draft a deed of agreement of admission of a new partner into a partnership firm.*
(8 marks)

Answer 2(a)

The object clause defines the very objects of its formation, existence and operations and powers which a company has towards the attainment of the objectives. There is no restriction on objects except it should be legal and lawful. While drafting the objects, care should be taken to see that:

- (i) the objects are stated in a precise and clear manner so that there is no ambiguity in their inter-presentation;
- (ii) each object is stated independently;
- (iii) there is no inconsistency or contradiction between the objects;
- (iv) the same objects are not repeated in other clauses of objects in different words and phraseology;
- (v) no object is illegal, immoral or against public policy;
- (vi) objects are properly arranged and divided and set in short sentences.

As per section 13 of the Companies Act, 1956 the objects clause is required to state (i) the main objects to be pursued by the company on its incorporation; (ii) subjects incidental and ancillary to the attainment of the main objects; and (iii) other objects not included in (i) and (ii) above. Further, it should state in case of non-trading companies the State(s) of its operation.

Main objects : The objects which are intended to be pursued by the company on its incorporation and in the immediate foreseeable future are its main objects. The objects clause should be of widest possible coverage in precise and clear expression. This will save the company from litigation on the ground that the object pursued by the company fall outside the permitted range of its activity

Objects incidental or ancillary : These are not independent objects and cannot be entered upon by the company independent of its main objects. These objects are pursued only to the extent they are necessary for attainment of the main objects. No borderline could be created between the main objects and objects incidental and ancillary to main objects. The attainment of main objects should be facilitated by the objects incidental

and ancillary. This makes it imperative that reasonable nexus or resemblance should exist or to be shown to exist in objects incidental and ancillary with main objects while drafting these clauses.

Other Objects : These are objects which are covered neither by main objects nor by objects ancillary or incidental thereto, but which are nevertheless necessary to enable the company to undertake all types of business activities which the company may anticipate to pursue. But other objects should not be ambiguous and irrelevant to the main objects of the company.

Answer 2(b)

Mortgage by Deposit of Title Deeds

Mortgage by deposit of title deeds is called in English law as equitable mortgage. It is an oral transaction and no documents like Deed of Mortgage is required to be executed. No written acknowledgement is required for creating this mortgage. It is however, prudent to have a record of transaction to avoid difficulties to establish the creation of the mortgage. In this case, a Memorandum of Mortgage by deposit of title deeds is prepared by the mortgagee to secure the specific mortgage money. The main characteristics of this type of mortgage are as under:

1. Debt even time barred, present and future advances are covered under the equitable mortgage. In other types of mortgage, future advances are not covered.
2. Delivery of title deeds is required to be made in Bombay, Madras and Calcutta and other specified towns to which the facility is extended by State Government from time to time through Gazette notification.

It is not necessary for creation of mortgage that the property be located in the specified town or the company making deposit should have its registered office in that town.

3. This deposit can be made by the company through its nominee or agent duly authorised.
4. Intent to create security by deposit of title deeds should be present at the time of such deposit in the mortgagor.
5. Neither ownership nor possession of the property passes to the mortgagee under the equitable mortgage.

Equitable mortgage is preferred by the lenders/banks/creditors as well as the commercial enterprises because of the inherent advantages viz. (a) to save time and avoid inconvenience of documentation, and registration; (b) to minimise cost of creating mortgage and cost of borrowed funds by saving stamp duty; (c) to maintain secrecy of the debt transaction; (d) it is a cut short method and skips many formalities like compliance of Section 230A of Income-tax Act, 1961, and 293(1)(a) of the Companies Act.

Answer 2(c)

Deed of Agreement of Admission into Firm of a New Partner

THIS DEED OF AGREEMENT IS made the day of 2009 BETWEEN AB son of aged r/o and

CD son of aged r/o partners in the firm CD & CO. of the one part, AND EF son of aged years resident of of the other part.

WHEREAS the said AB and CD are partners in the firm CD & Co. situated in and are bound as such under a deed of partnership executed by them on the day of 200.. hereinafter referred to as the "partnership deed".

AND WHEREAS and said EF is desirous of being admitted as a member in the aforesaid firm of CD & Co. and invest a sum of Rs. AND said AB and CD are willing to admit him as an additional partner.

NOW THEREFORE THE DEED WITNESSES that in pursuance of the said agreement and in consideration of the said EF bringing in and contributing the sum of Rupees (Rs.) only as additional capital of the above partnership firm, it is mutually agreed as follows:

1. The parties hereto shall, as from the date hereof be and continue partners for the unexpired residue of the terms mentioned in para of the partnership deed subject in all respects to the conditions, stipulations, and provisions of the aforesaid partnership deed, so far as applicable, and except as varied by this deed of agreement.
2. The capital mentioned in the partnership deed shall hereafter be changed to the sum of Rupees only and the partners shall hereafter have the undernoted shares in the capital.
AB shall have Rs. in the said capital;
CD shall have Rs. in the said capital; and
EF shall have Rs. in the said capital.
3. The profits and losses of the partnership shall continue to be borne by the partners hereto in proportion to their above named respective shares.

IN WITNESS WHEREOF the said AB, CD and EF have hereto at signed the day and the year first above mentioned.

WITNESSES:

- | | |
|----|-----------|
| 1. | Sd/- A.B. |
| 2. | Sd/- C.D. |
| 3. | Sd/- E.F. |

Question 3

- (a) *Arvind mortgages his houses at Delhi and Gurgaon to Suresh. Arvind then mortgages the Delhi house to Navin. On default, Navin brings Delhi house to sale in enforcement of his mortgage and he himself purchases Delhi house. Suresh then obtains an order for sale on his mortgage. What are the rights and remedies available to Navin ?* (5 marks)
- (b) *What special points must be taken into account while drafting notices in case of a company ?* (5 marks)
- (c) *Draft a power of attorney to execute a deed of sale.* (6 marks)

Answer 3(a)

The given problem is governed by section 81 of the Transfer of Property Act. A mortgagee acquires certain rights and incurs certain obligations in the property mortgaged. One of those rights is the right of marshalling. According to section 81 of the Transfer of Property Act “if the owner of two or more properties mortgages them to one person and then mortgages one or more of the properties to another person, the subsequent mortgage is, in the absence of a contract to the contrary, entitled to have the prior mortgage-debt satisfied out of the property or properties not mortgaged to him, so far as the same will extend, but not so as to prejudice the rights of the prior mortgagee or of any other person who has for consideration acquired an interest in any of the properties”.

In this case Navin is entitled to have the mortgaged debt satisfied out of the property not mortgaged to him (i.e house at Gurgoan) so long as the same will extend but not so to prejudice the rights of the Suresh.[See *Inderdawan v. Govind* ILR 23 Cal 790]

Answer 3(b)

1. Where the form of notice is prescribed by statutory rules or forms, it has necessarily to adhere to what is prescribed.
2. One has to study, the nature of the notice, the circumstances which warrant their issue or service. The language of the notice depends upon whether it is addressed generally or it is meant to an individual or a class or a Government official.
3. Notice shall be dated, signed by authorised person, mention date, place, time and nature of meeting [Section 172(1)].
4. One of the important contents of the notice is to state the business to be transacted at the meeting. Either it be separately enclosed or incorporated in the notice itself [Section 172(1)].
5. Another important feature of the notice is that, it should relate to the event either taken place or which is likely to take place, the time within which any particular compliance is required to be made either by person receiving the notice, or otherwise, the authority issuing the notice and the person(s) for whom it is meant.
6. Explanatory statement (Section 173) requirement shall be complied with as regards to special business to be transacted at the meeting. It should contain material facts, such as the nature of interest; extent of shareholdings etc. of directors/Manager as required as per Section 173(2).
7. If the meeting is to accord approval to a document, the explanatory statement must also state the time and place where that document can be inspected [Section 173(3)]
8. Where the resolution is to be passed ‘as a special resolution’, the intention to propose the resolution as such must also be stated in the notice [Section 189(2)(a)].
9. In the case of companies having share capital, the notice should also state with

reasonable prominence that a member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of himself and the proxy need not be a member [Section 176(2)]. This must appear in the body of the notice before the signature of the authorised person.

10. If the notice is published in a newspaper mainly to satisfy the requirement of giving a deemed notice to those members who have no registered address in India and who have not supplied any address within India for the giving of notices to him, the statement of material facts need not be annexed to the notice, but it should be mentioned in the notice that the statement has been forwarded individually to the members [proviso to sub-section (2) of Section 172].
11. Notice should be clear, concise and to the point which any reader can make out quickly. Use of bold letters for key aspects is ideal.
12. One has to comply with Section 190 about special notice, proper serving of notice, duty to give notice in time, and provision of statutory length of notice etc.
13. Notice if required may warrant, the receiver to act upon, and it should mention the consequences in case of failure to act.

The point is that if any essential feature is left out, serious legal consequences may ensue, which one has to avert. Sending a second notice, in place of an incorrect or illegal one adds to the cost.

Answer 3(c)

Power of attorney to execute a deed of sale

KNOW ALL MEN BY THESE PRESENTS that I, AB, etc, hereby appoint CD, etc., as my attorney in my name and on my behalf to do or execute all or any of the acts or things which I have to do in pursuance of an agreement dated..... between me and XY and which are hereinafter mentioned, that is to say,

1. To receive from the purchaser or his heirs or assigns the sum of Rs. _____ being the price agreed to be paid to me by XY for the purchase of (description of property) under an agreement dated the _____ and to give an effectual receipt and discharge for the same;
2. To execute a proper sale deed of the said property or any other deed or assurance necessary for the completion of the sale of such property;

AND I hereby agree that all acts deeds and things lawfully done by my said attorney shall be construed as acts, deeds, and things done by me and I undertake to ratify and confirm all and whatsoever that my said attorney shall lawfully do or cause to be done for me by virtue of the power hereby given.

IN WITNESS hereof I have signed this deed on this _____ day of ____ 200__ .

Signed, sealed and delivered

AB

In the presence of :

Witness

Question 4

- (a) *What are the requisites of an 'award' under the Arbitration and Conciliation Act, 1996 ?* (4 marks)
- (b) *Distinguish between the following :*
- (i) *'Document' and 'deed'.*
 - (ii) *'Affidavit' and 'petition'.*
 - (iii) *'Counter guarantee' and 'fidelity guarantee'.*
 - (iv) *'English mortgage' and 'simple mortgage'.* (3 marks each)

Answer 4(a)

Award means the decision of the arbitrator to whom the dispute is referred. Under Section 2(1)(c) of the Arbitration and Conciliation Act, 1996 arbitral award includes "an interim award".

Requisites of an Award

The general requisites of an award are:

- (a) the law requires that the award shall be made in writing and signed by all the members of the arbitral tribunal or by the majority of them if the reason for any omitted signature is stated, stating its date and the place of arbitration.
- (b) it must be consistent with the submission;
- (c) it must be certain;
- (d) it must be fair to the parties;
- (e) it must be final;
- (f) its implementation must be possible;
- (g) the award must state the reasons upon which it is based.

Answer 4(b)(i)**Document and Deed**

Document: Document as per General Clauses Act, 1894 means "any matter expressed or described upon any substance by means of letters, figures or marks, or by more than one of those means which is intended to be used, or which may be used, for the purpose of recording that matter". As for instance, a writing is a document; words printed, lithographed or photographed are documents; a map or plan is a document; an inscription on a metal plate or stone is a document; a caricature is a document. Thus, document is a paper or other material thing affording information, proof or evidence of anything.

Deed: Deed is the term normally used to describe all the instruments by which two or more persons agree to effect any right or liability. For example, Gift Deed, Sale Deed, Deed of Partition, Partnership Deed, Deed of Family Settlement, Lease Deed, Mortgage Deed and so on. A bond is also included in the wide field of expression 'Deed'.

A deed may be defined as a formal writing of a non-testamentary character, which purports and operates to create, declare, confirm, assign, limit or extinguish some right, title or interest.

A deed is a present grant rather than a mere promise to be performed in the future. Deeds are in writing, signed sealed and delivered. Deeds are instruments, but all instruments are not deeds.

Answer 4(b)(ii)

Affidavit and Petition

Affidavit : An affidavit is a statement or declaration on oath by the deponent. The consequences of a false affidavit are serious. Therefore, great care is required in drafting it.

Affidavits to be produced in a Court must strictly conform to the provisions of Order XIX, Rule 1 of the Code of Civil Procedure, 1908 and in the verification it must be specified as to which portions are being sworn on the basis of personal knowledge and which, on the basis of information received and believed to be true. In the latter case, the source of information must also be disclosed.

Petition : Petitions are complaints against the defendants or respondents in the event of any breach of contract or when a crime is committed or when loss or damages are incurred as the case may be.

Answer 4(b)(iii)

Counter Guarantee and Fidelity Guarantee

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”.

Answer 4(b)(iv)

Simple Mortgage and English Mortgage

In a simple mortgage, the mortgagor without delivering possession of the mortgaged property binds himself personally to pay the mortgage money and agrees expressly or impliedly that if he fails to pay the debt and interest in terms of the mortgage deed, the property will be sold and the proceeds applied in payment of the mortgaged money.

In an English mortgage, a mortgagor binds himself to repay the mortgaged money on certain date and transfers the mortgaged property absolutely to the mortgagee subject to the proviso that he will re-transfer it to the mortgagor upon payment of the mortgaged money as agreed.

Question 5

- (a) *The government of a particular State and Sriram Holdings (P) Ltd. went to arbitration and the arbitrator passed an award on 12th October, 2003 against the*

appellant, copy of which was received by appellant on 23rd October, 2003. Review was sought on 2nd April, 2004, after 6 months from the date of award. Objections to the award were filed after 10 months from the date of the award. Will the appellant be entitled to file objections under the Arbitration and Conciliation Act, 1996 ? Support your answer with case law. (4 marks)

(b) Explain habendum. What does a habendum clause signify in a document ? (4 marks)

(c) Define 'affidavit'. What rules and guiding principles should be followed while drawing up an affidavit ? (8 marks)

Answer 5(a)

The facts of the matter are similar to the case of *State of Arunachal Pradesh v. M/s Daman Construction Co.* (JT 2007)(4) SC 118.

Dismissing the appeal, the Supreme Court held that it was absolutely thoughtlessness on the part of the appellant to have written a letter after six months i.e., on 2.4.2004 seeking review of the interim award. The Application moved under Section 33(1) of the Arbitration and Conciliation Act, 1996 is not strictly covered under the said section, i.e., seeking certain correction in computation of errors, or clerical or typographical errors. The application is however designed seeking review of award which the tribunal has no power. Secondly, the prayer directing the respondent to furnish Bank Guarantee, as it is an interim award and not final, is also not covered under Section 33. Therefore, the reply given by the arbitrator does not give rise to any cause of action to the appellant so as to move an application under Section 34(3) of the Act. Hence the appeal is dismissed.

Answer 5(b)

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

In India such phrases as "to have and to hold" or such an expression as "to the use of the purchaser" can very well be avoided as in cases except those of voluntary transfers such an expression is superfluous.

Answer 5(c)

An affidavit being a statement or declaration on oath by the deponent, is an important document. Therefore, great care is required in drafting it. The consequences of a false affidavit are serious. The following rules should be remembered when drawing up an affidavit:

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

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

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

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

Question 6

(a) *What are the ingredients that are necessary to prepare —*

(i) *Power of attorney; and*

(ii) *Instrument of trust ?*

(3 marks each)

- (b) *Management issues an appointment letter to a probationer and the relevant para of his appointment letter reads as follows :*

“Clause (I) — You are hereby appointed as a Salesman.... You will serve a probationary period of six months; this period of probation may be extended by a further period of three months or more in suitable cases in the absolute discretion of the company. The company has the right to terminate your services during the period of probation or extended period of probation or before confirmation in writing without notice and without assigning any reason whatsoever.”

The probationer joined the services of the company on probation. The management terminated his services after 2 months of joining by a letter saying “we regret to terminate your services with immediate effect in terms of clause (I) of your appointment letter.”

Do you think what management did is correct ? What are the remedies available to the probationer ? (5 marks)

- (c) *What is ‘compounding of offences’ ? How does compounding of offences take place under the Securities and Exchange Board of India Act, 1992 ? (5 marks)*

Answer 6(a)(i)

A power of attorney as per section 1A of the Powers-of-Attorney Act, 1882, includes an instrument empowering a specified person to act for and in the name of the person executing it. It is always kept by the attorney. A power of attorney executed for the purpose of a specific act is called a “special power of attorney”. A power of attorney executed for the purpose of generally representing another person, or for performing more than one act, is called a ‘general power of attorney’.

A power of attorney can be executed by any person, who can enter into a contract i.e. a person of sound mind who has attained the age of majority.

Powers of attorney are executed in the form of Deed Poll, usually in the first person. It is a unilateral document. It begins either as - “KNOW ALL MEN BY THESE PRESENTS THAT I, ETC.” or “BY THIS POWER OF ATTORNEY, I, ETC.”. Generally, the operative words making the appointment are introduced directly without any recitals. If recitals become necessary, they should be added after the words “KNOW ALL MEN BY THESE PRESENTS” thus “THAT WHEREAS etc.”, and after recitals the operative part is introduced thus “Now I, the said AB, etc., hereby appoint, etc., or the deed may be drafted with the heading “THIS POWER OF ATTORNEY is made on the, etc., then adding the recitals, the operative part is introduced thus “NOW THIS DEED WITNESSES THAT I APPOINT, ETC.”.

The powers conferred on the attorney should be specifically stated after the appointment, preferably, in separate paragraphs. Sometimes after giving specific powers a general clause empowering the attorney to do all such lawful acts as the attorney should think reasonable is added, but this is not ordinarily necessary, as according to authorities such a clause does not extend or widen the authority.

Answer 6(a)(ii)

An instrument of trust is drafted either as a deed poll or as a regular deed between the author of trust and the trustee. Where trustees are strangers and a transfer of property is involved, it is better to draft the deed as a deed between the author of trust and the

trustees. Where the author is to be the trustee himself and the deed requires a mere declaration of trust, it is drafted as a deed poll. No specific words are necessary, but, whatever the words used, the deed should contain with reasonable certainty the matters mentioned under the heading 'Creation of Trust'.

While drafting a trust deed, it be seen that every clause in the deed is clear in its meaning. If there is any reference to any article, documents, rules, statutory Acts etc., the same are properly applied out. In case reference to these is to be repeated in the deed it is better to first define them and use the abbreviation in the deed subsequently.

The most important and vital part of a trust is the expression of an intention to create a trust which should be expressed in the deed in unequivocal language and with reasonable certainty. No particular or technical words are necessary but the words used must be definite and unequivocal. The intention is expressed clearly in the recitals of the deed and in the operative part also. If the trustee is a stranger the property is transferable to him "upon trust". If the author is himself the trustee, he declares in the operative part that he "dedicates" or "sets apart" the property in trust for such and such purpose and constitutes himself as the trustee.

Different directions are given to the trustees by the author as to the manner in which the trust is to be worked. These are the conditions and provisions of the trust and vary in different kinds of trusts according to the circumstances. These conditions should be clearly incorporated in the trust deed. If the situation so warrants, provision for the appointment of new trustees should also be made in the deed.

Answer 6(b)

What management did is not correct as the service is terminated without any reason and wrongfully. In a similar case *Management Brooke Bond of India (P) Ltd v. Y. K. Gautam*, AIR 1973 SC 2634, the Industrial Tribunal directed the re-instatement and later the Supreme Court upheld the award of the Tribunal.

In a service contract, the terms of employment should be definitely fixed and clearly expressed. Modes and grounds of determining the employment during the term is one of the important provisions, and the same should be clearly expressed in the service contract. The grounds on which the employment may be determined during the term are generally misconduct, negligence, or want of medical fitness. Subject to what has been stated earlier, it may also be determined at pleasure by notice, without giving any ground. In the case of misconduct or neglect, no notice is required, but, provision may be made for framing charges and taking defence as in the case of Government Servants.

An employee is entitled to damages for wrongful dismissal or reinstatement if the termination of the service is not properly made as directed by the courts depending upon the facts and circumstances of the case.

Answer 6(c)

Compounding of offences

'Compounding' means that the accused and the complainant have come to terms and the dispute between the parties has been settled amicably or adjusted by agreement and the complainant agrees not to prosecute the accused. The accused and the

complainant then make a joint application to the Court that the parties have come to terms and the case may not be proceeded with.

Compounding of offences under SEBI Act, 1992

Section 24A of SEBI Act, 1992 permits compounding of offences by the court where prosecution proceedings are pending. Section 24A of SEBI Act reads as under:

“Notwithstanding anything contained in the Code of Criminal Procedure, 1973 any offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.”

Compounding of offence can cover appropriate prosecution cases filed by SEBI before the criminal courts. Prosecution here means filing of criminal complaints before various criminal courts by SEBI for violation of provisions of securities laws which may lead to imprisonment and/ or fine. Compounding of offence can take place at any stage after filing criminal complaint by SEBI. Where a criminal complaint has not yet been filed but is envisaged, the process for consent orders will be followed rather than the one for compounding.

Settlement of proceedings through compounding can be sought by any person who is notified that a proceeding may or will be instituted against him/her, or any party to a proceeding already instituted, may, at any time, propose in writing for settlement.

Following factors, which are only indicative, may be taken into consideration for the purpose of compounding of offences under the respective statute:

- Whether violation is intentional.
- Party's conduct in the investigation and disclosure of full facts.
- Gravity of charge i.e. charge like fraud, market manipulation or insider trading
- History of non-compliance. Good track record of the violator i.e. it had not been found guilty of similar or serious violations in the past.
- Whether there were circumstances beyond the control of the party
- Violation is technical and/or minor in nature and whether violation warrants penalty.
- Consideration of the amount of investors' harm or party's gain.
- Processes which have been introduced since the violation to minimize future violations/lapses.
- Compliance schedule proposed by the party
- Economic benefits accruing to a party from delayed or avoided compliance.
- Conditions where necessary to deter future non-compliance by the same or another party.
- Satisfaction of claim of investors regarding payment of money due to them or delivery of securities to them.

- Compliance of the civil enforcement action by the accused.
- Party has undergone any other regulatory enforcement action for the same violation.
- Any other factors necessary in the facts and circumstances of the case.

Where compounding is proposed by a party, such application may be made to the court and a copy can be addressed to the “Division of Prosecution, Enforcement Department” at SEBI’s Mumbai address.

So far as process of compounding of offences is concerned, any party who wishes to compound an offence shall file an appropriate application before the court where complaint is pending with a copy addressed to the Prosecution Division, Enforcement Department of SEBI’s Mumbai office which will forward the application/ request to be placed before the high powered Committee. The terms of compounding as recommended by the Committee and approved by the Competent Authority would be placed before the court by the Prosecution Division by way of written submissions or application, as appropriate, for passing orders as the court deems fit.

The final acceptance of any offer of compounding will come in to effect only upon the court passing the compounding order.

Question 7

- (a) *Mention the orders against which no appeal lies to the Securities Appellate Tribunal (SAT). (4 marks)*
- (b) *“In presenting a case before the tribunal/quasi-judicial body, a Company Secretary owes duty to the court, to the client and to the opponent.” Describe these duties of the Company Secretary. (4 marks)*
- (c) *Briefly explain the contents of a service contract. Draft a specimen agreement of employment of manager of a business concern. (8 marks)*

Answer 7(a)

No appeal shall lie to the Securities Appellate Tribunals from an order made

- (a) by the Board on and after the commencement of the Securities Laws (Second Amendment) Act, 1999
- (b) by an Adjudicating Officer,

with the consent of the parties.

Answer 7(b)

Company Secretaries act as an authorized representative before various tribunals/ quasi judicial bodies. It is necessary for them to learn art of advocacy or court craft for effective delivery of results to their clients when they act as an authorized representative before any tribunal or quasi judicial body.

Company Secretaries should be able to formulate and present a coherent submission based upon facts, general principles and legal authority in a structured, concise and

persuasive manner. They should understand the crucial importance of preparation and the best way to undertake it and be able to demonstrate an understanding of the basic skills in the presentation of cases before the tribunals.

Duty to the Court

- (i) A Company Secretary shall, during the presentation of his case and while otherwise acting before a Court/Tribunal, conduct himself with dignity and self-respect. He shall not be servile and whenever there is proper ground for serious complaint against a judicial officer, it shall be his right and duty to submit his grievance to proper authorities.
- (ii) A Company Secretary shall maintain towards the Courts a respectful attitude, bearing in mind that the dignity of the judicial office is essential for the survival of a free community.
- (iii) A Company Secretary shall not influence the decision of a Court by any illegal or improper means. Private communication with the judge relating to a pending case is forbidden.
- (iv) A Company Secretary shall use his best efforts to restrain and prevent his client from resorting to sharp and unfair practices or from doing anything in relation to the Court, opposing counsel or parties which the Company Secretary himself ought not to do. A Company Secretary shall refuse to represent the client who persists in such improper conduct. He shall not consider himself a mere mouthpiece of the client, and shall exercise his own judgment in the use of restrained language in correspondence, avoiding scurrilous attacks in pleadings, and using intemperate language during arguments in Court.
- (v) A Company Secretary shall not enter appearance, act, plead or practice in any way before a Court/Tribunal or any other Authority, if the sole or any member thereof is related to the Company Secretary.
- (vi) A Company Secretary shall not appear in or before any Court or Tribunal or any other Authority for or against an organization or an institution, society or corporation, if he is a member of the Executive Committee of such organization or institution or society or corporation.
- (vii) A Company Secretary should not act or plead in any matter in which he is himself pecuniarily interested.

Duty to Client

- (i) A Company Secretary shall not ordinarily withdraw from engagements once accepted, without sufficient cause and unless reasonable and sufficient notice is given to the client.
- (ii) A Company Secretary shall not accept a brief or appear in a case in which he has reason to believe that he will be a witness and if being engaged in a case, it becomes apparent that he is a witness on a material question of fact, he should not continue to appear if he can retire without jeopardizing his client's interest.

- (iii) A Company Secretary shall at the commencement of his engagement and during the continuance thereof, make all such full and frank disclosures to his client relating to his connection with the parties and any interest in or about the controversy as are likely to affect his client's judgment in either him or continuing the engagement.
- (iv) It shall be the duty of a Company Secretary to fearlessly uphold the interest of his client by all fair and honourable means without regard to any unpleasant consequences to himself or any other. He shall defend a person accused of a crime regardless of his personal opinion as to the guilt of the accused, bearing in mind that his loyalty is to the law which requires that no man should be convicted without adequate evidence.
- (v) A Company Secretary shall not at any time, be a party to fomenting of litigation. A Company Secretary shall not act on the instructions of any person other than his client or his authorized agent.
- (vi) A Company Secretary shall not do anything whereby he abuses or takes advantage of the confidence reposed in him by his client.

Duty to Opponent

- (i) A Company Secretary shall not in any way communicate or negotiate upon the subject-matter of controversy with any party represented by an Advocate except through that Advocate.
- (ii) A Company Secretary shall do his best to carry out the legitimate promise/promises, made to the opposite-party.

Answer 7(c)

Contents of a Service Contract

Service contracts are drafted in the same way as other agreements. The terms of employment should be definitely fixed and clearly expressed and nothing should be left to presumptions. They are required to be both affirmative (describing the acts and duties to be performed) as well as negative (putting restrictions on the acts of the employee during and/or after the term of employment). It is therefore necessary to make provision for (1) the time or period of employment; (2) the remuneration and other perquisites, if any, including pay, allowances, commission, rent-free house, conveyance, etc.; (3) duties of employment; (4) powers of the employee; (5) leave and the terms on which it will be granted; (6) modes and grounds of determining the employment during the term; and (7) restrictive covenants.

As the employer and the employee may not be conversant with law, the terms of a service contract should be as explicit as possible and should be easily intelligible to a lay man.

In respect of Government service, normally no formal contract is executed and only an appointment order is issued and the terms of service are thereafter governed by statutory rules and Government order. The same is the position of statutory corporations as employers.

Period of Service : This may be definite or indefinite. If no period is fixed or an indefinite period is stated, e.g., “so long as the parties respectively please”, the contract is terminable by a reasonable notice on either side. What is a reasonable notice varies in different cases, according to the characters of the employment and the general custom, from 15 days to six months. When no term is fixed it is always proper to provide for determination by notice.

Remuneration : Remuneration may be fixed monthly salary, or fees or commission, or salary as well as fees or commission. Sometimes in business firms, employees are allowed a share in the profits in addition to a fixed salary. All these should be clearly provided.

Leave : Conditions and grounds on which, and the period for which leave may be granted as well as allowance payable during leave should be stated.

Determination of Employment : The grounds for determination of employment should be clearly expressed in the agreement. The grounds on which the employment may be determined during the term are generally misconduct, negligence, or want of medical fitness. Subject to what has been stated earlier, it may also be determined at pleasure by notice, without giving any ground.

Restrictive Covenants : It is usual to include restrictive covenants in the agreement such as that the employer will not undertake any other work or service or that he will not divulge the employer’s secrets or make improper use of his trade secrets or information about the employer’s affairs. While drafting restrictive covenants, it is necessary to see that they are not illegal.

Effect of Labour Laws : Many Acts have been passed by the Central or State legislatures relating to the conditions of employment of teachers and other employees of aided schools and colleges and of universities, and of workers in factories and commercial establishments, for e.g. the Factories Act, the Industrial Employment (Standing Orders) Act, the Payment of Wages Act, the Workmen’s Compensation Act etc. In drawing up a service contract for such an employee, the provisions of the relevant Acts must be kept in view.

Specimen Agreement of Employment of Manager of a Business Concern

AN AGREEMENT made on this..... day of..... BETWEEN AB, etc. (hereinafter called the “employer”) of the one part AND CD, etc. (hereinafter called the “manager”) of the other part.

WHEREAS

1. The employer wants to appoint a suitable person to work as manager for his business concern; and
2. CD, the party of the other part, has agreed to serve as manager of the employer for his business concern.

NOW THIS AGREEMENT WITNESSES as follows :

1. The manager shall work as such for a term of..... years from the day of..... at..... or any other place as desired by the employer.

2. The manager shall give his whole time and attention to the said business and shall use his best endeavour to improve and expand the same and shall in all respects diligently and faithfully obey and observe all lawful orders and instructions of the employer in relation to the conduct of the said business and shall not without his consent divulge any secrets or dealings thereto.
3. The manager shall keep at the place of business at..... proper books of account showing all goods and moneys received and delivered and disbursed by him with necessary particulars of all such transactions and shall duly account for all moneys belonging to the employer and coming into the hands or power of the manager and shall forthwith pay the same to the employer or his bankers for the time being except only such moneys as the manager shall be authorised by the employer to retain for immediate requirements of the said business.
4. The employer shall pay to the manager during the continuance of his engagements and provided he shall duly observe and perform the agreement herein on his part contained, the salary of Rs..... per mensem on the first day of every calender month commencing from the first day of..... without any deduction except such as he will be bound to make under the Income-tax law for the time being in force, AND shall also pay the manager at the end of each year during the aforesaid period a further sum equal to 5 per cent on the gross sale return for the said year (or on the net profits of the said business for the said year (if any) after making such deductions as are properly made according to the usual custom of the said business in the estimation of net profits) provided always that upon the death or termination of the engagement of the manager before the expiration of the said period of years/ the employer shall forthwith pay to him or his heirs, executors, administrators or other legal representatives, as the case may be, in respect of the services of the manager of the whole or any part of the current month a due proportion of the salary of Rs. per mensem together with such further sum in lieu of such percentage as aforesaid as shall bear the same proportion to the estimated gross return (net profits) for the then current year as the part of the said year during which he has served, shall bear to the whole year, the gross return (net profits) being calculated on average of the past three years.
5. The employer shall during the continuance of the manager's engagement provide him with a suitable furnished house for residence free of rent, rates and taxes (except the charges for electricity consumed by him or of extra water used by him) and the manager shall reside in the said house.
6. The manager shall make such tour as may be necessary in the interest of the said business or as he may be directed by the employer to make and the employer shall pay him all reasonable expense actually incurred in undertaking such tours (or a travelling allowance at per mile for all journey by road and first class fare for journeys performed by rail and a halting allowance of Rs..... per diem when a halt of not less than 8 hours is made at one place).
7. The manager shall be entitled during his engagement to leave on full pay for a period equal to 1/11th of the period of service rendered and to a further leave on half pay in case of illness or incapacity to be proved to the satisfaction of the employer for a period of 15 days in one year.

8. Either party hereto may terminate the engagement of the manager at any time before the expiration of the said term of.....years on giving or sending by registered post to the other party three calendar months, notice in writing, such notice to be given or sent in the case of the employer to his house at and in case of the manager to his place of business or residence provided by the employer and on the expiration of the said three months from the date of giving or posting such notice, the said engagement shall terminate provided that the employer may terminate the said engagement at any time on payment of three months' pay in advance in lieu of such notice as aforesaid.
9. If the manager at any time willfully neglects or refuses or from illness or other cause becomes or is unable to perform any of the duties under this agreement, the employer may suspend his salary (and sum by way of percentage) during such neglect, negligence or inability as aforesaid and may further immediately terminate the engagement of the manager without giving any such notice or making such payment or salary in advance as hereinbefore provided.
10. The manager will at his own expense find and provide two respectable sureties to the amount of Rs..... each for his good conduct and for the due performance by him of this engagement and if he fails to do so for a period of three months from this date, the employer may terminate his services forthwith.

IN WITNESS WHEREOF, the parties hereto have signed this deed on the day and the year first above written.

Witness

Employer

Witness

Manager

Question 8

(a) Write notes on the following :

(i) Communication etiquettes

(ii) Advocacy tips to professionals.

(4 marks each)

(b) What is 'deed of assignment' ? Draft a specimen deed of assignment of copyright of a novel. (8 marks)

Answer 8(a)(i)

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

Being corporate professionals, you must practice some basic etiquette tips that would help you to go up the ladder of success in the workplace.

Communication Etiquettes

- Always speak politely. Listen to others attentively. A good listener is always dear to every client.
- While speaking over telephones, always greet the other person while starting and ending the call.
- Speak only when the other person has finished talking instead of interrupting in between.
- Show interest in what other people are doing and make others feel good.
- Stand about an arm's length away while talking to others.
- Question another person in a friendly, not prying, manner.
- Make eye contact when talking to others.
- Be polite. Avoid foul language, unkind statements, and gossip.
- Keep your conversations short and to the point.
- Maintain your sobriety and politeness even if the client speaks something offensive or rude and avoid replying back in harsh tone/words.

Answer 8(a)(ii)

Advocacy tips to professionals

Company Secretaries should be able to formulate and present a coherent submission based upon facts, general principles and legal authority in a structured, concise and persuasive manner. They should understand the crucial importance of preparation and the best way to undertake it and be able to demonstrate an understanding of the basic skills in the presentation of cases before the tribunals.

Some of the tips given by legal experts which professionals like Company Secretaries should bear in mind while appearing before Tribunals or other quasi-judicial bodies are given herein below. They say while pleading, a judge in your pleadings looks for:

- (i) *Clarity* : The judge's time is limited, so make the most of it.
- (ii) *Credibility* : The judge needs to believe that what you are saying is true and that you are on the right side.
- (iii) *Demeanour* : We don't have a phrase "hearing is believing". The human animal which includes the human judge, is far more video than audio. The way we collect most of our information is through our eyesight.
- (iv) *Eye contact* : While pleading, maintain eye contact with your judge.
- (v) *Voice modulation* : Voice modulation is equally important. Modulating your voice allows you to emphasize the points you want to emphasize. Be very careful about raising your voice. Use your anger strategically. But use it rarely. Always be in control of it.

- (vi) *Psychology*: Understand judge’s psychology as your job is to make the judge prefer your version of the truth.
- (vii) *Be likeable*. At least be more likeable than your opponent. If you can convert an unfamiliar Bench into a group of people who are sympathetic to you personally, you perform a wonderful service to your client.
- (viii) Learn to listen.
- (ix) *Entertain your judge*. Humour will often bail you out of a tough spot.

Answer 8(b)

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

A transfer of an actionable claim is usually called an assignment thereof. Section 3 of the Transfer of Property Act, 1882 defines an actionable claim as:

“Actionable claim means a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of moveable property or to any beneficial interest in moveable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognise as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent.”

The term assignment is, however, of wider import. It is well settled that a transfer of property clearly contemplates that the transferor has an interest in the property which is sought to be conveyed.

Specimen of Deed of Assignment of Copyright of a novel

THIS DEED OF ASSIGNMENT made this..... day of..... between..... (hereinafter called the “author”) of the first part and Messrs..... carrying on the business of publishers at..... (hereinafter called the “publishers”) of the second part.

WHEREAS the author is entitled to the copyright of the novel known as.....;

AND WHEREAS the publishers approached the author for assignment thereof, which the author has agreed to do on the terms and conditions hereunder contained.

NOW THIS DEED OF ASSIGNMENT WITNESSES as follows:

1. In consideration of and subject to the covenants on the part of the publishers as hereinafter contained, the author does hereby grant, convey, transfer, sell, assign and assure unto and to the use of the publishers all that copyright as defined in Section 14 of the Copyright Act, 1957, of the book entitled..... on the subject of..... to have and hold the same as absolute owners thereof for the full term of copyright as prescribed by law.
2. The publishers shall so long as the said work or any adaptation, modification or translation thereof is published and sold, submit to the author twice every year

once during the month of January and the other during the month of June, a statement of account showing details of copies printed, published, held in stock and sold or disposed of (Except otherwise by sale of damaged or destroyed copies) and of the profits, if any, earned thereunder.

3. The publishers shall pay or cause to be paid to the author or his nominee or nominees a royalty at the rate of..... per cent on the sale proceeds of the copies of the work or adaptations or translations thereof that may be actually published and as disclosed in the statement of account referred to in clause (2). No royalty shall be payable on any copies of the work that may be damaged or destroyed or disposed of otherwise than by regular sale.
4. That the publishers shall also pay to the author half the net profits earned by them, if any, from any transfer, sale or assignment of any of the rights comprising the copyright or from grant of any interest or license therein: provided that the publishers shall not be entitled to and shall not do or cause anything to be done in derogation of the author's rights, particularly the right to royalty reserved hereunder.
5. That the author does hereby agree to revise the work and bring it up to date or otherwise modify, alter, adapt or translate it or get it translated whenever reasonably required by the publishers provided also that the publishers will not normally require the author to do so more than once in two years; provided further that in case the author shall fail and/or neglect, and/or refuse, to revise, modify, alter, translate the work or get it translated as and when reasonably required by the publishers, they shall be at liberty to get the same done on his account by any person or persons of their choice after due notice to the author and deduct all costs, charges and expenses out of moneys payable to the author: provided also that in selecting the person proposed to revise, modify, alter, adapt or translate the work and in fixing the remuneration to be paid therefor, the author's wishes, if any, shall so far as possible, be respected by the publishers.
6. That the author has delivered (or shall deliver within a period of.....) the manuscript of the said work to the publishers.
7. That the author does hereby declare that the work of which the copyright is being hereunder assigned is entirely the original work of the author and that the same does not in any manner whatsoever violate or infringe any existing copyright or any other right of any other person or other persons; and further that it does not contain anything which may be considered as obscene, libellous, scandalous or defamatory.
8. The author hereby agrees to indemnify and keep the publishers indemnified against all claims, demands, suits and other actions and proceedings, if any, that may be instituted or taken and also against all damages, costs, charges, expenses which the publishers shall or may suffer, on account of printing, publication or sale of the said work or any part thereof, or by reason of such printing, publication and/or sale being an infringement of some other person's copyright or other rights in the work or by reason of its containing anything which may in any sense be obscene, libellous, scandalous or defamatory.

9. The publishers shall print and publish the work or cause the same to be printed and published as soon as practicable within a period of twelve months from the date of this contract, and in default thereof, the author may, by a notice in writing, call upon the publishers to print and publish the work within two months of the receipt of the said notice; and if the publishers shall still fail and/or neglect to print and/or publish the work within the said period, save and except in so far as they are prevented from doing so by circumstances beyond their control, the author shall be at liberty to rescind the contract on giving a notice to that effect to the publishers when the copyright shall revert fully to the author and all the rights of publishers shall as from that date stand determined.
10. That in case of a dispute or difference arising between the parties touching the meaning, construction, interpretation, breach or fulfilment or non-fulfilment of the terms of these presents or any clause or condition thereof, the same shall be referred to arbitration. The award of such arbitrator, shall be final and binding on both the parties and this clause shall be deemed as of submission within the meaning of the Arbitration and Conciliation Act, 1996 and its statutory modification and re-enactment.
11. That the words "author" and "publishers" or "parties" used hereinabove shall unless there be something contrary to the context, include their respective heirs, survivors, successors, representatives, executors, administrators and assigns and successors in business.

IN WITNESS WHEREOF the parties hereto have executed these presents on the date, month and the year hereinbefore mentioned in the presence of the witness.

Witness :

Author

Witness :

Publisher

PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 2009

FINANCIAL, TREASURY AND FOREX MANAGEMENT

Time allowed : 3 hours

Maximum marks : 100

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

Question 1

Comment on any four of the following :

- (i) Financial sector acts as conduit for the transfer of financial resources from net savers to net borrowers.*
- (ii) Under capital rationing, the standard net present value (NPV) decision rule no longer holds true.*
- (iii) Most businesses need cash funds to meet contingencies.*
- (iv) Apart from the retention of profits and capitalising the accumulated earnings, the bonus shares serve several other objectives.*
- (v) Foreign exchange risk can be managed both internally and externally.*

(5 marks each)

Answer 1(i)

In any economy, the financial sector plays a major role in the mobilization and allocation of savings. Financial institutions, instruments and markets which constitute the financial sector act as conduit for the transfer of financial resources from net savers to net borrowers, i.e. from those who spend less than they earn to those who spend more than they earn. The Financial sector performs this basic economic function of intermediation essentially through four transformation mechanisms :

- (i) Liability-asset transformation (i.e., accepting deposits as a liability and converting them into assets such as loans);*
- (ii) Size-transformation (i.e., providing large loans on the basis of numerous small deposits);*
- (iii) Maturity transformation (i.e. offering savers alternate forms of deposits according to their liquidity preferences while providing borrowers with loans of desired maturities); and*
- (iv) Risk transformation (i.e. distributing risks through diversification which substantially reduces risks for savers which would prevail while directly in the absence of financial intermediation).*

Answer 1(ii)

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

Answer 1(iii)

This motive of holding cash takes into account the element of uncertainty associated with any form of business. The uncertainty can result in prolongation of the working capital operating cycle or even its disruption. It is possible that cost of raw materials or components might go up or the time taken for conversion of raw materials into finished goods might increase. For such contingencies, some amount of cash is kept by every firm. The motive of holding cash for contingencies is based on the need to maintain sufficient cash to act as a cushion to buffer against unexpected events. One never knows about the happening of natural calamities or sudden increase in cost of raw materials or any other factor such as strike, lock-out etc. Such events may seriously interrupt even the best planned financial plans and thus temporarily make the cash budget ineffective and non-existent. Therefore, the business should maintain larger cash balance than required for day to day transactions in order to avoid unforeseen situation arising because of insufficient cash.

Answer 1(iv)

The basic idea behind issue of bonus shares is the objective of retention of profits and capitalizing the accumulated earning for financing, from internal sources, the cost of company's expansion, modernization or diversification scheme. Issue of bonus shares does not affect the liquidity position of the company. The company issues bonus shares to serve the following ends :

- (a) to enhance the prosperity of the company by conserving the cash outflows;
- (b) increase in equity shares through bonus issue reduces the rate of dividend; Usually high rate of dividend may attract adverse notice to the general public or authorities towards profiteering;
- (c) to transfer the formal ownership of surplus and reserves to equity holders by issuing bonus shares;
- (d) with broad based equity structure, a company can better bargain the debt to balance its capital structure and increase earnings on equity shares through financing leverage;
- (e) creating liquidity and marketability of the equity shares by scaling down the market price of the shares.

Answer 1(v)

There are a number of techniques that can be used for internal hedging the exchange rate risk. It is easier to hedge transaction and translation risks internally than to hedge economic risk, due to difficulties associated with quantification of economic risks and long time periods over which exposure to economic risk occurs. The main internal techniques are matching, netting, leading and lagging and invoicing in the domestic currency but the degree to which firms hedge their exposures internally is often limited.

The foreign exchange risk can also be managed by external techniques. The most important methods are forward contracts futures and borrowing and lending in money market. Now a days a number of alternatives are available in the form of derivative instruments including, swaps and options.

Question 2

- (a) *Mona Machines Ltd. has provided you the following information for the year 2008:*

<i>Production for the year</i>	<i>...</i>	<i>69,000 units</i>
<i>Finished goods in store</i>	<i>...</i>	<i>Average 3 months</i>
<i>Raw materials in store</i>	<i>...</i>	<i>Average 2 months' consumption</i>
<i>Work-in-progress (assume 50% completion stage with full material consumption)</i>	<i>...</i>	<i>Average 1 month</i>
<i>Credit allowed by creditors</i>	<i>...</i>	<i>Average 2 months</i>
<i>Credit given to debtors (assume at selling price)</i>	<i>...</i>	<i>Average 3 months</i>
<i>Selling price per unit</i>	<i>...</i>	<i>Rs. 50</i>
<i>Raw material cost</i>	<i>...</i>	<i>50% of selling price</i>
<i>Direct wages</i>	<i>...</i>	<i>10% of selling price</i>
<i>Overheads</i>	<i>...</i>	<i>20% of selling price</i>

Company keeps Rs. 1,00,000 in cash. There is regular production and sale cycle, and wages and overheads accrue evenly. Wages are paid in the next month of accrual. Material is introduced in the beginning of production cycle.

You are required to calculate working capital requirement of Mona Machines Ltd. (10 marks)

- (b) *Silver Oak Ltd., an Indian company, is mainly engaged in international trade with US and UK. It is currently 1st January. It will have to make a payment of \$7,29,794 in the coming six months time. The company is presently considering the various alternatives in order to hedge its transactional exposure through its London office. The following information is available :*

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Exchange Rates :

\$/£ Spot rate : 1.5617 - 1.5773

6-month \$ forward rate : 1.5455 - 1.5609

<i>Money Market Rates</i>	<i>Borrow</i>	<i>Deposit</i>
	(%)	(%)

<i>US Dollar</i>	6	4.5
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<i>Sterling</i>	7	5.5
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Foreign currency option prices (Cents per £ for contract size £12,500) :

<i>Exercise Price</i>	<i>Call Option (June)</i>	<i>Put Option (June)</i>
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\$1.70/£	3.7	9.6
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Suggest which of the following hedging option is the most suitable for Silver Oak Ltd. :

- (i) *Forward exchange contract*
- (ii) *Money market*
- (iii) *Currency option.* (6 marks)

(c) *Monark Ltd. is considering two alternative financial plans to start a new project. In Plan-I, it is likely to issue equity shares of Rs.16 lakh and 13% preference capital of Rs.4 lakh. In Plan-II, the company will issue equity shares of Rs.8 lakh, 13% preference capital of Rs.4 lakh, and 15% debentures of Rs.8 lakh. The face value of equity shares in both plans is Rs.10. Tax rate is 30%.*

You are required to determine level of EBIT at which the EPS would be same under both the plans. (4 marks)

Answer 2(a)

Computation of Net working capital of Mona Machines Limited

<i>Nature of asset/liability</i>	<i>Basis of calculation</i>	<i>Amount (Rs.)</i>
(A) Current Assets		
(i) Raw Material Stock	Average 2 months $\frac{69,000 \times 25 \times 2}{12}$	2,87,500
(ii) Work-in-progress	Average 1 month	
(a) Raw material	$\frac{69,000 \times 25 \times 1}{12}$	1,43,750
(b) Wages (50% completion)	$\frac{69,000 \times 5 \times 1}{12 \times 2}$	14,375
(c) Overheads		
(50% completion)	$\frac{69,000 \times 10 \times 1}{12 \times 2}$	28,750
(iii) Finished goods stock	Average 3 months $\frac{69,000 \times 40 \times 3}{12}$	6,90,000

<i>Nature of asset/liability</i>	<i>Basis of calculation</i>	<i>Amount (Rs.)</i>
(iv) Sundry debtors (at selling price)	Average 3 months $\frac{69,000 \times 50 \times 3}{12}$	8,62,500
(v) Cash balance	Actual	1,00,000
	Total Current Assets.... (A)	21,26,875
(B) Current Liabilities		
(i) Creditors for materials	Average 2 months $\frac{69,000 \times 25 \times 2}{12}$	2,87,500
(ii) Creditors for wages	Average 1 month $\frac{69,000 \times 5 \times 1}{12}$	28,750
	Total Current Liabilities(B)	3,16,250
(c) Net working capital (A - B)		18,10,625

Answer 2(b)(i) *Using Forward Exchange Contract*

$$\text{\$ } 729794 / 1.5455 = \text{\pounds } 472206$$

(ii) *Using Money Market*

Silver Oak Ltd. must make a deposit now

Six months dollar deposit rate : $4.5/2 = 2.25\%$

$$Z \times 1.0225 = \text{\$ } 729794$$

$$Z = \frac{\text{\$ } 729794}{1.0225} = \text{\$ } 7,13,735$$

Hence amount required to be deposited @ 4.5% = \$ 713735

Cost of buying \$ 713735 at current spot rate is $713735 / 1.5617 = \text{\pounds } 457024$ Six months sterling borrowing rate = $7/2 = 3.5\%$ Interest for six months on £ 457024 = $(\text{\pounds } 457024 \times 0.035) = \text{\pounds } 15996$

Total Cost = £ 457024 + £ 15996 = £ 473020

(iii) *Using Currency option*Each contract will deliver = $1.7 \times 12500 = \text{\$ } 21250$ No. of put option contract required = $729794 / 21250 = 34.34$ or 34Cost of total contracts = $0.096 \times 12500 \times 34 = \text{\$ } 40800$ Sterling cost of option = $40800 / 1.5617 = \text{\pounds } 26,125$ Sterling required = $34 \times \text{\pounds } 12500 = \text{\pounds } 425000$ to buy \$ 722500 @ \$ 1.70

PP-FTFM-December 2009	6		
Shortfall	=	729794 — 722500	= 7294
Cost of sterling using forward rate	=	7294/1.5455	= 4720 £
Total cost using option	=	26125+425000+4720	= £ 455845

Therefore currency options are the cheapest mode of hedging transaction exposure.

Answer 2(c)

Point of indifference is that point where the EPS would be the same. Point of Indiff

$$\begin{aligned}
 &= \frac{(1-t)EBIT - P_1}{N_1} = \frac{(1-t)(EBIT - I) - P_2}{N_2} \\
 &= \frac{(1-0.3)(EBIT - 52,000)}{1,60,000} = \frac{[(1-0.3)(EBIT - 1,20,000) - 52,000]}{80,000} \\
 &= .7EBIT - 52,000 = 2[.7EBIT - 84,000] - 52,000 \\
 &= .7EBIT - 52,000 = 1.4EBIT - 1,68,000 - 1,04,000 \\
 &= .7EBIT - 1.4EBIT = - 1,68,000 - 1,04,000 + 52,000 \\
 &= -.7EBIT = - 2,20,000 \\
 &= EBIT = \frac{- 2,20,000}{.7} = 3,14,286
 \end{aligned}$$

At the Rs. 3,14,286 of EBIT the EPS of both companies will same at Rs. 1.05.

Question 3

- (a) *Vaibhav Ltd. is engaged in manufacturing of machines used in construction. It is considering the possibility of purchasing from a supplier a component it now makes. A supplier has agreed to supply the component in the required quantities at a unit price of Rs. 18. The transportation and insurance charges are Re.1 per unit.*

Presently, the company produces the component from a single raw material in economic lots of 3,000 units at a cost of Rs.4 per unit. The average annual demand is 40,000 units. The annual holding cost for company is Re.0.50 per unit and it has set a minimum stock level of 800 units. The direct labour costs of the component are Rs. 12 per unit. The company also hires a machine at a rate of Rs.400 per month on which the components are produced. Suggest whether the company should produce or procure the component. (14 marks)

- (b) *Two companies Rita Ltd. and Gita Ltd. are considering to enter into a swap agreement with each other. Their corresponding borrowing rates are as follows:*

Name of Company	Floating Rate	Fixed Rate
Rita Ltd.	LIBOR	11%
Gita Ltd.	LIBOR + 0.3%	12.5%

Rita Ltd. requires a floating rate loan of £8 million while Gita Ltd. requires a fixed rate loan of £8 million.

- (i) Show which company had advantage in floating rate loans and which company has a comparative advantage in fixed loans.
- (ii) If Rita Ltd. and Gita Ltd. engage in a swap agreement and the benefits of the swap are equally split, at what rate will Rita Ltd. be able to obtain floating finance and Gita Ltd. be able to obtain fixed rate finance ?

Ignore bank charges.

(6 marks)

Answer 3(a)

Ordering cost can be obtained on the basis of EOQ equation = $EOQ = \sqrt{\frac{2AO}{C}}$

Let the ordering cost equal to M, so

$$EOQ = \frac{2AM}{C} \text{ or } 3000 = \sqrt{\frac{2 \times 40,000 \times M}{0.50}}$$

$$3000^2 = \frac{80,000 M}{0.50}$$

$$\text{OR } 3000 \times 3000 \times 0.50 = 80,000 M$$

$$M = \frac{45,00,000}{80,000} = \text{Rs. } 56.25$$

Ordering cost = Rs. 56.25

$$\begin{aligned} \text{Average Stock level} &= \text{Minimum Stock} + \frac{1}{2} \text{EOQ} \\ &= 800 + \frac{1}{2} (3000) = 2300 \text{ Units} \end{aligned}$$

Cost of making component (Annual basis)	Rs.
Ordering cost of 40000 units = 13.33 or 13 orders @ 56.25	731.25
Holding or storage cost = 2300 unit x 0.50	1150.00
Cost of direct material 40000 x 4	160000.00
Direct Labour Cost 40000 x 12	480000.00
Hire Charges 400 x 12 months	4800.00
Cost of manufacturing component	<u>646681.25</u>
Purchase cost of component = 40,000 x 18	720000.00
Add : Transportation and Insurance charges 40000 x 1	40000.00
	<u>Rs. 760000.00</u>

Since the cost of manufacturing component is less than the purchase of Component, the Company should manufacture the component.

Answer 3(b)

(a) Assuming LIBOR say for 10% company Gita Ltd. floating rate is three per cent more expensive than company Rita Limited rate; but its fixed rate is 12.5% which is more expensive than Rita Ltd.. Hence the company Rita Ltd. has a more comparative advantage in fixed rate loans and company Gita Ltd. has a comparative advantage in floating rate loans.

(b) Net Potential Gain = (LIBOR - (LIBOR + 0.3) + (12.5 - 11)

$$= -0.3 + 1.5 = 1.2 \text{ per cent}$$

i.e. 0.6 per cent benefit to each company

Net floating rate cost to Rita Ltd. would be = LIBOR - .6%

And net fixed rate cost to Gita Ltd. would be 12.5% - .6% = 11.9%

So the swapping the interest rate obligations, both companies would be benefitted to the extent of .6%.

Question 4

Distinguish between any four of the following :

- (i) 'Factoring' and 'bill discounting'.
- (ii) 'Operating lease' and 'finance lease'.
- (iii) 'Business risk' and 'financial risk'.
- (iv) 'Efficient portfolio' and 'optimal portfolio'.
- (v) 'Translation risk' and 'transaction risk'.

(5 marks each)

Answer 4(i)**Factoring and Bill Discounting**

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

Answer 4(ii)**'Operating Lease' and 'Finance Lease'**

<i>Operating Lease</i>	<i>Finance Lease</i>
(a) It is a rental agreement where the lessee is committed to pay a periodic lease rental to the lessor.	It is like an installment loan. It is a legal commitment to pay for the entire cost of equipment plus interest over a period of time.

<i>Operating Lease</i>	<i>Finance Lease</i>
(b) It provides for maintenance expenses and taxes by lessor.	It excludes the provisions for maintenance or taxes which are paid separately by the lessee.
(c) Leasing company assumes risk of obsolescence.	Lessee assumes the risk of obsolescence.
(d) Contract period ranges from intermediate to short-run.	Contract period ranges from medium to long run.
(e) The financial commitment is restricted to regular rental payment.	The lessee involves a financial commitment similar to loan by a leasing company. It places lessee in a position of borrower.

Answer 4(iii)

Business Risk and Financial Risk

Business Risk : The projects which carry the risk of not being able to successfully market the products fall within the category of business risk. For such risk premium is needed on investment proposed to be made in such project and so the expected rate of return on such investment will be higher than those in risk free investment.

Financial Risk : A project may carry financial risk when it is not able to generate sufficient funds to cover interest payments on its debts or pay dividend to the shareholders. Therefore, for investment in such project the rate of return is supposed to be higher.

Answer 4(iv)

Efficient Portfolio and Optimal Portfolio

Efficient Portfolio : Efficient Portfolio is that which lies along the capital market line. These are the portfolios which offer

- (a) the maximum level of expected return for a given level of risk or
- (b) the minimum level of risk for a given level of return.

These portfolios lie along the efficient frontier of the set of all possible portfolios in a graph of portfolio returns against portfolio risk. It is not possible to determine that which portfolio an individual will prefer, as it would be decided by the risk-return attitude of investor.

Optimal Portfolio : The efficient portfolio which is best suited to the risk return characteristics of a particular individual investor is an optimal portfolio for the investor. It represents a tangency point of the individual investor's utility function or indifference curve on the efficient frontier.

Answer 4(v)**Translation Risk and Transaction Risk**

Translation Risk : It is also called accounting exposure. It refers to and deals with the probability that the firm may suffer a decrease in assets value due to devaluation of foreign currency even if no foreign exchange transaction has taken place. The risk is particularly relevant for the companies, which have subsidiaries in other countries. Due to translation exposure the values of assets, liabilities, expenses and profits of foreign subsidiaries may change. Two related decision areas are involved in translation exposure management , (a) Managing balance sheet items to minimize the net exposure (b) Deciding how to hedge against this exposure.

Transaction risk : Transaction risk refers to the potential change in the value of a foreign currency denominated transaction due to changes in the exchange rate. Credit purchases and sales as well as borrowing and lending denominated in foreign currencies and uncovered forward contracts are some examples of transaction exposure. Transaction exposure basically covers the following :

- (a) *Rate Risk* : It occurs (a) when there is mismatch of maturities and borrowings and (b) In foreign exchange, it results in net exchange positions
- (b) *Credit Risk* : A situation when borrower is not in a situation to pay
- (c) *Liquidity Risk* : Less chances of receiving payments.

Question 5

Alfa Ltd. is in the business of manufacturing bearings. Some more product lines are being planned to be added to the existing system. To manufacture the planned product lines, the firm needs a machine which if purchased outright will cost Rs. 10,00,000. Modern Hire-Purchase and Leasing Co. has offered two proposals as below :

Proposal - I (Hire-Purchase)

Rs. 2,50,000 will be payable on signing of the agreement. Three annual installments of Rs. 4,00,000 will be payable at the end of each year starting from year first. The ownership of the machine will be transferred automatically at the end of third year. The company will be able to claim depreciation on straight line basis with zero salvage value.

Proposal - II (Lease)

Rs. 20,000 will be payable towards initial service fee upon signing of the agreement which is tax-deductible expense. Annual lease rental of Rs. 4,32,000 is payable at the end of each year starting from the first year for a period of three years.

Evaluate the above two proposals and advise the company as to which proposal implies lesser cost given that tax-rate is 35% and discount rate is 20%. (Calculations may be rounded off to Rupee.)

(20 marks)

Answer 5**Proposal I (Machine on Hire Purchase)****Computation of Interest and Depreciation**

<i>Year</i>	<i>Hire Purchase (Rs.)</i>	<i>Interest (Rs.)</i>	<i>Cash Price (Rs.)</i>	<i>Depreciation (Rs.)</i>	<i>Interest and Depreciation (Rs.)</i>
0	2,50,000	—	2,50,000	—	—
1	4,00,000	2,25,000	1,75,000	3,33,333	5,58,333
2	4,00,000	1,50,000	2,50,000	3,33,333	4,83,333
3	4,00,000	75,000	3,25,000	3,33,334	4,08,334
	14,50,000	4,50,000	10,00,000	10,00,000	14,50,000

Workings :

The total hire purchase price is Rs. 14,50,000 and the cash price is Rs. 10,00,000. So the interest is Rs. 4,50,000 which is allocated in the ratio of hire purchase price outstanding i.e. 3:2:1

Computation of Present Value of Cash Outflows

<i>End of the Year</i>	<i>Hire Purchase Instalment (Rs.)</i>	<i>Tax shield @ 35% of Interest and debentures (Rs.)</i>	<i>Net Outflow (Rs.)</i>	<i>PV Factor (Rs.)</i>	<i>Present value of Outflows (Rs.)</i>
0	2,50,000	—	2,50,000	1.0000	2,50,000
1	4,00,000	1,95,417	2,04,583	0.8333	1,70,479
2	4,00,000	1,69,167	2,30,833	0.6944	1,60,290
3	4,00,000	1,42,917	2,57,083	0.5787	1,48,774
	Present value of outflows				7,29,543

Proposal II (Machine on Lease)**Computation of Present Value of Cash Outflows**

<i>End of the Year</i>	<i>Lease charges (Rs.)</i>	<i>Tax shield @ 35% (Rs.)</i>	<i>Net Outflow (Rs.)</i>	<i>PV Factor (Rs.)</i>	<i>Present value of Outflows</i>
0	20,000	7,000	13,000	1.0000	13,000
1	4,32,000	1,51,200	2,80,800	0.8333	2,33,991
2	4,32,000	1,51,200	2,80,800	0.6944	1,94,988
3	4,32,000	1,51,200	2,80,800	0.5787	1,62,499
Present value of outflows					6,04,478

Evaluation of Proposals

The present value of cash outflows in case of hire purchase is Rs. 7,29,543 and in case of lease is Rs. 6,04,478. So the lease option (Proposal II) implies lesser cost and the firm should procure the machine on lease basis.

Question 6

(a) The following data is related to Raman Ltd. :

Year	Raman Ltd.		Nifty Average Index	Nifty Dividend Yield	Return on Government Stock
	Average Share Price	Dividend Per Share			
3	278	14	2,600	4%	8%
2	294	17	2,990	6%	10%
1	326	18	3,040	6.5%	9%
Current	370	20	3,280	6.5%	9%

Calculate —

- (i) Expected return on shares of Raman Ltd.; and
- (ii) Beta (B) value using Capital Asset Pricing Model (CAPM). (14 marks)
- (b) Following facts are available for Astro Ltd. : (i) Cash turnover rate is 5; (ii) Annual cash outflow is Rs. 1,75,000; and (iii) Accounts payable can be stretched by 12 days.

What would be the effect of stretching accounts payable on the minimum operating cash requirements ? If the firm can earn 10% on its investments, what would be the savings on cost ? (Assume 360 days in a year.) (6 marks)

Answer 6(a)**Expected return on Raman Ltd.'s shares**

(a) Average percentage annual capital gain :

$$\text{Let } g = \text{average annual capital gain } 278(1+g)^3 = 370$$

$$\text{Therefore } g = \sqrt[3]{370 \div 278} - 1 = 1.10 - 1.00 = 0.10 \text{ or } 10\%$$

(b) Average annual dividend yield :

Year	Div	÷ Share Price	=	Dividend Yield
III Year	14	÷ 278		0.050
II Year	17	÷ 294		0.058
1st Year	18	÷ 326		0.055
Current Year	20	÷ 370		0.054
Total				0.217

$$0.217 \div 4 = 0.054 \text{ or } 5.4\%$$

The expected return on the Raman Company's share would be

$$E(r_A) = \text{Average annual capital gain} + \text{average dividend yield}$$

$$E(r_A) = 10\% + 5.4\% = 15.4\%$$

Expected Return on the market portfolio (Nifty) :

(i) Average annual percentage capital gain

$$\text{Let } g = \text{average annual capital gain}$$

$$2600(1+g)^3 = 3280$$

$$\text{Therefore } g = \sqrt[3]{3280 \div 2600} - 1 = 0.08 \text{ or } 8\%$$

(ii) Average annual dividend yield

$$4 + 6 + 6.5 + 6.5 = 23\% \div 4 = 5.75\%$$

Therefore the expected return on Nifty index acting as surrogate for market portfolio is :

$$E(r_M) = 8\% + 5.75 = 13.75$$

$$\text{Average annual risk-free return} : 8 + 10 + 9 + 9 = 36\% \div 4 = 9\%$$

So

$$E(r_A) = 15.4\%$$

$$E(r_M) = 13.75\%$$

$$r_f = 9\%$$

β of the share can be found by using CAPM : $E(r_A) = r_f + (\beta_A (E(r_M) - r_f))$

$$15.4\% = 9.0\% + (\beta_A (13.75\% - 9\%))$$

$$= \beta_A$$

$$\beta_A = 1.347$$

Answer 6(b)

Cash cycle of the firm =

Present cash cycle = $360 \text{ days} / 5 = 72 \text{ days}$

Proposed cash cycle when accounts payable can be stretched by 12 days -

$$72 \text{ days} - 12 \text{ days} = 60 \text{ days}$$

Proposed cash turnover rate would be = $360 \text{ days} / 60 \text{ days} = 6$

Minimum operating cash requirement -

$$\text{Present} = \text{Rs. } 1,75,000 / 5 = \text{Rs. } 35,000$$

$$\text{Proposed} = \text{Rs. } 1,75,000 / 6 = \text{Rs. } 29,167$$

$$\text{Reduction in investment} = \text{Rs. } 35,000 - \text{Rs. } 29,167 = \text{Rs. } 5,833$$

$$\text{Therefore Savings in cost} = \text{Rs. } 5,833 \times 0.10 = \text{Rs. } 583.30$$

Question 7

Write notes on any four of the following :

- (i) Financial instruments used for venture financing
- (ii) Factors affecting dividend policy of a firm
- (iii) Optimal capital structure
- (iv) Financing cost escalation
- (v) Domestic resource cost. (5 marks each)

Answer 7(i)

Financial Instruments used for venture financing

The instruments used for venture financing can broadly be categorized into :

- *Equity Share Capital* : Venture Capital firm take ownership position but their stake does not exceed 49%. The venture capitalist holds the investment made for a prescribed minimum period. At the end of the period, it can divest its holdings either through sale of its holdings to the promoter at a mutually agreed price or through offer of sale in the secondary markets.

- *Conditional Loan* : The conditional loan either carries a low or no interest. In case no interest is charged, the loan carries a charge linked to the level of sale generated by the project on commercialization.
- *Income Notes* : Income notes are a combination of conventional and conditional loans.

The financing mix for each project is determined on the basis of factors such as the type of company (new or existing), contribution being made by promoters, the debt-equity ratio, the nature of the project being undertaken by the company and its project potential.

Answer 7(ii)

Factors affecting dividend policy of a firm

Firm-oriented matters relating to dividend policy can be grouped under the following categories, affecting directly or indirectly the determination and the appropriateness of the policy :

- (1) Firms' contractual obligations, restrictions in loan agreement and/or legal limitations/considerations; and insufficiency of cash to pay dividends.
- (2) Liquidity, credit standing and working capital requirements and considerations. Ability to borrow, nature of stockholders, degree of control, timing of investment opportunities, inflation and need to repay debt.
- (3) Need for expansion-availability of external finance, financial position of promoters, relative cost of external funds, the ratio of debt to equity.
- (4) Business cycle considerations.
- (5) Factors relating to future financing
- (6) Past dividend policies and stockholders relations.

Answer 7(iii)

Optimal Capital Structure

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

Answer 7(iv)

Financing Cost Escalation

Cost escalation results in the increase in project cost for many reasons viz. Delay in implementation of project, inflationary pressure on corporate purchasing etc.

Financing cost escalation will depend upon the corporate arrangements as to how the project cost has originally been financed. There may be the following different ways to treat the financing of cost escalation:

1. When the project is new and financed by owner fund only - In such cases, the raising of equity is costly but issue of right shares to existing shareholder could be planned and this cost be met out.
2. When the company is existing company and project cost is being financed by its internal funds - In this case the company can use its reserves and surplus in financing cost escalation.
3. Where the company has been using borrowed sums in addition to equity capital for financing the project cost, it can always make request for additional funds to the lending institutions to meet the cost escalations or over runs in the project cost. In case the cost escalation is of greater magnitude then the company will have to go to raise funds from equity holders besides raising loans from the institutions so as to maintain the debt equity ratio in the existing balanced and planned proportions.

Answer 7(v)

Domestic Resource Cost

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

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

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

CORPORATE RESTRUCTURING AND INSOLVENCY

Time allowed : 3 hours

Maximum marks : 100

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

PART A

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

Question 1

- (a) State whether the following statements are correct or incorrect citing briefly relevant provisions of the law :
- (i) Court cannot refuse to sanction a scheme of arrangement which has been approved by majority of shareholders/creditors of the companies concerned.
 - (ii) Court would not insist on prior approval of stock exchange(s) while sanctioning a scheme of arrangement.
 - (iii) The word 'amalgamation' or 'merger' is not defined anywhere in the Companies Act, 1956.
 - (iv) The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 also apply to acquisition of global depository receipts (GDRs) or American depository receipts (ADRs).
 - (v) Filing of draft letter of offer with SEBI should be deemed or construed as conclusive evidence that the same has been vetted or approved by SEBI.
 - (vi) An offer made by the acquirer can be withdrawn unconditionally at any time without any demur or resistance of any party since the acquirer is at liberty to withdraw his offer.
 - (vii) The order of court sanctioning the scheme of arrangement is final and effective. Companies need not do any thing thereafter in respect of courts sanction. (2 marks each)
- (b) Distinguish between 'management buy-out' and 'management buy-in'. (3 marks)
- (c) A company whose shares were listed on a stock exchange for 3 months as on the relevant date made preferential allotment at Rs. 100 per share. On completing the period of 6 months of being listed on the stock exchange, the company recomputed the share price based on the guidelines issued by SEBI in this respect and price of share so recomputed came to Rs.150 per share. The company demanded additional amount of Rs. 50 per share from the allottees of shares. Is the action of the company justified ? Give reasons. (4 marks)
- (d) Grow Well Ltd. wants to adopt strategic planning to ensure its growth in the present day highly competitive scenario. As part of the management team, you are assigned with the role of highlighting the essential features such a planning should have. Suggest the features which you consider are vital for any strategic planning. (4 marks)

Answer 1(a)(i)**Statement is correct.**

When a scheme of compromise/arrangement is sound not opposed to public policy and does not violate any law/statute and nature justice and is supported by majority of shareholders/creditors, the Court would sanction the scheme under Section 391 of the Companies Act, 1956.

Answer 1(a)(ii)**Statement is correct.**

However, pursuant to clause 24 of the listing agreement, all listed companies shall have to file scheme/petition proposed to be filed before any Court/Tribunal under Sections 391, 394 and 101 of Companies Act, 1956, with the stock exchange, for approval, at least a month before it is presented to the Court or Tribunal.

Answer 1(a)(iii)**Statement is correct.**

The word 'amalgamation' or 'merger' is not defined anywhere in the Companies Act, 1956. However Section 2(1B) of the Income Tax Act, 1961 defines 'amalgamation'.

Answer 1(a)(iv)**Statement is partially correct.**

It applies to the acquisition of Global Depository Receipts or American Depository Receipts provided as long as they are converted into shares carrying voting rights.

Answer 1(a)(v)**Statement is incorrect.**

Filing of draft Letter of Offer with SEBI should not in any way be deemed or construed that the same has been cleared, vetted or approved by SEBI. The Letter of Offer is submitted to SEBI for a limited purpose of overseeing whether the disclosures contained therein are generally adequate and are in conformity with the Takeover Regulations.

Answer 1(a)(vi)**Statement is incorrect.**

As per Regulation 27, no public offer, once made, shall be withdrawn except when:

- (a) the statutory approval(s) required have been refused;
- (b) the sole acquirer, being a natural person, has died; and
- (c) there are such circumstances which in the opinion of SEBI merits withdrawal.

Answer 1(a)(vii)**Statement is incorrect**

Unless the copy of order is filed with ROC within 30 days from the Court's Order, the scheme can not be treated as effective.

Answer 1(b)

Management buy out – This situation occurs when the existing operating management and/or investors wish to buy the whole business, a division of the business or perhaps a product line. Specific financing is often provided by venture capitalists. In a management buy out, shareholders must be extra vigilant. The managers involved are of course looking to secure the best deal for themselves and this could lead them to withhold certain information from the shareholders. Shareholders often seek independent advice in these circumstances.

Management buy in - This is the situation when a group of managers from outside the business wish to buy into the business and run it, or buy into a division of the existing company.

Answer 1(c)

The action of the company is justified. Chapter XIII of SEBI (Disclosure and Investor Protection) Guidelines, 2000 clearly provided the rules regarding the price at which shares be issued on a preferential basis. The action of the company is in tune with those guidelines and hence correct as Chapter XIII, specially provides that where the equity shares are listed for less than six months, on completing a period of six months of being listed on a stock exchange, the company shall recompute the price of the shares in accordance with the provisions mentioned above and if the price at which shares were allotted on a preferential basis under clause was lower than the price so recomputed, the difference shall be paid by the allottees to the company.

Answer 1(d)

The salient features of strategic planning are as under:

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

Question 2

(a) *“Section 391 is a boon to the corporate restructuring.” Critically examine the statement and discuss the relevant provisions relating to corporate restructuring. (8 marks)*

(b) *Will the court sanction a scheme of amalgamation where companies to the*

scheme tend to reshuffle their objects clause in the memorandum of association? Support your answer with case law. (4 marks)

- (c) *Relax Movies Ltd. is going for takeover of another company. Your advice is sought whether the company has to go for mandatory bidding. Advise with reference to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (3 marks)*

Answer 2(a)

Section 391 of the Companies Act, 1956 is a boon to corporate restructuring. This section along with Section 394, has proved to be a major legislative blessing for corporate restructuring in a variety of ways, such as amalgamation (merger) of two or more companies, demerger, division or partition of a company into two or more companies, hiving off a unit, as well as a compromise with the members or creditors of a company or an arrangement with respect to the share capital, assets or liabilities of the company etc.

It has been held in several cases that Section 391 is a 'complete code' or 'single window clearance system', and that the Court has been given wide powers under this section, to frame a scheme for the revival of a company. Being a complete code, the Court can, under this 'section', sanction a scheme containing all the alterations required in the structure of the company for the purpose of carrying out of the scheme.

Section 391 contemplates a compromise or arrangement between a company and its creditors or any class of them, or its members or any class of them, and provides machinery whereby such a compromise or arrangement may be binding on dissentient persons by an order of the Court. [*Oceanic Steam Navigation Co. In re.* (1939) 9 Comp. Cas. 229 (Ch.D)].

Answer 2(b)

Court will sanction the scheme if alteration of the memorandum is by reshuffling of the Objects Clause by shifting Other Objects to Main Objects, if transferee company has complied with provisions of Section 149(2A) [*Re: Rangkala Investments Ltd.* (1996) 1 Comp LJ 298 (Guj)].

Answer 2(c)

Takeovers usually take place when shares are acquired or purchased from the shareholders of a company at a specified price to the extent of at least controlling interest in order to gain control of that company. A person may acquire the voting shares of a listed company. A company may acquire shares of an unlisted company through what is called the acquisition under Section 395 of the Companies Act, 1956. Where the shares of the company are closely held by a small number of persons, a takeover may be effected by agreement with the holders of those shares. However, where the shares of a company are widely held by the general public, it involves the process of mandatory bidding as set out in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997, require acquirers to make bids for acquisition of certain level of holdings subject to

certain conditions. Regulations 10, 11 and 12 of the said Regulations contain necessary provisions. A takeover bid is required to be introduced through a public announcement through newspapers. Such requirements arise in the following cases:

- (a) for acquisition of 15% or more of the shares or voting rights;
- (b) for acquiring additional shares or voting rights to the extent of 5% of the voting rights in any financial year ending on 31st March if such person already holds not less than 15% but not more than 55% of the shares or voting rights in a company;
- (c) for acquiring shares or voting rights, along with persons acting in concert to exercise more than 55% but less than 75% of voting rights in a company;
- (d) for acquiring control over a company.

Question 3

- (a) *Whether in a scheme of arrangement the meeting of shareholders and creditors can be dispensed with ? Supplement your answer with the help of case law. (4 marks)*
- (b) *Whether non-compliance with the disclosure and related requirement is a violation of the SEBI Takeover Code ? Give your answer by referring to case law. (4 marks)*
- (c) *Explain whether the transferee company is required to increase its authorised share capital by following the procedure laid down in the Companies Act, 1956 even though after amalgamation its authorised share capital is sufficient to issue shares to the shareholders of transferor company. (4 marks)*
- (d) *Briefly state whether permission of the Reserve Bank of India is necessary for the compromise and arrangement of non-banking finance company (NBFC) with a bank. (3 marks)*

Answer 3(a)

Members' and creditors' approval to the scheme of amalgamation is sine qua non for Court's sanction. Without that the Court cannot proceed. This approval is to be obtained at specially convened meetings held as per court's directions [Section 391(1)]. However, the court may dispense with meetings of members/creditors. Normally, creditors' meetings are dispensed with subject to certain conditions. For instance, members' meeting may be dispensed with if all the members' individual consent is obtained.

Where the written consent to the proposed scheme is granted by all the members and secured and unsecured creditors, separate meeting of members and secured and unsecured creditors can be dispensed with. – *Re Feedback Reach Consultancy Services (P) Ltd.* (2003) 52 CLA 260: (2003) CLC 498: (2003) 42 SCL 82: (2003) 115 Comp Cas 897 (Del).

Answer 3(b)

No, there is no violation of takeover Regulations, the non-filing of resolution and non-disclosure of the pre-shareholding pattern and post-shareholding pattern cannot be

considered a violation of Takeover Code, but a short-coming or a lapse on the part of company would result in a breach, if there is an intention to do so. [*Ramesh Chandra Mansukhani NIR v. Adjudication Officer, SEBI (SAT)*].

Answer 3(c)

No. Since the authorized capital of the transferor company stands merged from the appointed date and transferred to and re-organised and re-classified as the authorized share capital of the transferee company and the combined share capital (authorized by articles) is sufficient to allot shares of the transferee company, the transferee company need not increase its authorized share capital. [*Motorola India (P) Ltd.*, in re 73 CLA 1].

Answer 3(d)

Section 44A of Banking Regulation Act, 1949 does not apply where NBFC is proposed to be merged with a Banking company. In case of *IndusInd Enterprises and Finance Ltd. v. IndusInd Bank Ltd. and (ICICI Ltd.)* Reported in 2002(3) COMP. L.J. 111, the contention that prior permission of RBI is necessary for the proposed amalgamation was rejected. However as per the recent RBI Notification, prior approval of RBI is necessary in cases of acquisition transfer of control of NBFCs' accepting deposits.

Question 4

- (a) Discuss 'funding through rehabilitation finance' as a source of funds for mergers/ takeovers. (6 marks)
- (b) Draft a suitable Board resolution with respect to takeover for the following :
- (i) Appointment of a merchant banker,
- (ii) Opening of an Escrow account. (3 marks each)
- (c) Can shareholders seek an amendment to the swap ratio in the scheme of merger? Supplement your answer by referring to case law. (3 marks)

Answer 4(a)

BIFR has been arranging such takeover from time to time in which creditor financial institutions and banks have been providing consortium financial packages in promoting mergers.

Merger or takeover may be provided for in a scheme of rehabilitation under the Sick Industrial Companies (Special Provisions) Act, 1985.

The Sick Industrial Companies (Special Provisions) Act, 1985 provides for reference to the Board for Industrial and Financial Reconstruction (BIFR) of a sick industrial company. Once a reference is made, BIFR will cause an enquiry, appoint an operating agency for determination of measures necessary for rehabilitation of the sick company, direct the preparation of a rehabilitation scheme, which may provide, inter alia, for

- (i) rehabilitation finance for the sick company;
- (ii) merger of the sick company with a healthy company or merger of a healthy company with the sick company;
- (iii) takeover of the sick company by a healthy company;
- (iv) such other preventive, ameliorative and remedial measures as may be appropriate.

The scheme is prepared by the operating agency, and after the same is sanctioned becomes operative and binding on all the concerned parties including the sick company and other companies – amalgamating, merging, the amalgamated or the merged companies.

Answer 4(b)(i)

Appointment of Merchant Banker

“RESOLVED THAT M/s being Category-I Merchant Banker be and is hereby appointed as Merchant Banker for aforesaid public offer, on the terms and conditions as contained in the draft letter of appointment placed before the meeting duly initialed by the Chairman for the purpose of identification, for making the public announcement of the takeover offer in the newspapers, forward the same to the Securities and Exchange Board of India, Stock Exchange(s) and to the target company and to draft the Letter of Offer to be sent to the shareholders of, target company in accordance with the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997”.

Answer 4(b)(ii)

Opening of Escrow Account

“RESOLVED THAT an Escrow Account be opened with Bank and Rs.....be deposited in the said account.

RESOLVED FURTHER THAT M/s....., Merchant Banker, be and is hereby authorised to operate the above said account and the Bank be and is hereby authorised to act on the instructions given by M/s, Merchant Banker, in relation to operation of bank account.”

RESOLVED FURTHER THAT Mr., Director of the company, be and is hereby authorised to collect and communicate the same to.....Bank, the names and specimen signatures of the person authorised by M/s., Merchant Banker, to operate the above said bank account.”

Answer 4(c)

The exchange ratio is a matter of expert determination. It is the major ground on which the foundation of scheme of amalgamation is based and any change in the exchange ratio may vitiate the scheme. In this regard, a reference can be made to the decision of the Bombay High Court wherein it was held that swap ratio forms integral part of a scheme of amalgamation, and no shareholder can seek amendment to the swap ratio in a scheme of amalgamation. [*Dinesh Veajlal Lakhani v. Parke Davis (India) Ltd.* (2005) 66 CLA (Bombay)].

Question 5

- (a) *What are the safeguards incorporated in takeover process so as to ensure that shareholders get their payments under the offer or receive back their share certificates ?* (4 marks)
- (b) *Gopal has acquired shares in Aadil Ltd., but he is yet to be registered as a member. He has made an application to the court for modification in the scheme*

proposed under section 391. Is he entitled under the Companies Act, 1956 to move such an application ? (4 marks)

(c) *The capital structure of Johar Ltd. is as follows :*

- *5 lakh equity shares of Rs. 10 each fully paid-up.*
- *10 lakh equity shares of Rs. 10 each on which Rs.5 is paid-up.*
- *Free reserves of Rs.3 crore.*

The Board of directors of the company has passed a resolution authorising the buy-back of shares worth Rs.40 lakh for the financial year 2009-10. Is the Board of directors empowered to do so ? Give reasons. (4 marks)

(d) *Abhay Ltd. has filed a petition before the High Court of Bombay for sanction of a scheme of amalgamation with Gel Well Ltd., and the petition is posted for hearing, to Monday, the 8th March, 2010. The court has ordered to serve notice of the hearing of the petition on the creditors. As the Company Secretary of Abhay Ltd., draft the notice.* (3 marks)

Answer 5(a)

Safeguards provided to shareholders in Takeover process:

- (i) Acquirer, before making public announcement has to open an Escrow Account with a Commercial Bank or deposit a bank guarantee in favour of merchant banker.
- (ii) Merchant banker to confirm adequate financial arrangements.
- (iii) In case of failure of acquirer to make payment, merchant banker to distribute proceeds as under:
 - 1/3 of amount to target company.
 - 1/3 to regional SEs for investor fund.
 - 1/3 to be distributed on prorata basis among shareholders.

Answer 5(b)

Yes. Under Section 392(2), the court may on its own motion or on application of any person interested in the affairs can make an order for modification. Application can be made by any person interested, which included a person who has obtained a transfer of shares but yet to be registered as a member. It is not restricted to a creditor or liquidator of the company. [*K.K. Gupta v. K P Jain* (1979) 49 Company Cases 342: AIR 1979 SC 734].

Answer 5(c)

Board by passing a resolution can authorize the buy-back of securities not exceeding 10% of the total paid-up equity capital and free reserves of the company [Proviso to section 77A(2)].

But the buy-back of equity shares in any financial year should not exceed 25% of the total paid-up equity capital of the company [Proviso to section 77A(2)(c)].

In this case

10% of paid-up equity share capital and free reserves = Rs.40,00,000 i.e. 10% of (Rs.50,00,000+Rs.50,00,000+Rs.300,00,000)

25% of paid-up equity capital + Rs.25,00,000 i.e. 25% of (Rs.50,00,000 + Rs.50,00,000).

So the Board is not empowered to buy-back shares worth Rs.40,00,000.

Answer 5(d)

IN THE HIGH COURT OF JUDICATURE AT MUMBAI

Ordinary Civil Jurisdiction

Company Petition No. _____ of _____

Company Application No. _____ of _____

In the matter of Sections 391 and 394 of the Companies Act, 1956

And

In the matter of Scheme of Amalgamation between ABC Ltd. and XYZ Ltd.

ABC Ltd. a company incorporated under the Companies Act, 1956, having its registered office at _____, Mumbai.

ABC Ltd. _____ Petitioner

Notice to Creditors

Please take notice that a petition under sections 391 and 394 of the Companies Act, 1956, for sanction of the Scheme of Amalgamation of the Petitioner Company with XYZ Ltd. was presented by the Petitioner Company on the _____ was admitted on the _____ day of _____, and the said Petition is fixed for hearing before the Learned Judge taking company matters on Wednesday the 8th day of March 2010 at _____ AM/ PM.

PART B

(Answer ANY TWO questions from this part.)

Question 6

- (a) *Laxmi Bank Ltd. has approached you for your professional advice about the rights available to it for enforcing the security interest under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002. Highlight the rights and the advantages to the bank by resorting to that mode of recovery citing the relevant provisions of the said Act. (5 marks)*
- (b) *Kuber Bank Ltd. has obtained a decree from a civil court to recover an amount of Rs.20 lakh with 12% interest and the court has allowed it to proceed against the commercial building given as security for the loan. Can the decree be treated as a debt under the SARFAESI Act, 2002 ? Cite the relevant provisions of law in support of your answer. (5 marks)*

- (c) *Amir Bank has issued a bank guarantee for and on behalf of Madhuri Ltd., an industrial company in connection with loans granted to the company. The company became sick. While the proceedings before Board for Financial and Industrial Reconstruction (BIFR) is going on, the beneficiary of the bank guarantee invoked it and demanded payment from Amir Bank. The bank has sought your expert opinion in the matter. Give your opinion based on legal provisions and judicial decisions. (5 marks)*

Answer 6(a)

Enforcement of Security interest by a Creditors

Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 provides for the enforcement of security interest by a secured creditor straight away without intervention of the court, on default in repayment of instalments, and non compliance with the notice of 60 days after the declaration of the loan as a non-performing asset. It must, however, be remembered that the classification of assets as non performing is not on the mere whims and fancies of the financial institutions. The Reserve Bank of India has a detailed policy providing guidelines or prudential norms in that regard.

The Secured Creditor has been defined to mean any bank or financial institution or any consortium or group of banks or financial institutions and includes debenture trustee appointed by any bank or financial institution or securitisation company or reconstruction company or any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance.

The secured creditor has two options. It can either transfer the assets to a securitisation or reconstruction company or exercise the powers under the Act.

Section 13(4) of the Act empowers the recourse to one more of the following measures, after giving proper notice, for the recovery of the secured debts, namely:

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

Advantages

Bank can take possession of the security and sell it without the intervention of court.

As per section 15 of the Act –

On publication of the notice of taking over the management of the business of the borrower the directors of the company or administrators of the business deemed to have vacated their office.

Shareholders cannot pass resolutions or appoint directors without the consent of the bank.

No proceeding for winding up of the borrower company or the appointment of receiver shall lie in any court without the consent of the bank.

If any reference is pending, it shall abate if 75% of the secured creditors have taken measures to recover their secured debts.

Answer 6(b)

Section 2(1)(ha) of the SARFAESI Act defines that “debt” shall have the meaning assigned to it in clause (g) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. As per Section 2(g) of the Act, “Debt” means any liability (inclusive of interest) which is claimed alleged as due from any person by a bank or a financial institution or by a consortium of banks or financial institutions during the course of any business activity undertaken by the bank or the financial institution or the consortium under any law for the time being in force, in cash or otherwise, whether secured or unsecured, or assigned or whether payable under a decree or order of any civil court or any arbitration award or otherwise or under a mortgagee and subsisting on, and legally recoverable on, the date of the application.

So the decree can be treated as a debt.

Answer 6(c)

Section 22 of SICA, 1985 grants several immunities to a sick industrial company. one such immunity is that no suit for the recovery of money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company shall lie or proceed with further except with the consent of BIFR or its Appellate Authority.

The above protection is available in respect of an industrial company when an inquiry under Section 16 is pending in relation to the said industrial company or when any scheme referred to under Section 17 is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal under Section 25 relating to an industrial company is pending.

The protection under section 22 of SICA is a superior protection and has an overriding effect on any other law or any other instrument having effect under other laws.

So the beneficiary is not entitled to invoke the guarantee without the permission of the BIFR [*Maharashtra Tubes Ltd. v. State Industrial and Investment Corporation of Maharashtra Ltd. (SC)*, *Patheja Bros. Forgings and Stamping v. ICICI Ltd. (SC)*].

Question 7

- (a) *Explain the role of BIFR and the concerned High Court in winding-up of a sick industrial company mentioning the relevant provisions of the law and judicial decision(s).* (5 marks)
- (b) *There was an agreement between a company having its registered office at Delhi with its creditors having their office at Mumbai. It contained a clause that in case of dispute between them, only the courts in Mumbai will have the jurisdiction. On the basis of the clause, the creditors filed a winding-up petition before High Court of Bombay. The company has asked your professional opinion in the matter. How will you advise the company ?* (5 marks)
- (c) *Recovery Officer under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 has issued an order and the defendant wants to challenge the order. What will be your advice to the defendant based on the relevant provisions in the Act ?* (5 marks)

Answer 7(a)**Role of BIFR and concerned High Court**

- After making necessary inquiry under Section 16 and after giving an opportunity to all concerned parties, if BIFR is of the opinion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time and it is not likely to become viable in future and as such it is just and equitable to wind up the company, BIFR may record and forward its opinion to the concerned High Court.
- The High Court shall, on the basis of the opinion of the Board, order winding up of the sick industrial company and may proceed and cause to proceed with the winding up of the sick industrial company in accordance with the provisions of the Companies Act, 1956.
- For the purpose of winding up, the High Court may, with the consent of the operating agency, appoint any officer of the operating agency, as the liquidator and such officer, if appointed shall be deemed to be, and have all the powers of, the official liquidator under the Companies Act, 1956.
- When BIFR recommends the winding up of a sick industrial company pursuant to Section 20(1) of the SICA, 1985 and forwards its opinion to the connected High Court, the High Court is bound to order the winding up of the company on the basis of the opinion of BIFR.
- Once BIFR forwards its opinion to the connected High Court, the role of BIFR comes to an end in respect of the said sick industrial company.

Answer 7(b)

Only Delhi High Court where the registered office of the company is situated has jurisdiction in winding up, even if there is an agreement between the company and its

creditors that Mumbai courts will have jurisdiction in case of dispute between them and the company. Cases – *GTC Industries Ltd. v. Parasrampur Trading (All HC)*, *LKP Merchant Financing v. Arwin Liquid Gases (Guj)*.

Answer 7(c)

The defendant has to challenge the order of the Recovery Officer by way of appeal to the Debt Recovery Tribunal within 30 days on which a copy of the order is issued to him. The Tribunal may, after giving an opportunity to the appellant to be heard and after making such inquiry as it deems fit, confirm, modify or set aside the order of the Recovery Officer in exercise of his powers under section 25 to 28 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

Question 8

- (a) *The trade union of workers of a company has filed a winding-up petition of their company. State the legal position citing relevant case law. (5 marks)*
- (b) *Debt Recovery Tribunal (DRT) has passed an interim order attaching the property of the defendant. The defendant wants to challenge this order on the ground that DRT has no power to pass interim orders. Explain the legal provisions in this regard. (5 marks)*
- (c) *As the Company Secretary of a company, mention your duties in respect of compulsory winding-up. (5 marks)*

Answer 8(a)

Section 439 of the Companies Act, 1956 confers right upon certain persons to file a winding up petition. The said section does not authorize the workers to make a winding up petition. So the workers cannot make a winding up petition. (no locus standi)

But workers are entitled to be heard as interveners but not as parties. After the winding up order is made the workers may appeal against it. But once the order becomes final, the workers shall not participate in further proceedings [*National Textile Workers' Union v. P.R. Ramakrishnan (SC)*].

Answer 8(b)

The Debt Recovery Tribunals are empowered to pass interim orders whether by way of injunction or stay or attachment against the defendant to debar him from transferring, alienating or otherwise dealing with, or disposing of, any property and assets belonging to him without the prior permission of the tribunal. However, there are judgments of Supreme Court and the High Courts which have laid down the conditions which must be followed by the Tribunals before passing such orders.

Generally, they have to first hear the defendants before the orders are passed. The Tribunal should be satisfied by affidavit or otherwise that the defendant with the intent to obstruct or delay or frustrate the execution of any order for recovery of the debt that may be passed against him is about to dispose of the property, to remove it from the local jurisdiction of the Tribunal, likely to cause any damage to the property or create third party interest before passing the orders.

Answer 8(c)**Duties of the Secretary in respect of Compulsory Winding Up**

The duties of the Secretary in respect of compulsory winding up of the company may be enumerated as follows:

- (i) If the company itself makes the petition for compulsory winding up, the Secretary should help the directors in drawing up the petition.
 - (ii) He should see that a copy of winding up order, when passed by the Court is filed with the Registrar within 30 days of the making of the order.
 - (iii) He should help in preparation of the statement of affairs of the company in the prescribed form for submission to the Official Liquidator. He should see that it is properly verified by an affidavit.
 - (iv) He should give all necessary information to the Court, when called upon by it during the course of the winding up.
 - (v) He should see that all documents, correspondence etc., issued by the company during the period of winding up contain a statement that the company is being wound up.
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ADVANCED TAX LAWS AND PRACTICE

Time allowed : 3 hours

Maximum marks : 100

NOTE : All references to sections mentioned in Part-A of the Question Paper relate to the Income-tax Act, 1961 and relevant Assessment Year 2009-10, unless stated otherwise.

PART A

(Answer ANY TWO questions from this part)

Question 1

- (a) Choose the most appropriate answer from the given options in respect of the following :
- (i) Which of the following does not fall under the State List as stipulated in the Article 246 read with Schedule VII of the Constitution of India —
- (a) Excise on alcoholic liquors and narcotics
 - (b) Taxes on consumption and sale of electricity
 - (c) Taxes on advertisements in newspapers
 - (d) Taxes on advertisements other than those contained in newspapers.
- (ii) If a company assessee has not filed the prescribed income-tax return within the prescribed time limit, carry forward of losses sustained under the head 'profits and gains of business or profession' or 'capital gains' and its set-off will not be permitted as per the provisions of —
- (a) Section 139(3) read with section 80
 - (b) Section 139(1)
 - (c) Section 139(4)
 - (d) Section 139(5).
- (iii) Credit of Minimum Alternate Tax (MAT) in respect of excess amount of tax paid under section 115JB could be carried forward from assessment year 2006-07 onwards for —
- (a) 5 Assessment years
 - (b) 7 Assessment years
 - (c) 8 Assessment years
 - (d) 4 Assessment years.
- (iv) Which of the following reflects the correct position regarding the binding powers of the Central Board of Direct Taxes (CBDT) —
- (a) The instructions of the CBDT are binding on the department and the assessee
 - (b) Courts are bound by the instructions of the CBDT
 - (c) The instructions are binding on the department, but not on the assessee
 - (d) The instructions by the CBDT may impose a burden on the assessee.

- (v) *An association of persons and body of individuals who are subject to tax audit in the immediately preceding financial year, making payment to resident contractor under section 194C —*
- Are not liable to deduct tax at source*
 - Shall be liable to deduct tax at source*
 - Are liable to deduct tax at source, if the turnover during the current year exceeds Rs.40 lakh*
 - None of the above.* (1 mark each)
- (b) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
- Section 2(23A) defines 'foreign company' as a company, which is _____. However, all non-Indian companies are not necessarily_____.*
 - The Appellate Tribunal's decision would have _____ within the jurisdiction and has a _____ value outside the concerned jurisdiction.*
 - A loss incurring company and a profit making company may _____ in order to reduce the overall incidence of _____ under the Income-tax Act, 1961.*
 - Depreciation on a generator purchased and kept as stand by will be allowed in spite of the same not put to use, as it has _____ use by the assessee during the year.*
 - The return of income has to be signed by the _____ in the case of company and in his absence by one of the _____. (1 mark each)*
- (c) *Examine whether the following are 'assets' under the provisions of the Wealth-tax Act, 1957 :*
- A commercial complex.*
 - A building occupied by the assessee for business purposes.*
 - Aircrafts owned and used by the assessee for business purposes.*
 - Land owned by the assessee situated outside a municipality but within a notified area.*
 - Jewellery, bullion and utensils made of precious metals. (1 mark each)*

Answer 1(a)(i)

- (c) Taxes on advertisement in newspaper

Answer 1(a)(ii)

- (a) Section 139(3) read with Section 80

Answer 1(a)(iii)

- (b) 7 Assessment years

Answer 1(a)(iv)

- (c) The instructions are binding on the department, but not on the assessee.

Answer 1(a)(v)

- (b) Shall be liable to deduct tax at source

Answer 1(b)

- (i) Section 2(23A) defines 'foreign company' as a company, which is **Not a domestic company**. However, all non-Indian companies are not necessarily **foreign companies**.
- (ii) The Appellate Tribunal's decision would have **Binding effect** within the jurisdiction and has a **persuasive** value outside the concerned jurisdiction.
- (iii) A loss incurring company and a profit making company may **merge** in order to reduce the overall incidence of **liability to tax or tax liability** under the Income-tax Act, 1961.
- (iv) Depreciation on a generator purchased and kept as stand by will be allowed in spite of the same not put to use, as it has a **passive** use by the assessee during the year.
- (v) The return of income has to be signed by the **Managing Director** in the case of company and in his absence by one of the **Directors** .

Answer 1(c)

- (i) Any property in the nature of commercial establishment or complexes are not assets as per Section 2(ea)(i)(5) of the Wealth-tax Act, 1957.
- (ii) Any house occupied by an assessee for the purpose of business or profession carried on by him is exempt from Wealth Tax under section 2(ea)(i)(3).
- (iii) Aircraft etc. (other than those used by the assessee for Commercial Purpose) are treated as assets as per Section 2(ea)(iv). Aircraft used by the assessee for its own business shall be treated as commercial purpose and therefore not treated as assets under Wealth Tax Act.
- (iv) Land situated outside municipality but within the area (not being more than 8 kms from the local limits of any municipality) as notified by the Central Government is considered as an urban land and an asset under Section 2(ea)(v) Explanation (1)(b).
- (v) Jewellery, bullion and utensils made of precious metals are treated assets under the Wealth Tax Act provided these are not held as stock in trade by the assessee [Section 2(ea)(iii)]

Question 2

- (a) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *Taxes on income and corporation tax are collected by the Central Government and distributed between the Union and States.*
- (ii) *Companies formed under section 25 of the Companies Act, 1956 without*

any profit motive, trade, professional or similar associations become liable to tax under the Income-tax Act, 1961 under certain circumstances.

- (iii) *The minimum penalty for repayment of deposits in contravention of section 269T is Rs. 25,000 and is imposed by the Assessing Officer.*

(2 marks each)

- (b) *Modern Ltd. entered into an agreement with Synergy Ltd. for granting on lease to Synergy Ltd. its 8,000 sq. mtrs. land lying vacant adjacent to the factory premises of Synergy Ltd. for a period of 12 years commencing from May, 1996.*

Under the terms of the agreement, Synergy Ltd. had to build a factory building, pay an annual rent @ Rs.100 per sq. mtr. of the leased land of 8,000 sq. mtrs. and surrender the building to Modern Ltd. at the end of the lease without any consideration. Synergy Ltd. complied with the terms and conditions of the lease agreement.

The depreciated value of the building surrendered and taken possession by Modern Ltd. in May, 2008 was Rs.4.22 crore. Accounts department of Modern Ltd. is of the opinion that an equivalent amount is to be taken in the accounts of the year 2008-09 as income received.

Critically examine the matter and offer your comments. (3 marks)

- (c) *“Mona Industries Ltd. had incurred substantial expenditure on foreign tours undertaken by the chairman and managing director for setting-up of two new factories. The amount was claimed as a business expenditure.” Comment.*

(3 marks)

- (d) *“Under certain circumstances, the Commissioner of Income-tax cannot revise the order of his subordinate authority under section 264.” Explain. (3 marks)*

Answer 2(a)(i)

Incorrect

Revenues/incomes arising by way of collection of income tax are distributed between union and states. Proceeds of corporation tax are not divisible with the States vide Article 270(1) read with Article 4(a) of the Constitution of India.

Answer 2(a)(ii)

Correct

Under Section 28(iii) of the Income Tax Act, 1961 trade, professional or similar associations are liable to tax in respect of the income they derive from rendering of specific services to their members. Therefore, such entities even if they are non-profit making associations become liable to tax.

Answer 2(a)(iii)

Incorrect

Penalty for the repayment of deposit in contravention of Section 269T is laid down in Section 271E. An amount equal to the loan or deposit so repaid shall be levied as penalty by the Joint Commissioner.

Answer 2(b)

The opinion of the Accounts Department of Modern Ltd. is incorrect. The depreciated value of the building is of course to be brought into the books of accounts.

However, the equivalent amount viz. Rs.4.22 crores cannot be treated as income from the business or operations. By its very nature it is a capital receipt and is not a revenue income. The amount cannot be treated as a revenue receipt unless it is conclusively established that this represented deferred rent as the lease rent was unreasonably low. Further Modern Ltd. is not in the business of real estate to treat the benefit as incidental revenue receipt earned during the course of such business.

On similar facts, the Bombay High Court in *CIT v. Elphinstone Dye Works Pvt. Ltd.* 82 ITR 654 has held that the written down value of the building in such a situation can be treated only as a capital receipt.

Answer 2(c)

The amount is not allowable as an admissible expense of the company. The foreign tour of the C&MD was connected with the setting-up of two new factories. The expenses were of capital nature and not allowable as business expenditure under section 37. The position as stated above is in accordance with the decision of the Allahabad High Court in *Modern Industries Ltd. v. CIT* [1977 110 TR 855] which itself was based on the decision of Gujarat High Court in *CIT v. Saurashtra Cement and Chemical Industries Ltd.*

Answer 2(d)

The Commissioner of Income Tax (CIT) is empowered to order revision of an order of any authority sub-ordinate to him (as per Section 118) under the provisions of Section 264(1). He can pass the order suo moto or on the application by the assessee. Suo moto revision order can be passed only within one year of the date of order. In case of an application for revision under this section by the assessee, the application must be made within one year from the date on which the order was communicated to him or the date, on which he otherwise came to know of it, whichever is earlier. The Commissioner may admit an application made after the expiry of that period if he is satisfied by the sufficient cause shown to him. The revisional order passed under section 264 cannot be prejudicial to the interest of the assessee.

Following are the circumstances in which no revision can be made as per Section 264(4) :

- (i) If the order is appealable to the Commissioner of Appeals, such order cannot be revised until the time within which such appeal may be made expires. If an appeal has been made to the Commissioner (Appeals) revisional power cannot be exercised while the appeal is pending but it may be exercised after the appeal has been disposed of for the purposes of Section 264, the Commissioner (Appeals) is an authority subordinate to the Commissioner of Income Tax. Hence the order of Commissioner (Appeals) can be revised.
- (ii) If the order is appealable to the Commissioner (Appeals) or the Appellate Tribunal, revision power cannot be exercised until the time within which such appeal may

be made expires. If the assessee waives his right of appeal, the Commissioner may revise the order even before the expiry of time for appeal. But once the order has been made the subject of an appeal the revisional powers come to an end. If the Commissioner (Appeals) or the Appellate Tribunal refuses to entertain the appeal on the ground that it is time barred or grants permission to the appellant to withdraw the appeal, the order cannot be said to be subject of an appeal and the assessee would be entitled to apply to the Commissioner for revision.

Question 3

- (a) *A new 100% deduction has been introduced recently to encourage the business of operating and maintaining hospitals located anywhere in India, other than excluded areas, subject to specified conditions. Explain briefly those conditions. (5 marks)*
- (b) *“The assessing officer has no power to make adjustment of any kind to income returned by an assessee at the time of processing the return of income under section 143(1).” Critically examine the statement. (5 marks)*
- (c) *State the procedure to be followed in the following cases :*
- (i) *Company seeks relaxation for admission of time-barred claims. (2 marks)*
- (ii) *Company seeks the return of books seized in the course of search made under section 132. (3 marks)*

Answer 3(a)

Sub-section (11C) inserted in Section 80-IB by the Finance Act, 2008 with effect from 1st April, 2009 (Assessment Year 2009-10), grants deduction of 100% of profits and gains derived from business of operating and maintaining hospitals located anywhere in India other than the excluded areas on fulfilling the following four conditions :

- (i) The hospital is constructed and should start functioning in India during the period from 1st April, 2008 to 31st March, 2013.
- (ii) It has atleast 100 beds for patients;
- (iii) The construction is in accordance with the Regulations or By-laws of the local authority; and
- (iv) Report of Audit in the prescribed form certifying the correctness of claim for deduction is furnished along with the return of income.

Excluded areas' cover the areas comprising the urban agglomerations of Greater Mumbai, Delhi, Kolkata, Chennai, Hyderabad, Bangalore and Ahmadabad, the districts of Faridabad, Gurgaon, Ghaziabad, Gautam Budh Nagar and Gandhi Nagar and the City of Secunderabad.

The deduction will be available for a period of five consecutive assessment years, beginning with the initial assessment year i.e., assessment year relevant to the previous year in which the business of the hospital starts functioning.

Answer 3(b)

Prior to the amendments by the Finance Act, 2008, Section 143(1) did not contain

any provisions for making adjustment to the returned income for correcting any arithmetical error or internal inconsistencies.

A significant amendment has been made by the Finance Act, 2008 with regard to the procedure to be followed for summary assessment under section 143(1). As per the amended section 143(1), the total income or loss of an assessee shall be computed after making adjustments to the returned income in respect of the following :

- (i) Any arithmetical error in the return; or
- (ii) An incorrect claim, if such incorrect claim is apparent from any information in the return.

For the purpose of Section 143(1), "An incorrect claim apparent from any information in the return" means such claim on the basis of an entry, in the return of income :

- (i) of an item, which is inconsistent with another entry of the same or some other item in such return.
- (ii) in respect of which, information required to be furnished under the Income-Tax Act to substantiate such entry, has not been furnished; and
- (iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage of ratio or fraction.

Answer 3(c)(i)

Section 119(2)(b) specifically empowers the CBDT to authorize any income-tax authority, other than a Commissioner (Appeals), to admit any application or claim for any exemption, deduction, refund or any other relief under the Act made by the assessee after the expiry of the time limit specified by or under the Act for the making of such application or claim and to direct the income-tax authority concerned to deal with the same on merits in accordance with law, ignoring the time limit laid down in the Act. The Board, however, shall make such authorization and direction, only if it considers that it is desirable or expedient so to do for avoiding genuine hardship in any case or class of cases and this may be done by the Board either by a general order or any special order. The company has to make an application addressed to the secretary CBDT. No particular form has been prescribed for this purpose.

Answer 3(c)(ii)

Where any books etc., seized in the course of a search made under section 132 of the Act are to be retained by the Assessing Officer for a period of more than thirty days from the date of the order of assessment under clause (c) of Section 158BC thereof, it is necessary for him to record in writing the reasons for their retention after the expiry of the period as above said and to obtain the approval of the Chief Commissioner or the Commissioner of Income Tax or the Director General or Director for the purpose. Once an order is passed authorizing such retention under section 132(8) it must be communicated to the assessee because the statutory right conferred on such person under section 132(10) would be completely lost to the party legally entitled to the books if he is not told when the order of approval was made and for what length of time. Section 132(10) provides that where the person legally entitled to the books of accounts

etc. seized, objects for any reason to the approval given under section 132(8) he may make an application to the Board stating therein the reasons for such objection and requesting for the return of the books etc. The application is to be addressed to the Secretary CBDT. There is no prescribed form for this purpose.

PART B

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

Question 4

- (a) *Choose the most appropriate answer from the given options in respect of the following :*
- (i) *For the purpose of central excise, the following is a 'manufacture' —*
- Filteration/purification of commercial grade castor oil*
 - Cutting and polishing of diamonds*
 - Testing and quality control*
 - Making coffee beans from raw coffee berries.*
- (ii) *Under the central excise law, the following are not 'goods' —*
- Immovable iron and steel structures*
 - Structures like bridges, lock gates, towers, trusses and column frames in their movable state*
 - Plates, rods, angles, sections, section tubes and the like in their pre-assembled or disassembled state*
 - PSC girders manufactured in casting yard and not at site and then taken for launch on sub-structure.*
- (iii) *Levy of excise duty in respect of the following does not fall within the exclusive powers conferred on the Parliament/Union Government by the Constitution of India —*
- Tobacco and other goods*
 - Medicinal and toilet preparations*
 - Medicinal and toilet preparations containing alcoholic liquor, opium or narcotics*
 - Alcoholic liquors for human consumption, opium and narcotic drugs.*
- (iv) *In determination of the value of imported goods, the following costs are not to be added if they are not already included in the invoice price —*
- Commission and brokerage*
 - Cost of containers which are treated as being one with the goods for customs purpose*
 - Buying commission*
 - Cost of packing whether labour or materials.*

- (v) *The form for 'bill of entry' for warehousing is printed on —*
- (a) *White paper*
 - (b) *Yellow paper*
 - (c) *Green paper*
 - (d) *Light pink paper.*
- (vi) *For offences committed under sections 132 to 135 of the Customs Act, 1962, a court shall take cognizance —*
- (a) *Suo motu*
 - (b) *When it is brought to the notice of a court by anybody*
 - (c) *With the previous sanction of the Commissioner of Customs*
 - (d) *None of the above.*
- (vii) *An ad hoc exemption from customs duty to non-government organisation will be issued subject to condition —*
- (a) *That the imported goods will not be put to any commercial use*
 - (b) *That the imported goods will not be sold, gifted or parted by the importer in any manner*
 - (c) *That (a) and (b), as above, alongwith prior permission of the Ministry of Finance*
 - (d) *None of the above.* (1 mark each)
- (b) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
- (i) *As per the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, the term 'produced' includes _____.*
 - (ii) *Under section 13 of the Customs Act, 1962, duty is not payable on pilfered goods only in case where the goods are pilfered after the unloading and before the issue of _____.*
 - (iii) *Section 18 of the Customs Act, 1962 provides for _____ of duty.*
 - (iv) *Any goods on which import duty has not been paid and which are entered for exportation under section 74 of the Customs Act, 1962 shall be liable to _____ under section 113 of the Act.*
 - (v) *It follows from the definition of 'excise duties' that for anything to be liable to excise duties it must be goods and _____ and it must be produced or manufactured in India.*
 - (vi) *Recording of sound or other phenomena on audio or video tape _____ under excise law.*
 - (vii) *If the raw material is supplied on principal to principal basis (e.g. Bala Ltd. supplies raw materials to job workers), the supplier is _____ under excise law.*
 - (viii) *Under section 35(1), any person aggrieved by any decision or order passed under the Central Excise Act, 1944 by an officer lower in rank than a*

Commissioner may appeal to the Commissioner (Appeals) by filing an appeal within _____ from the date of communication of the order contested.
(1 mark each)

- (c) Discuss the essential ingredients of the concept of 'manufacture' under the Central Excise Act, 1944 and as outlined by the Supreme Court in *Union of India vs. Delhi Cloth and General Mills and others*. (5 marks)

OR

In the following events, state when does the taxable event occur in the course of imports under the customs law with reference to the principles laid down by the Supreme Court in the cases of *Garden Silk Mills Ltd. vs. Union of India*; and *Kiran Spinning Mills Vs. CC* :

- (i) Unloading of imported goods at the customs port;
- (ii) Date of entry into Indian territorial waters;
- (iii) Date on which the goods cross the customs barrier; and
- (iv) Date of presentation of bill of entry. (5 marks)

Answer 4(a)(i)

- (d) Making coffee beans from raw coffee berries

Answer 4(a)(ii)

- (a) Immovable iron and steel structures

Answer 4(a)(iii)

- (d) Alcoholic liquors for human consumption, opium and narcotic drugs

Answer 4(a)(iv)

- (c) Buying Commission

Answer 4(a)(v)

- (b) Yellow Paper

Answer 4(a)(vi)

- (c) With the previous sanction of the Commission of Customs

Answer 4(a)(vii)

- (c) that (a) and (b) as above, alongwith prior permission of the Ministry of Finance.

Answer 4(b)

- (i) As per the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, the term 'produced' includes **Grown, manufactured, mined** .
- (ii) Under section 13 of the Customs Act, 1962, duty is not payable on pilfered goods only in case where the goods are pilfered after the unloading and before the issue of **the order of clearance** .

- (iii) Section 18 of the Customs Act, 1962 provides for **Provisional assessment** of duty.
- (iv) Any goods on which import duty has not been paid and which are entered for exportation under section 74 of the Customs Act, 1962 shall be liable to **Confiscation** under section 113 of the Act.
- (v) It follows from the definition of 'excise duties' that for anything to be liable to excise duties it must be goods and **Excisable goods** and it must be produced or manufactured in India.
- (vi) Recording of sound or other phenomena on audio or video tape **shall amount to manufacture** under excise law.
- (vii) If the raw material is supplied on principal to principal basis (e.g. Bala Ltd. supplies raw materials to job workers), the supplier is **not manufacturer** under excise law.
- (viii) Under section 35(1), any person aggrieved by any decision or order passed under the Central Excise Act, 1944 by an officer lower in rank than a Commissioner may appeal to the Commissioner (Appeals) by filing an appeal within **Sixty days** from the date of communication of the order contested.

Answer 4(c)

Section 2(f) of the Central Excise Act, 1944 provides an inclusive definition of the term 'manufacture'. According to Section 2(f), "manufacture" includes any process :

- (i) incidental or ancillary to the completion of a manufactured product;
- (ii) which is deemed as a manufacturing process as specified in the Central Excise Tariff Act, 1985;
- (iii) which in relation to goods specified under Schedule III of the Central Excise Act, 1944 involves packing or repacking of such goods in a unit or container or labeling or relabeling of containers including the declaration or alteration of retail sale price on it or adoption of any other treatment on the goods to render the product marketable to the consumer.

For Schedule III items valuation scheme based on retail price under Section 4A is applicable.

Manufacture of any product is through a series of manufacturing processes taking place in a sequence. At a particular stage after the necessary processes are completed the product emerging may be functional. However, a few more processes may be necessary to render the product saleable. Saleability is a crucial condition for deciding excisability. The processes which take place to render the product already functional to become saleable can be considered as "incidental or ancillary to the completion".

In the absence of an exhaustive definition of the term manufacture the principles laid down by judicial pronouncements provide guidance in determining what processes constitute manufacture.

The decision by the Supreme Court in *Union of India v. Delhi Cloth and General Mills and Others* (ELT-1977 J-199) is a land mark judgement. It was pronounced inter alia :

“Manufacture implies a change but every change is not manufacture;; and yet every change of an article is the result of treatment, labour and manipulation. But something more is necessary and there must be a transformation; a new and different article must emerge, having a distinct name, character or use”.

It may also be inferred from various judgments that mere value addition through a process should not tantamount to manufacture.

Answer to Alternate Question 4(c)

As per Section 2(23) of the Customs Act, 1962 import means bringing into India from a place outside India.

As per Section 2(27) “India” includes the territorial waters of India. The limit of the territorial waters is the line every point of which is at a distance of twelve nautical miles from the nearest point of the appropriate base line.

In *Chetan Kumar v. CC (1988 33 ELT Madras)* the High Court held that chargeability arises when the imported goods get mixed-up with the land mass of India and the chargeability takes place when the goods are unloaded.

In *Apar Pvt. Ltd. v. UOI 1985(22) ELT 644 the Bombay High Court* held that “the taxable event occurs no sooner the goods enter the territorial waters of India and does not postpone till they are actually off loaded on the land mass or till the goods are valued under section 14 or till the date for determining the rate of customs duty that should be levied under Section 15 arrives.....”

There were many conflicting judgements by different High Courts.

In *UOI v. Apar Pvt. Ltd. [1999(112) ELT 3]* the Supreme Court overruled the Full Bench decision of the Bombay High Court 1985 referred to above.

The Supreme Court held that the rate of duty and tariff valuation applicable to any imported goods shall be the rate and valuation in force on the date determined in accordance with Section 15(1) of the Customs Act as follows :

- (a) In case of goods cleared for home consumption the date of presentation of Bill of Entry under Section 46 or the date of grant of entry inwards to the vessel whichever is later.
- (b) In case of goods from bonded warehouse the date of actual removal from the warehouse.

In *Garden Silk Mills Ltd. v. UOI 1999 SC ELT 358 the Supreme Court* held the import of goods in India commences when the goods enter into territorial waters but continues and is completed when goods become part of the mass of goods within the country. The taxable event is reached at the time when the goods reach customs barrier and BE for home consumption is filed .

In case of warehoused goods, the goods continue to be in customs hand. Hence import takes place only when goods are cleared from the ware house.

In *Kiran Spinning Mills v. C.C. 1999 (113) 753 SC*. The same three members Bench of the Supreme Court which decided Garden Silk Mills case held that import is completed only when the goods cross the customs barrier. The taxable event is the day of crossing the customs barrier and not on the date when the goods landed in India or had entered territorial waters of India.

In case of goods which are in the warehouse the customs barrier would be crossed when they are sought to be taken out of the customs and brought to the mass of goods in the country.

Question 5

(a) *Discuss in brief the essential features of the following under central excise law and give one example of each :*

- (i) *Specific rates of duty;*
- (ii) *Tariff values; and*
- (iii) *Duty based on MRP.* (2 marks each)

(b) *An excisable product is covered under the provisions of the Standards of Weights and Measures Act, 1976 and falls in the category of 'specified goods' subject to excise duty on the basis of retail sale price. Following particulars are made available :*

MRP printed on the package is Rs.10,894 per unit. The price is inclusive of excise duty of 14% and education and secondary and higher education cess at the currently applicable rates as per the Finance Act, 2008.

Compute the assessable value, excise duty and cess payable if it is eligible for an abatement of 38%. (5 marks)

(c) *Distinguish between conditions for availing CENVAT credit in respect of 'duty paid on inputs' and 'duty paid on capital goods'.* (4 marks)

Answer 5(a)(i)

Specific Rates of Duty under Central Excise Law

These are unit rates based on quantity. The base unit may be a kg. a centimeter, a tonne etc. Some examples are :

- Cigarettes millimeter (length)
- Cement tonne (weight)
- Marble slab Sq. M (Area)

Presently specific rates have been announced for : (a) cigarettes (length basis); (b) Matches (per 100 boxes/packs); (c) Sugar (per quintal); (d) Marble slabs and tiles (per sq m); (e) colour TV when MRP is not marked or when MRP is not the sole consideration (based on screen size in cm) (f) Cement (per tonne); (g) Molasses resulting from the clinkers extraction of sugarcane (per ton basis).

Answer 5(a)(ii)

Tariff Value : Duty as a percent of the Tariff Value Fixed under Section 3(2). Tariff value is a Notional Value.

Presently Tariff Values have been fixed for :

- (a) Pan masala packed in retail packs of upto 10 gms. per pack;
- (b) Tariff value for ready made garments falling under heading 61 to 62 has been prescribed @ 60% of retail sale price of such goods as specified on the package.

Answer 5(a)(iii)

Duty Based on MRP : Section 4A of the Central Excise Act empowers Central Government to specify goods on which duty is payable based on retail sale price. Important provisions are as follows :

- (a) The goods should be covered under provisions of Standards of Weights and Measures Act, 1976 or Rules;
- (b) Central Government has to issue a notification in Official Gazette specifying the commodities to which the provision is applicable and the abatements permissible. Central Government can permit reasonable abatement (deductions) from the retail sale price as per section 4A(2).
- (c) While allowing such abatement Central Government shall take into account excise duty, sales tax and other taxes payable on the goods;
- (d) The retail sale price shall be the maximum price at which the goods i.e. excisable goods in packaged condition are sold to ultimate customer. It includes all taxes, freight, transport charges, commission payable to dealers and all charges towards advertisement, delivery, packing, forwarding charges etc. If under certain law retail sale price is required to be declared without taxes and duties then the retail price shall be construed accordingly. [Explanation 1 to Section 4A].
- (e) If more than one retail sale price is printed on the same packing the maximum of such price will be considered the retail sale price. Explanation 2(a) to Section 4A. If different MRPs are printed on different packages for different areas each such price will be the retail sale price. [Explanation 2(c) to Section 4A];
- (f) Tampering, altering or removing MRP is an offence and goods are liable to confiscation Section 4A(4).

So far about 108 articles have been covered under this scheme e.g. chocolates in any form falling under 1806, biscuits falling under 19053219 manufactured with the aid of power, computer under 847130, refrigerators under 8418.10.

Answer 5(b)

Assessable value of the product for levying Central Excise duty on the basis of MRP value under section 4A of the Central Excise Act works out as follows :

- (i) MRP printed on the package = Rs.10894 per Unit.
- (ii) The above is inclusive of Central Excise duty @ 14% on Assessable Value and Education and Secondary and Higher Education Cess at the currently applicable rates—which are 2% and 1% on Central Excise duty respectively.

As an abatement of 38% is allowed, Assessable Value is 62% of MRP.

(iii)	(a)	Central Excise duty = .14 = .14 x .62	=	0.0868
	(b)	Education Cess = .14 x .02 = .0028 x .62	=	0.001736
	(c)	SAH 14 = .14 x .01 = .0014 x .62	=	<u>0.000868</u>
				0.089404
		Total = .1442 x .62 =		0.089404

- (iv) MRP for the purposes of Section 4-A after excluding the Central Excise Duty and Education Cess and SAH Education Cess

$$= \frac{10894}{1.0894} = 10,000$$

MRP = Rs.10,000 exclusive of duty and Education and SAH Education Cess

- (v) Abatement permitted @ 38% Rs. 3800
 (vi) Assessable Value for Central Excise Duty = Rs. 6200
 (vii) Central Excise duty @ 14% = Rs. 868
 (viii) Education Cess 2% of vii = Rs. 17.36
 (ix) SAH Education Cess 1% of vii = Rs. 8.68
 (x) Total of vii + viii + ix = Rs.894.04

Education Cess and SAH Education cess = Rs. 26.04.

Answer 5(c)

The distinction in availment of CENVAT Credit in respect of inputs and capital goods is as follows :

- (i) 100% of duty paid on inputs can be taken by the manufacturer and service provider immediately on bringing them in the factory premises-Rule 4(1);
- (ii) There is no compulsion that the credit must be taken immediately. There is no time limit for taking credit after bringing goods. But it cannot be taken before the goods are brought into the factory.
- (iii) A maximum of 50% only is allowed as credit on capital goods received in the factory/premises in the first financial year of purchase Rule 2(2)(a).
- (iv) However 100% credit is allowed in the following cases.
 - When the capital goods are cleared as such in the same financial year.
 - When additional duty of Customs under Section 3(5) of the Customs Tariff Act is paid by the manufacturer on capital goods imported.

Service provider is not all eligible to take credit on additional duty of customs paid under section 3(5) of the Customs Tariff Act.

Where 100% cannot be taken and only a part of the duty has been taken as credit the remaining balance of credit can be taken in the subsequent financial year if the capital goods are still in possession.

However, possession as a condition for availing the remaining credit in the next financial year is not applicable to the following capital goods.

Components, spares, accessories; refractories and refractory materials; moulds, dies and specified goods under Chapter 68 of CETA.

It is not necessary to purchase capital goods to get CENVAT Credit. Credit can be taken even on those obtained by lease, hire purchase, loan arrangement [Rule 4(3)].

Question 6

- (a) Write a note on 'compounded levy scheme' under the central excise law. (5 marks)
- (b) "Circulars of the Central Board of Excise and Customs cannot prevail over law laid down by the Apex Court." Examine the statement, considering the relevant provisions of the Central Excise Act, 1944 read with Article 141 of the Constitution of India and the relevant case(s) decided by the Apex Court. (5 marks)
- (c) "With the advent of VAT regime, the multiplicity of rates prevalent till then has been reduced to four broad categories." Elucidate. (5 marks)

Answer 6(a)

Compounded Levy Scheme: Rule 15 of Central Excise Rules provides that Central Government may by notification, specify the goods in respect of which the assessee shall have option to pay duty of excise on the basis of specified factors relevant to production of such goods and at specified rates. Central Government can specify procedure for payment, abatement allowable, interest and penalty payable etc.

This is termed as compound levy. It is devised for administrative convenience and a simplified scheme. It is an optional scheme.

Under the scheme the manufacturer has to pay prescribed duty for the specified period on the basis of factors relevant to production like the capacity of the machines used etc. After making the lump sum periodic payment the manufacturer does not have to follow any procedure of excise regarding storage and clearance of goods.

An assessee can opt out of the scheme to the normally applicable procedures but a hybrid procedure is not permitted.

The scheme is presently applicable to stainless pattas/patties and Aluminum circles. These articles are not eligible for SSI exemption. The scheme was applicable to panmasala and gutkha upto 30th June, 2008.

Answer 6(b)

This statement is based on the judgement of Supreme Court in case of Commissioner of Central Excise *Mumbai v. Hindustan Spinning & Weaving Mills Ltd. & Another* dated April 16, 2009.

Section 37B of the Central Excise Act, 1944, read with Article 141 of the Constitution of India, 1950 deals with the powers of the CBEC to issue various orders, instructions and directions to Central Excise & Customs Offices from time to time. Such orders, instructions, directions/circulars are binding in Law on the authorities under the respective statutes but they are not binding on quasi-judicial authorities like Tribunal, High Courts or Supreme Court. Circulars of Board cannot prevail over law laid down by Apex Court.

The *Apex Court in CCE v. Ratan Melting & Wire Industries (2008) 13 SCC 1* has held that circulars and instructions issued by Board are no doubt binding in Law on authorities under respective statutes, but when the Supreme Court or High Court declares law on question arising for consideration, it would not be appropriate for the Court to direct that circular should be given effect to and not the views expressed in a decision of the Supreme Court or High Court. Moreover, to lay emphasis on circular would mean that valuable right of challenge would be denied to the assessee and there would be no scope for adjudication by the Supreme Court or High Court.

Answer 6(c)

In contrast to the multiplicity of rates under erstwhile Sale Tax Laws, the VAT regime has four broad rates other than the 0% for exempted goods in the nature of unprocessed agricultural goods and goods of social importance. The four categories are as follows :

- (i) 1% for precious and Semi-precious metals;
- (ii) 4% for inputs used for manufacturing and declared goods;
- (iii) 20% for demerit/luxury goods.
- (iv) Rest of the commodities are taxed at a Revenue Neutral Rate of 12.5%.

Question 7

- (a) *Following particulars are available in respect of certain goods imported into India: FOB price : US\$30,000*

Exchange rate :

Notified by RBI Rs. 50 = US\$1

Notified by CBEC Rs. 48 = US\$1

Compute the assessable value as per the Customs Act, 1962 and the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. (5 marks)

- (b) *A commodity is imported into India from a country covered by a notification issued by the Central Government under section 9A of the Customs Tariff Act, 1975. Following particulars are made available :*

CIF value of the consignment : US\$25,000

Quantity imported : 500 kgs.

Exchange rate applicable : Rs.50=US\$1

Basic customs duty : 20%

Education and secondary and higher education cess as applicable as per the Finance Act, 2008.

As per the notification, the anti-dumping duty will be equal to the difference

between the cost of commodity calculated @ US\$70 per kg. and the landed value of the commodity as imported.

Appraise the liability on account of normal duties, cess and the anti-dumping duty.

Assume that only 'basic customs duty' (BCD) and education and secondary and higher education cess are payable. (5 marks)

- (c) Anand Ltd. has imported certain goods which were confiscated on the grounds that the appellant had mis-declared some goods in terms of value and some were found mis-declared in terms of description, value and quality and that personal penalty was imposed on the company and its directors. Critically examine the above facts and the justifiability of the action taken, having regard to relevant recent judicial rulings. (5 marks)

Answer 7(a)

In the information given FOB Price is = 30,000 US Dollars.

For the purpose of determination of Assessable value CIF price/cost forms the basis. Information regarding the cost of freight, that is cost of transportation upto the Indian Port is not available. As such 20% of FOB Price is to be added towards cost of transportation as per Rule 10(2)(a) and (i) proviso of the Customs valuation (Determination of Value of Imported Goods) Rules, 2007. Cost of insurance is not available. As such 1.125% of FOB Price is to be added as per Rule 10(2)(c) and proviso (iii).

In addition loading, unloading and handling charges associated with the delivery of the imported goods at the place of importation as Rule 10(2)(b) should be added. These charges otherwise known as landing charges shall be 1% of (FOB Value + Transportation Cost + Insurance cost) in other words 1% of CIF Value under proviso (ii) under Rule 10(2).

As per Explanation (a) to Section 14(2) the rate of exchange as determined by the CBEC is to be adopted for conversion into Indian rupees.

Assessable value in the case referred is worked out in accordance with the above provisions.

FOB value	30,000	US dollars
Add : 20% towards Transportation	6,000	US dollars
	<u>36,000</u>	US dollars
Add : Insurance @ 1.125% of CF cost	405	US dollars
	<u>36,405</u>	CIF cost in US dollars

Converted into Rupees as notified by CBEC $36,405 \times 48 = 1747440$ INR

CIF Value	=	1747440 INR
Landing charges		<u>17474.4 INR</u>
Assessable Value		<u>1764914.40 INR</u>

Answer 7(b)**Duty liability on the imported goods**

1. CIF cost of 500 Kgs.	US dollars 25,000
2. CIF cost @ 1 US dollar = Rs. 50 INR	Rs.12,50,000
3. Add Landing charges @ 1%	12,500
4. Assessable Value	12,62,500
5. Basic customs Duty @ 20% of (4)	2,52,500
6. Education Cess @ 2% of (5)	5050
7. SAH Education Cess @ 1% of (5)	2525
8. Liability on account of normally applicable duties and cess	
Total of 5 + 6 + 7	2,60,075
Computation of Anti-dumping duty.:	
Landed cost (4 + 8)	15,22,575 INR
Rate of Commodity/goods as per	
Anti dumping Notification per Kg. for 500 Kgs.	US dollars 70
Quantity imported 500 x 70	US dollars 35,000
Value as per notification	US dollars 35,000
Exchange rate 1 US dollar = Rs.50 INR	
A Value in Rupees	17,50,00 INR
Landed cost of the imported goods as computed earlier	15,22,575 INR
B Anti-Dumping duty A – B =	2,27,425 INR

Answer 7(c)

The case study is based on the Supreme Court judgement in the case of *Varsha Plastic Pvt. Ltd. & Another v. Union of India and others* dated 15.2.2009.

Section 151A read with section 14 of the Customs Act, 1962 is relevant here. The burden is on customs authorities to establish the case of mis-declaration of goods or valuation or that the declared prices did not reflect the true transaction value.

In the above case, the goods imported by the appellants were confiscated on the ground that the appellant had mis-declared some goods in terms of value and some were found mis-declared in terms of description, value and quality and also imposed personal penalty on the firm and its directors. The appellants, instead of assailing the order in original in a statutory appeal approached the High Court by filing a special civil

application *inter alia* challenging the constitutional validity of the provision of Section 151A and also put in issue the legality and validity of the provisions of Section 151A and also put in issue the legality and validity of the standing Order No.7493/99 issued by the Chief Commissioner of Customs, Mumbai with regard to valuation of plastic items. The High Court did not find any merit in so far as the constitutional validity of Section 151A was concerned. As regards to the question on standing order the High Court held that the impugned standing order is to be taken only as assistance in exercise of quasi-judicial power of determining the value for the purpose of levy of customs duty by the concerned authorities and therefore it was not liable to be struck down. The controversy before the Supreme Court was confined to the legality and validity of the Standing Order No.7493/99.

The Supreme Court observed that once nature of goods has been mis-declared, the value declared on the imported goods becomes unacceptable. It does not in any way affect the legal position that the burden is on the customs authorities to establish the case of mis-declaration of goods or valuation or that the declared price did not reflect the true transaction value.

PART C

Question 8

Attempt any four of the following :

- (i) *Several Indian companies are migrating abroad to minimise their tax obligations and to avail of lower rates of tax. Discuss with reference to our current levels of tax on incomes. (5 marks)*
- (ii) *Explain how the arm's length price in relation to an international transaction is computed under the comparable uncontrolled price method as per Rule 10B of the Income-tax Rules, 1962. (5 marks)*
- (iii) *Discuss the modes of granting relief under avoidance of double taxation agreements and the effect of such agreements between the Government of India and the governments of other countries under section 90A of the Income-tax Act, 1961. (5 marks)*
- (iv) *Explain the salient features of the tax incentives available to foreign institutional investors (FIIs) under the provisions of section-115AD of the Income-tax Act, 1961. (5 marks)*
- (v) *Explain the powers of the authority for advance rulings in regard to rejection of an application and modification of an order. (5 marks)*
- (vi) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
 - (a) *The credit for taxes paid _____ should be allowed in the year in which the foreign taxed income is _____ in India.*
 - (b) *Under the income test, a foreign corporation is considered a passive foreign investment company (PFIC) if _____ percent or more of the foreign corporation's gross income for the taxable year consist of passive income.*
 - (c) *Organisation for Economic Co-operation and Development - Model Convention (OECD-MC) defines double taxation as 'the imposition of*

_____ in two (or more) States on the same tax payer in respect of the same subject matter and for identical periods’.

(d) Rule 10A(a) dealing with the Transfer Pricing defines an ‘uncontrolled transaction’ to mean a transaction between enterprises other than _____, whether resident or non-resident.

(e) Anti-dumping and countervailing duties are imposed under the _____ Act. (1 mark each)

Answer 8(i)

The statement given reflects the view that the level of corporate taxes in India are comparatively higher than those prevalent in some other foreign countries.

The present rates of corporate tax as applicable for the Assessment Year 2009-10 are as follows :

	Domestic Companies	Foreign Companies
1. Basic Rate	30%	40%
2. Surcharge applicable only if the taxable income is more than Rs.1 crore in the Previous year.	10%	2.5%
3. Education Cess	2%	2%
4. Secondary and Higher Education	1%	1%
5. Effective Rate of tax	33.99%	42.23%

In respect of foreign companies, some specified categories of income such as royalty, fees for technical services etc. are taxed at a special rate of 10%. The final liability of a foreign company will depend on the applicability of the Double Taxation Avoidance Agreement between India and the foreign country to which the company belongs if any. The rates prescribed in the DTAA or the normal rates prescribed under the Indian Income Tax Act whichever is more beneficial to the assesee shall be made applicable.

Royalties received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after 31st March 1961 but before 1.4.1976 or fees for rendering technical services received by Government or Indian concern in pursuance of an agreement made by it with the Government or Indian concern after 29.2.1964 but before 1.4.1976 and where such agreement has, in either case been approved by the Central Government other than domestic companies are liable for a basic rate of 50% + Surcharge 2.5% + Education Cess 2% + SAH Education cess 1% and the effective rate works out to 52.75%.

The effective rates are too high compared with other tax jurisdictions abroad. Therefore, some Indian companies are going abroad or considering to do so.

The relatively high effective rate of tax also acts as a disincentive in attracting foreign investments and technical services etc. The foreign companies presently operating

in India may also consider migrating to other countries which provide for more favourable tax jurisdiction.

Answer 8(ii)

As per Section 92C of the Income Tax Act, 1961 the arm's length price in relation to an international transaction shall be determined by any of the following methods :

- (a) Comparable uncontrolled price method;
- (b) Resale Price Method;
- (c) Profit split method;
- (d) Cost plus method;
- (e) Transactional Net Margin Method;
- (f) Such other method as may be prescribed by the Board under Rule 10B

Out of the above the most appropriate method shall be adopted having regard to the nature of transaction or class of transactions or class of associated persons or functions performed. Comparable uncontrolled price method is one of the methods prescribed under Rule 10B of the IT Rules. The salient features of the method are as follows :

- (i) The price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
- (ii) Such price is adjusted to account for, differences, if any between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the prices in the open market.
- (iii) The adjusted price arrived at under such clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction :

	<i>Amount (Rs.)</i>
(1) Pricing of an unrelated party transaction	X
(2) <i>Less</i> : Adjustments made for related party Specific transaction	Y
(3) Pricing of an unrelated transaction	X – Y
(4) Pricing of the related party transaction	Z

Compare 3 and 4

If 4 is greater than 3 then ALP is 4 i.e. Z

If 3 is greater than 4 then ALP is 3 i.e. X – Y.

The most important aspect of this method is the identification of an identical transaction, in a situation where a price is charged for product or service between

unrelated parties. While applying the method, the comparability between controlled and uncontrolled transactions should not be only judged from the comparability of the product but should also take into consideration the effect on price of other broader business functions. Even minor differences in contractual terms, or economic conditions, geographical areas, risks assumed, functions assumed etc. could affect the amount charged in an uncontrolled transaction.

Answer 8(iii)

Modes of Granting relief under Avoidance of Double Taxation Agreements

Generally there are two modes viz : (i) exemption method and (ii) tax credit method.

Under exemption method a particular income is taxed in one of the two countries.

Under tax credit method an income is taxable in both the countries in accordance with their tax laws read with the ADT Agreement. However, the country of residence of the tax payer allows him credit for the tax charged thereon in the country of source against the tax charged on such income in the country of residence.

In the ADT Agreements entered into by India a combination of both the methods is provided.

The effect of an ADT agreement is as follows :

- (a) If no tax liability is imposed under the Act the question of resorting to the agreement would not arise, no provision of the agreement can possibly fasten a tax liability not imposed by the Act.
- (b) If a tax liability is imposed by the act the agreement may be resorted to for nullifying or reducing it.
- (c) In case of difference between the provisions of the Act and of the agreement the provisions of the agreement prevail over the provisions of the Act and can be enforced by the appellate authorities and the Courts.

Section 90A has been inserted under the Finance Act, 2006 with effect from 1.6.2006. Section 90A provides for relief in respect of agreements entered into between a specified association in India with any specified association outside India. The Central Government may by notification in the Official Gazette make necessary provision for :

- (a) adopting and implementing such agreement, for double taxation relief;
- (b) avoidance of double taxation;
- (c) exchange of information;
- (d) the prevention of avoidance of evasion of tax; or
- (e) the recovery of tax

Answer 8(iv)

Section 115AD provides for special rates of Income tax to Foreign Institutional Investors in respect of the following incomes.

- (a) Income (other than dividend covered under section 115-O) in respect of securities

listed in a recognized stock exchange in India (other than units covered under section 115AB

Special Rate Applicable 20%

- (b) Any short-term capital gain on transfer of securities covered under section 111A

Special Rate Applicable 10%

Other Securities

Special Rate Applicable 30%

- (c) Long-term Capital gains arising there from

Special Rate Applicable 10%

Where the gross total income of FII

- (i) Consists only of income in Clause (a) Sub-section (1) no deduction shall be allowed to it under Sections 28 to 44C or Clause (i) Clause (iii) of Section 57 or under Chapter VI-A.
- (ii) Includes any income referred to in Clause (a) or Clause (b) of Sub-Section (1) the gross total income shall be reduced by the amount of such income and the deductions under chapter VIA shall be allowed as if the gross total income as so reduced were the gross total income of the FII.

Answer 8(v)

The Authority for Advance Ruling (AAR) shall not allow an application when the questions raised in the application relate to the following :

- (i) if it is already pending before any income-tax authority or Appellate Tribunal or Court; or
- (ii) if it involves the determination of fair market value of any property; or
- (iii) it relates to a transaction or issue which is designed prima facie for the avoidance of Income Tax

Modification of order by AAR : Where the authority finds suo moto or on a representation made to it by the applicant or the Commissioner or otherwise, but before the ruling pronounced by the authority has been given effect to by the Assessing Officer, that there is a change in law or facts on the basis of which the ruling was pronounced, it may by order modify such ruling in such respects as it considers appropriate, after allowing the applicant and the Commissioner a reasonable opportunity of being heard.

Answer 8(vi)

- (a) The credit for taxes paid **Overseas** should be allowed in the year in which the foreign taxed income is **doubly taxed** in India.
- (b) Under the income test, a foreign corporation is considered a passive foreign investment company (PFIC) if **75** percent or more of the foreign corporation's gross income for the taxable year consist of passive income.

- (c) Organisation for Economic Co-operation and Development - Model Convention (OECD-MC) defines double taxation as 'the imposition of **Comparable Taxes** in two (or more) States on the same tax payer in respect of the same subject matter and for identical periods'.
 - (d) Rule 10A(a) dealing with the Transfer Pricing defines an 'uncontrolled transaction' to mean a transaction between enterprises other than **Associated Enterprises**, whether resident or non-resident.
 - (e) Anti-dumping and countervailing duties are imposed under the **Customs Act**.
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PROFESSIONAL PROGRAMME EXAMINATION
DECEMBER 2009
**STRATEGIC MANAGEMENT, ALLIANCES AND
INTERNATIONAL TRADE**

Time allowed : 3 hours

Maximum marks : 100

PART A

(Answer ANY TWO questions from this part)

Question 1

- (a) *“Organisations are becoming more responsive, flexible and adaptable to changing business situation.” Comment with example. (5 marks)*
- (b) *IOC Ltd. has changed its vision statement to capture the collective aspirations of its stakeholders to create a ‘shared vision’ rather than ‘vision shared’. Comment. (5 marks)*
- (c) *Discuss Porter’s Five Forces Model of industry analysis. (5 marks)*
- (d) *Describe the main approaches to evaluation of strategic alternatives. (5 marks)*

Answer 1(a)

It is correctly remarked that organizations are becoming more responsive, flexible, and adaptable to changing business situations. Today, businesses are becoming more complex due to rapid changes in environment. It is becoming increasingly difficult to predict the environment accurately. The internal and external environments of organizations are now driven by multitudes of forces that were hitherto non-existent. Earlier, the changes in technology were not so rapid but today the information from all over the globe is pouring in through the computers. The world in fact has shrunk. This has created fierce competition as the customers and stakeholders have become more aware of their rights.

The number of events that affect domestic and world market are now far too many and too often. Over reliance on experience in such situations may really work out to be very costly for companies. For example, Reliance has shifted to more creativity, innovation and new ways of looking at business and doing it in novel ways. The earlier concepts of having highly specialized departments and developing specialization of labour is losing its credibility. Organizations are becoming more responsive, flexible, and adaptable to changing business situations. In such an environment which is charged with high level of competition, developing competitive edge for survival and growth has become imperative for companies. For example ITC began as a tobacco company. Over the years, it has diversified into paper (ITC Bhadrachalam), hotels (Welcome Group), food (ITC Agro), and garments (Wills Lifestyle) in order to take advantage of changing environments and to achieve its growth objectives.

Answer 1(b)

“Shared Vision” connotes the idea of stakeholders’ acceptance and commitment to the vision whereas “Vision Shared” gives the impression of compliance of the vision

imposed from the top management. The former creates a sense of communality that permeates the organization and gives coherence to diverse activities. On the other hand, the latter connotes sharing of values already decided by the higher management. The former indicates bottom up approach and the latter top down approach of the management.

Answer 1(c)

Porter's five forces model of industry analysis

The nature of competition in an industry in large part determines the content of strategy, especially business-level strategy. Based as it is on the fundamental economics of the industry, the very profit potential of an industry is determined by competitive interactions between different market forces. Where these interactions are intense, profits tend to be whittled away by the activities of competing firms. Where they are mild and competitors appear docile, profit potential tends to be high.

All these forces assist in identifying the presence or absence of potential high returns. The clear understanding of these forces and their influences on competition within an industry enables the strategist to identify the most advantageous strategic position.

The five forces that influence the intensity of competition are explained below:

- (i) *Intensity of Rivalry among Competitors* : Some industries appear inactive because of a low level of rivalry among competitors. An example might be industrial fasteners, the manufacturers of nuts and bolts and other devices used to connect the components of products.
- (ii) *Power of Buyers* : From an industry's point of view, the buyers can usually be classified into three major categories i.e.: consumers, industrial customers, and commercial customers. Consumers include the purchasers of the firm's service or product for their own use. Goodyear, for example, sells tyres directly to the people who use them in their cars and two wheelers. Industrial buyers include the companies which purchase the firm's product or service to be used as a component in its product. Continuing with the Goodyear example, automobile manufacturers who put Goodyear tyres on new cars would be one group of its industrial buyers. Commercial customers include other companies that sell Goodyear's products to consumers.
- (iii) *Power of Suppliers* : The suppliers of goods and services to an industry have the power to influence their customers through their ability to set price and control quality, delivery time, and order quantity. If these customers cannot manage successfully one supplier against another to protect their interest, then the industry's profits can be drained off by the suppliers.
- (iv) *Substitute Products* : Substitute products refer to those products of industries which serve similar consumer needs. Existence of close substitutes represents a strong competitive threat which limits the price fixation power and the profitability of the firm. Conversely, if the firm's products have very few substitutes, then the company has the opportunity to raise prices and earn additional profits. It is an eye opener for the firms to select those lines which have least substitutes.

- (v) *Potential Entrants* : New entrants to an industry pose several threats to existing competitors. New competitors can reduce the market share of all participants by dividing the pie into more pieces. As a result of this they may also bring new technology or greater resources not available to present competitors and capture a high market share position quickly to the detriment of all existing participants.

Answer 1(d)

Once the organization identifies various strategic alternatives, the next important step of strategic management process is to make a choice from among available alternative strategies. The rationale of strategic choice is to direct resources towards objectives in accordance with chosen strategy.

Different approaches are developed by experts to evaluate strategic alternatives and choose the best among them subject to given conditions. We can classify the evaluation approach in the following categories:

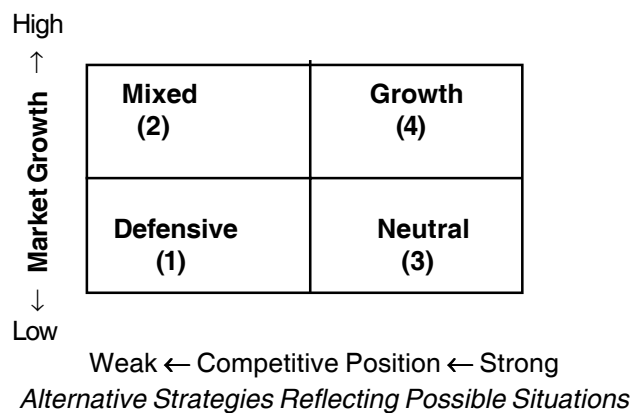
- (i) Simple Approach
- (ii) Analytical Models Approach.

(i) Simple Approach

Let the strategic alternatives be grouped on the basis of key variables, viz., potential market growth and the firm's competitive position. This is a logical starting point since the appropriateness of the strategic choice depends upon the firm's position in relation to the external market and its competitive position assuming that the firm has or can secure the necessary financial resources. The alternative strategies may thus be said to comprise the following combinations of the two variables:

- (1) Low market growth potential/Weak competitive position.
- (2) High market growth potential/Weak competitive position.
- (3) Low market growth potential/Strong competitive position.
- (4) High market growth potential/Strong competitive position.

The quadrant 1 which represent the defensive situation in the following diagram shows low market growth potential and weak competitive position. The organization may seriously consider the defensive retrenchment or divestment—and use excess cash to invest in areas where profit potential is greater.



The quadrant 2 depicts the mixed situation where an organization has high market growth potential and weak competitive position. In this situation, some variant of the combination or mixed strategy is called for.

In quadrant 3 the organization is in neutral situation where the organisations having low market growth potential but strong competitive position. In this situation, organization should normally favour a stable growth strategy so as to maintain its market share.

The Quadrant 4 depicts growth situation which reflects high market growth potential and strong competitive position. These strategies are ideally suited for growing organization situation.

(ii) Analytical Models Approach

A number of analytical conceptual models have been developed by experts for managers to evaluate strategic alternatives before making a choice. Some of them include: Growth share Matrix—Boston Consulting Group (BCG) Model; General Electric's Stoplight Grid, Life Cycle Theory, etc.

Question 2

Read the following extract from the annual report of Sterlite Industries (India) Ltd. and answer the questions given at the end :

“Our business and operations are subject to a variety of risks and uncertainties which are no different from any other company in general and our competitors in particular. Risks are identified through a formal risk management programme with the active involvement of business managers and senior management personnel at both the subsidiary level as well as the corporate level. Each significant risk has an ‘owner’ within the group at a senior level, and the impact to the group, if a risk materialises and its likelihood of crystallization is regularly reviewed. A risk register and matrix is maintained, which is regularly updated in consultation with business managers. The risk management process is coordinated by our management assurance function and is regularly reviewed by our Audit Committee. Key business decisions are discussed at the monthly meetings of the Executive Committee and senior managers address risk management issues when presenting initiatives to the Executive Committee. The overall internal control environment and risk management programme is reviewed by our Audit Committee on behalf of the Board of directors.

The areas identified for risk management by the company include – Treasury Management; Commodity Risks; Political, Legal, Economic and Regulatory Risks; Ore Reserves and Resources; Delivery of expansion projects on time and within budget; ASSET use and Insurance; Safety, Health and Environment Risks; Operational Risks; Financial Risks; Liquidity; Foreign Currency; Interest Risks; Counterparty Risks; and Employees.

During the year 2008-09, the world witnessed several mine closures, production cutbacks and deferral of projects. Despite such negative market sentiments and a depressed outlook for demand, we remain focused on our basic objectives of achieving a least-cost position and developing low capital cost projects on or ahead of schedule and within budgets. Thus the year 2009-10 augurs well.”

Questions —

- (i) *What is risk management ?*
- (ii) *What are the major steps in risk management process ?*
- (iii) *Who is responsible for putting in place risk management process ?*
- (iv) *What is the risk management style in the company ?*
- (v) *What could be the possible reasons to have negligible provision for bad and doubtful debts ?* (4 marks each)

Answer 2(i)

Risk Management' is an integral part of business process. It is the process for identifying and assessing opportunities and avoiding and mitigating losses. It is a logical and systematic process of establishing the context, identifying, analyzing, evaluating, treating, monitoring and communicating risks associated with any of the business activity, functions in a way that enables an organization to minimize losses and maximize opportunities/gains. In practice, it is about identifying potential variations from what is planned targets and managing those to maximize opportunity, minimize loss and improve decisions and outcomes. Corporate risk has been classified into (a) Enterprise risk management and (b) Project risk management.

Answer 2(ii)

Risk management process consists of following main steps:

- (i) *Risk identification* : Risk cannot be managed unless it is first identified. Once the context of the business has been defined, the next step is to utilize the information to identify as many risks as possible. The aim of risk identification step is to identify possible risks which may affect, either negatively or positively, the objectives of the business and the functioning of the enterprise.
- (ii) *Risk assessment* : Every organization is continuously exposed to an endless number of new or changing threats and vulnerabilities that may affect its operation or the fulfillment of its objectives. Identification, analysis and evaluation of these threats and vulnerabilities are the only way to understand and measure the impact of the risk involved and hence to decide on the appropriate measures and controls to manage them.
- (iii) *Risk measurement and analysis* : Risk measurement includes a determination of (a) The probability or chance of the losses that will occur, (b) The impact of the losses upon the financial affairs of the firm, and (c) The ability to predict the losses during the financial period.

The risk analysis assists in determining which risks have a greater consequence or impact than others. This helps to provide a better understanding of the possible impact of risk, or the likelihood of its occurring, in order to make a decision about committing resources to control the risk.
- (iv) *Risk evaluation* : Risk evaluation implies ranking in terms of importance, and ranking suggests measuring some aspect of the factors to be ranked. Risk

evaluation involves comparing the level of risk found during the analysis process with previously established risk criteria, and deciding whether these risks require treatment.

- (v) *Risk treatment*: Risk treatment is basically concerned with identifying options for treating or controlling risk, in order to either reduce or eliminate negative consequences, or to reduce the likelihood of an adverse occurrence. Risk treatment should also aim to enhance positive outcomes. It is often either not possible or cost-effective to implement all treatment strategies
- (vi) *Risk monitoring and review*: Risk monitor and review is an essential and integral step in the risk management process. A business owner must monitor risks and review the effectiveness of the treatment plan; strategies and management system which have been set up to effectively manage the risk.

Answer 2(iii)

Part IV(C) of Clause 49 of the Listing Agreement requires laying down procedures for informing the board members about the risk management and internal control systems in critical areas of operation. The CEO and CFO are responsible for putting in place risk management and internal control system in critical areas of operations of their companies. These procedures have to be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. Simply stated, the company has to adopt appropriate risk management policies, commensurate with its size and requirement of business, and review these periodically in the light of changing economic and corporate scenario. In the present case, for practical purposes, each significant risk has a "owner" within the Group at a senior level. The risk management issues are discussed at the Executive Committee meetings held every month and the overall risk management programmes are reviewed by the Audit Committee on behalf of Board of Directors.

Answer 2(iv)

The company has a participative style of risk management involving the top, middle and lower management at the holding and subsidiary companies. The company has in place a formal risk identification programme at the holding and subsidiary level where the board identifies and manages various business risks. The holding, subsidiary and departments manage risk continuously and systematically. Such a risk management process is essentially a part and parcel of the operations and management function of the company at corporate level.

Answer 2(v)

The company could have negligible provision of bad and doubtful debt by proper management of default risk. This is to manage the uncertainty associated with realization of receivables from the customers. The underlying objective is to ensure timely receipt of contractual interest and principal from the short-term and long-term debtors. It involves (i) insisting on payment by letter of credit; (ii) receiving part payment in advance; and (iii) strict receivable management.

Question 3

- (a) *Critically examine the major characteristics of information systems (IS). (8 marks)*

- (b) *In the context of Management Information Systems (MIS), state, with reasons in brief, whether the following statements are correct or incorrect :*
- (i) *Study of MIS is about the use of computers.*
 - (ii) *More data in reports means more information for managers.*
 - (iii) *Accuracy in reporting is of vital importance.*
 - (iv) *Strategic information meets information requirements of the top management.*
(2 marks each)
- (c) *“Internal control can provide only reasonable, but not absolute assurance that the objectives are achieved.” Critically examine the statement with four inherent limitations of internal control systems.*
(4 marks)

Answer 3(a)

Information system refers to a set of people, procedures and resources that collects, transforms, and disseminates information in an organization.

In other words an information system is a system of collecting, storing, retrieving and processing data for providing appropriate and timely information to managers at different levels of organization hierarchy for helping them in performing managerial activities. It consists of people, procedures, methods, equipments and other resources that work together in a desired manner to provide necessary information supports to managers with an objective to increase effectiveness of management

The major characteristics of Information Systems are as follows :

- (i) *Repetitiveness* : The information produced by these systems is usually repetitive in nature at periodic intervals such as daily, weekly, or monthly.
- (ii) *Predictability*: The information they produce usually does not contain any surprises for the manager or the users of the information.
- (iii) *Emphasis on the past* : The information generated by the systems usually describe the past.
- (iv) *Detailed nature* : The information produced is very detailed.
- (v) *Internal origin* : The data for operational system usually spring entirely from internal sources.
- (vi) *Structured form* : The form of the data input and the form of the output produced by the operational information systems is structured.
- (vii) *Great accuracy* : The accuracy of the data used as input to such systems and of the output produced by such systems is usually very high.

However, there is no such tailor made information system which can be universally applied to **all situations**. Therefore it has to be adjusted as per the requirements **and objectives** of an organization.

Answer 3(b)

In the context of Management information system (MIS) correctness or incorrectness of the following statements are clarified below:

- (i) **The statement is incorrect.** MIS may or may not be computer based on use of computer. Computerization is just a tool for installation of required MIS, depending

on several factors like how critical is the response time required for getting the information, how big is the organization and how complex are the needs of information processing.

- (ii) **The statement is incorrect** because what is important is the quality of data and information in reports rather than the quantity of data and information. In fact, the data provided in reports should meet information requirements of management. Unorganized mass of data may create confusion than bringing clarity to the issues.
- (iii) **The statement is correct** at the operating level because the degree of accuracy is closely related to the decision problem. For example, accuracy is really important in medicine, control of aircrafts, design of dams, bridges, flyovers and railway tracks.
- (iv) **The statement is correct** because the top level management requires strategic internal and external information for formulating long-term objectives, strategies and major policies and programmes of the company. It is the top management, who is concerned with the determining, maintaining and supplying of required information.

Answer 3(c)

Internal control system means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

Experience proves that best of internal control system in any organization can provide *only reasonable, but not absolute assurance* that the objectives are achieved. The four inherent limitations of internal control are as under:

- (i) Management's usual desire is that a control should be cost-effective, i.e., the cost of a control procedure should not be disproportionate to the potential loss due to fraud or error.
- (ii) Most of the controls tend to be directed at anticipated types of transactions and not at transactions of unusual nature.
- (iii) The potential for human error due to carelessness, distraction, mistakes of judgement or the misunderstanding of instructions can not be ruled out.
- (iv) The possibility of circumvention of controls through collusion with parties outside the entity or with employees of the entity may be present.

PART B

(Answer ANY ONE question from this part.)

Question 4

- (a) Explain whether every technical collaboration is a strategic alliance. (5 marks)
- (b) Explain briefly the various types of strategic alliances. (5 marks)
- (c) What are the advantages of a technical collaboration? (5 marks)
- (d) What are the important factors for the success of a technical collaboration? (5 marks)

Answer 4(a)

Every technical collaboration is a strategic alliance. Any arrangement or agreement under which two or more firms cooperate in order to achieve certain commercial objectives is referred to as strategic alliance. A true strategic alliance is a written arrangement between two companies that complement each other in a particular identified area. It is a commitment by the two companies to provide capabilities or cross servicing in certain identified areas.

Strategic alliance has three distinguishing characteristics:

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

Answer 4(b)

Various types of strategic alliances are as follows:

- Joint Venture.
- Equity strategic alliances.
- Non-equity strategic alliances.
- Global strategic alliances.
- Research & Development.
- Management contract.
- Franchising.
- Supply or purchase agreement.
- Marketing or distribution agreement.
- Agreement to provide technical services.
- Licensing of know-how, technology, design or patent.

Answer 4(c)

Advantages of a technical collaboration are as follows:

- Move to decisively seize opportunities before they disappear.
- Respond more quickly to change.
- Adapt with greater flexibility.
- Gain overseas presence.
- Gain overseas expertise and technology.
- Increase a company's market share.
- Gain access to a new market or beat others to that market.

- Quickly shore up internal weaknesses.
- Gain a new skill or area of competence.
- Rapidly meet a company's need for key resources.
- Gain a means of Distribution in International market.
- Overcome legal or Regulatory barriers.
- Diversification of business.
- Avoiding competition.
- Focus on New Products and Restructuring.
- Gaining cost and quality competitiveness defend business interests, updating technology.
- Increasing efficiency through economies of scale, specialisation etc.

Answer 4(d)

Certain key success factors are:

- *Mutual Trust* : Mutual trust at senior management level carry ventures through turbulent times.
- *An ability to compromise* : When there are two strong companies, the ability to compromise is not easy to achieve. If you expect to receive some valuable technology, production or marketing know how from a partner, you must be willing to give something.
- *Favourable business condition* : Launching an alliance when favourable business conditions exist makes a venture life considerably easier for its partners.
- *Alliance Autonomy* : The autonomy mandates a high degree of responsibility and good judgement by the ventures management.
- Dynamic management structure.
- Encouragement of calculated initiatives.
- Systematic task setting.
- Equal distribution of authority.
- Streamlined communication channels.
- Development of multi-manager roles.

The benefits of alliances can be leveraged by adequate internal communication mechanisms. Managing alliances will test even the most competent of executives. The capabilities include not only careful planning and implementation, but also a broad perspective and an open mind.

Question 5

Modern Pharmaceuticals Ltd., India (hereinafter called the First Party), is entering into a joint-venture agreement with Afro-Drugs, Nigeria (hereinafter called the Second

Party) to incorporate a new company in India for setting-up a pharmaceutical manufacturing project. In this context, answer the following :

- (a) *What is the nature of the joint-venture project ?* (5 marks)
- (b) *Draft the following clauses to be included in the joint-venture agreement/articles of association of the new company :*
- (i) *Allotment of shares to the first Party and second party with lock-in-period.*
 - (ii) *Suitable restrictions on the transfer of shares during the lock-in-period.*
 - (iii) *Exit route.*
 - (iv) *Right to first refusal in case any party decides to exit.*
 - (v) *Arbitration under the London Court of International Arbitration.*
- (3 marks each)

Answer 5(a)

The nature of the joint-venture project is equity joint venture. The equity joint venture is an arrangement whereby a separate legal entity is created in accordance with the agreement of two or more parties. The parties undertake to provide money or other resources as their contribution to the assets or other capital of that legal entity. The entity is generally established as a limited liability company and is distinct from either of the parties which participate in its creation. The newly created company, thus, becomes the owner of the resources contributed by the parties to the joint venture arrangement. Each of the parties in turn becomes the owner of the company having equity in the company.

The parties to a joint venture agreement agree on purposes and functions of the newly created entity, the proportion of capital contribution by each party and the share of each party in the profits of the company and on other matters such as its management, operation, duration and termination and exit route etc.

Answer 5(b)

The drafts of clauses are as under in the joint venture agreement/articles of association of the new company:

- (i) The New Company shall initially allot 51% (fifty one per cent) shares to the Mordern Pharmaciutical Ltd. (herein after called FIRST PARTY) and 49% (forty nine per cent) shares to the Afro-drugs, Nigeria (herein after called SECOND PARTY) in the total paid-up capital of the New Company. The initial allotment of shares shall be subject to a lock-in-period of three (3) years from the date of allotment of shares by the New Company.
- (ii) The shares held by the FIRST and SECOND PARTY during the locked-in-period can be transferred to and amongst the promoters. They shall, however, not sell, transfer, pledge and assign their shares and voting rights to any third party during the locked-in period, save and except to banks and financial institution or any other government or statutory body to fulfill the conditions for seeking loan and investments for the Company.
- (iii) In case of unavoidable circumstances like statutory hurdles, non cooperation or irreconcilable difference, if either PARTY would have to exit from the New

Company, the Board of Directors shall appoint and engage independent chartered accountants of neutral nationality to evaluate and determine the 'Net Asset Value' of the shares as per the latest available Balance Sheet and Profit and Loss Account of the new company.

- (iv) The continuing PARTY shall have 'the right to first refusal' in case any PARTY decides to exit. The exiting PARTY shall, therefore, offer its entire shares to the continuing PARTY at the Net Asset Value price. Valuation shall be made by a independent chartered accountants of neutral nationality.
- (v) Any dispute arising out of or in connection with this joint-venture agreement, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the Rules of the London Court of International Arbitration (LCIA) at London.

PART C

(Answer ANY TWO questions from this part.)

Question 6

Write notes on any four of the following :

- (i) Controversy on Regional Free Trade Agreements.*
- (ii) Advantages of India joining the Association of South-East Asian Nations (ASEAN).*
- (iii) Main objectives of the World Trade Organisation (WTO).*
- (iv) Rules of origin.*
- (v) Dispute Settlement System – rules-based or justice-based. (5 marks each)*

Answer 6(i)

Regional Free trade agreements are considered policy compulsions, but highly controversial in terms of economic advantages. On the one hand, RFTAs are promoted as the instrument of forging partnerships to strengthen their position in the global economy and to sustain economic growth. These are considered vehicles of mutual gains between developing countries by opening up of the trade and services sectors bilaterally. However, there is question about the economic gains from the Regional FTAs. It may cause increasing unaccountable concentration of power and decision making; environmental degradation; eroding workers rights; brain drain from poor countries to rich countries; protectionism for the rich and open market for poor; positive or negative form of interdependence. There are also concerns about the non-transparent/transparent pricing mechanism and massive hidden subsidies and recurring trade deficits.

Answer 6(ii)

Advantages of India joining the ASEAN

- Enhancing India's close economic cooperation and to work towards an India-ASEAN Regional Trade and Investment Area (RTIA) as a long term objective.
- Minimising barriers and deepen economic linkages of India.
- Increasing intra-regional trade and investment.

- Increasing economic efficiency.
- Creating a larger market with greater opportunities and larger economies of scale for the businesses; and
- Enhancing the attractiveness to capital and talent.

Answer 6(iii)

Main objectives of the WTO

- Promotion of free trade among member countries
- Expanding trade in goods and services,
- Optimal use of the world's resources in accordance with the objective of sustainable development, and environmental protection.
- Ensuring that developing countries, especially the least developed countries (LDCs), secure a proper share in the growth of international trade.
- Removal of obstacles to free trade.
- Administration of Rules, Regulations for settlement of trade related dispute among member countries under Dispute Settlement Mechanism.
- Providing technical advice in trade related matter to all member countries.

Answer 6(iv)

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

Answer 6(v)

Dispute Settlement System

The WTO dispute settlement system is a rule-oriented system where recommendations and rulings must aim at achieving a satisfactory settlement in accordance with the rights and obligations of the Members under the WTO Agreement. As a result, all solutions to matters formally raised under the consultation and dispute settlement provisions of the WTO agreements must not nullify and impair benefits accruing to any Member under those agreements.

Under the DSU, the “players” in a dispute settlement process are subject to certain rules aimed at ensuring due process and unbiased recommendations and rulings. For

instance, there must not be any ex parte communications with the panel or Appellate Body members concerning matters under consideration by the panel or the Appellate Body.

The WTO dispute settlement mechanism provides for three main ways of resolving disputes: (i) bilateral consultations; (ii) good offices, conciliation and mediation; and (iii) adjudication, including arbitration.

With the exception of arbitration, adjudication cannot be requested until consultations have taken place or unsuccessful attempts to consult have been made. The Dispute Settlement Mechanism contains rules and procedures to be followed by WTO Members.

Question 7

- (a) *Prepare an executive note for the Director (R&D) explaining the roles and functions of the Trade-Related Aspects of Intellectual Property Rights (TRIPS), World Intellectual Property Organisation (WIPO) and Patent Cooperation Treaty (PCT). (10 marks)*
- (b) *Briefly explain the dispute settlement procedure of the WTO with particular reference to dispute settlement body and provision for appeal and decision-making process. (10 marks)*

Answer 7(a)

The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is an attempt to narrow the gaps in the way these rights are protected around the world, and to bring them under common international rules. When there are trade disputes over intellectual property rights, the WTO's dispute settlement system is available. The second part of the TRIPS agreement looks at different kinds of intellectual property rights and how to protect them. The purpose is to ensure that adequate standards of protection exist in all member countries. The Council for Trade-Related Aspects of Intellectual Property Rights monitors the working of the agreement. The areas covered under the TRIPS agreement include Copyright and related rights, such as Trademarks, including service marks, Geographical indications, Industrial designs, Patents, Layout-designs (topographies) of integrated circuits, Undisclosed information including trade secrets.

The World Intellectual Property Organization (WIPO) is an international organization dedicated to helping ensure that the rights of creators and owners of intellectual property are protected worldwide and that inventors and authors are, thus, recognized and rewarded for their ingenuity. In 1974, WIPO became a specialized agency of the United Nations system of organizations, with a mandate to administer intellectual property matters recognized by the member states of the UN. WIPO expanded its role and further demonstrated the importance of intellectual property rights in the management of globalized trade in 1996 by entering into a cooperative agreement with the World Trade Organization.

WIPO seeks to:

- Harmonize national intellectual property legislation and procedures.
- Provide services for international applications for industrial property rights.

- Exchange intellectual property information.
- Provide legal and technical assistance to developing and other countries.
- Facilitate the resolution of private intellectual property disputes.
- Marshal information technology as a tool for storing, accessing, and using valuable intellectual property information.

Patent Cooperation Treaty (PCT) implements the concept of a single international patent application which has legal effect in the countries which are bound by the treaty and which are designated by the applicant. Once such an application is filed, an applicant receives valuable information about the potential patentability of his invention (through the international search report and the optional international preliminary examination report) and has more time than under the traditional patent system to decide in which of the designated countries to continue with the application. Thus, the PCT system consolidates and streamlines patenting procedures and reduces costs, providing applicants with a solid basis for important decision-making.

Answer 7(b)

The operation of the WTO dispute settlement process involves the Dispute Settlement Body, the panels and the Appellate body, the parties and the WTO Secretariat. The General Council discharges its responsibilities with respect to dispute settlement through the Dispute Settlement Body, which is composed, of representatives of all WTO members. Panels and the Appellate Body are the entities in charge of adjudicating disputes. The former are composed of experts selected on an ad hoc basis. The latter is a permanent group of seven experts in trade issues and trade law in charge of reviewing the legal aspects of the reports issued by panels.

As a general rule the DSB is to take decisions by consensus, as is the case for all decision-making in the WTO. It is deemed to have decided by consensus on a matter submitted for its consideration, if no WTO Member, present at the meeting of the DSB when the decision is taken, formally objects to the proposed decisions. However, a radically different procedure is followed in decision-making at four key stages in the dispute settlement process: establishment of panel, adoption of panel and Appellate Body reports and authorization for retaliation. At these stages the decision is taken to accept the request or adopt the report unless there is a consensus against it.

Only WTO Members can take part in dispute settlement under the WTO. WTO dispute settlement is not open to WTO observers, other international organizations, non-governmental organizations, local governments or private persons.

The WTO dispute settlement mechanism provides for three main ways of resolving disputes: (i) bilateral consultations; (ii) good offices, conciliation and mediation; and (iii) adjudication, including arbitration. With the exception of arbitration, adjudication cannot be requested until consultations have taken place or unsuccessful attempts to consult have been made.

Either side can appeal a panel's ruling. Sometimes both sides do so. Appeals have to be based on points of law such as legal interpretation. They cannot reexamine existing evidence or examine new evidence.

The appeal can uphold, modify or reverse the panel's legal findings and conclusions. Normally appeals should not last more than 60 days, with an absolute maximum of 90 days. The Dispute Settlement Body has to accept or reject the appeals report within 30 days and rejection is only possible by consensus.

These approximate time lines for each stage of a dispute settlement procedure are target figures. In addition, the countries can settle their dispute themselves at any stage. The approximate period of settlement of dispute is 1 year (without appeal) and 1 year 3 months (With appeal).

Question 8

Attempt any five of the following :

- (i) *Explain 'domestic industry' in the context of dumped goods. (4 marks)*
- (ii) *Explain the 'principle of distortion'. (4 marks)*
- (iii) *"Presently Indian exporters are facing non-tariff barriers and quantitative restrictions from the European Union facing economic slowdown." In this context, distinguish between the 'non-tariff barriers' and 'quantitative restrictions'. (4 marks)*
- (iv) *The Indian manufacturers of industrial goods and chemicals have complained to the Director General of Safeguard, Ministry of Finance, about heavy losses suffered by them due to cheap import of industrial goods and chemicals from China. State whether the Director General of Safeguard should exercise total control over import of industrial goods and chemicals or impose import duties on the imported industrial goods and chemicals. (4 marks)*
- (v) *The European Union has registered complaint with the WTO that India is restricting import of foreign liquor by imposing very high duties. Comment on the Indian plea that sale of liquor in India is a State subject. (4 marks)*
- (vi) *US has imposed a 98.4% anti-dumping duty against the Chinese imports of steel pipes, besides additional countervailing duties to off-set the subsidies given by China on steel pipes. What remedy is available to China ? (4 marks)*

Answer 8(i)

Domestic industry in the context of dumped goods means the Indian producers of like articles as a whole or those producers whose collective output constitutes a major proportion of total Indian production. Producers who are related to the exporters or importers or are themselves importers of the allegedly dumped goods shall be deemed not to form part of the domestic industry.

Answer 8(ii)

Essentially, trade is distorted if prices are higher or lower than normal, and if quantities produced, bought, and sold are also higher or lower than normal — i.e. higher than the levels that would usually exist in a competitive market. For example, import carriers and domestic subsidies can raise crop prices on a country's internal market. The higher prices can encourage over-production, and if the surplus is to be sold on world markets, where prices are lower, then export subsidies have to be paid. When some countries

subsidize and others do not, the result can be that the subsidizing countries are producing considerably more than they normally would.

Answer 8(iii)

Non tariff barriers are technical regulations and standards; import licensing; rules for the valuation of goods at customs; preshipment inspection; further checks on imports; investment measures.

Quantitative Restrictions, on the other hand, refer to specific limits imposed by countries on the quantity or value of goods that can be imported or exported to regulate or prohibit international trade. Quantitative Restrictions specifically refer to measures such as licensing requirements for exports/imports, quotas and ceilings.

Answer 8(iv)

The Director General (DG) of Safeguard, on the complaints of the India manufacturers, cannot put total control over import of industrial goods and chemicals imported from China because a total control violates the WTO multilateral trading norms.

The right course of action is that DG Safeguard can carry out safeguard investigations against import of industrial goods and chemicals. The investigations if lead to the conclusion that there is sharp increase in the import of industrial chemicals, leading to losses for the domestic industry, it can impose 200-day temporary import duties on the import of industrial chemical. The safeguard duty could be in place up to three years if the injury continues. Safeguard duty usually takes the form of increased duties and acts as quantitative restriction on imports.

The WTO allows use of 'Special Safeguard Measures (SSM)' to its members for preventing injury to a local industry due to imports. The SSM leads to imposition of additional import duties on products after it is conclusively proved that there has been a surge in the import of an identified product leading to domestic market disruption and injury to the industry. India can use the WTO approved SSM where special import duties are imposed to prevent import surges to help Indian industry against cheap imports.

Answer 8(v)

There is a threefold distribution of legislative powers stipulated in Article 246 read with Schedule VII of the Constitution of India. List I of the Union list in Schedule VII comprises of 99 items or subjects over which the Union shall have the exclusive powers of legislation. List II comprises of 61 items over which the State Legislature shall have the exclusive powers of legislation. List III the concurrent list comprises of 52 items over which the Parliament and the Legislatures of States shall have concurrent powers.

Imposition of excise duties on alcoholic liquor for human consumption, opium etc is the legislative competence of the State Government under Article 246 read with Schedule VII of State List.

Answer 8(vi)

The Chinese Government can seek and question the safeguard investigation report of the US Government on the import of steel pipes by the US industry. In case the investigation lacks of factual data, the Chinese Government can ask for withdrawal of the antidumping and countervailing duties. China can use the WTO's dispute settlement procedure to seek the withdrawal of the subsidy.

PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 2009

**DUE DILIGENCE AND CORPORATE
COMPLIANCE MANAGEMENT**

Time allowed : 3 hours

Maximum marks : 100

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

Question 1

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

- (i) Private companies are not required to employ the whole-time Company Secretary.
- (ii) A member of the Institute of Company Secretaries of India (ICSI) in whole-time practice can issue compliance certificate in respect of any number of companies without any ceiling whatsoever.
- (iii) Unlisted companies cannot float global depository receipts (GDRs) in India under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.
- (iv) The provisions regarding number of Board meetings and periodicity of Board meetings contained in clause 49 of the listing agreement and section 285 of the Companies Act, 1956 are identical.
- (v) Investment in Indian depository receipts (IDRs) is an investment opportunity for foreign investors to invest in Indian companies.

(2 marks each)

(b) Suraj, a Practising Company Secretary ignored some material discrepancies while issuing compliance certificate to a company. Explain the professional responsibility involved and state whether any penal provisions are prescribed for taking action in such circumstances. *(5 marks)*

(c) Explain the significance of securities management and compliances by a Company Secretary under the Companies Act, 1956. *(5 marks)*

Answer 1(a)(i)

Incorrect

As per section 383A(1) of the Companies Act 1956 every company having paid up capital exceeding a prescribed amount is required to appoint a whole-time company secretary. This is applicable to a private companies also if the paid up capital exceeds the prescribed amount.

Answer 1(a)(ii)

Incorrect

A member of the Institute in practice who is entitled to issue compliance certificate pursuant to the proviso to sub-section (1) of section 383A of the Companies Act,

1956 (1 of 1956) shall be deemed to be guilty of professional misconduct if he issues compliance certificates and/or signs Annual Return for more than eighty companies in aggregate i.e. (total number of companies in respect of which compliance certificate is issued or Annual Return is signed) in a calendar year. However, in the case of a firm of Company Secretaries, the ceiling of eighty companies aforesaid would apply to each partner therein who is entitled to sign the compliance certificate.

Answer 1(a)(iii)

Correct

Unlisted companies, which have not yet accessed the Global Depository Receipt / Foreign Currency Convertible Bond route for raising capital in the international market would require prior or simultaneous listing in the domestic market, while seeking to issue (i) Foreign Currency Convertible Bonds and (ii) Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

Answer 1(a)(iv)

Incorrect

As per Clause 49 of the listing agreement, the Board shall meet at least four times a year with a maximum time gap of four months between any two meetings.

As per Section 285 of the Companies Act, 1956, the meeting of Board of Directors shall be held atleast once in every three months and atleast four such meetings shall be held in a year.

Hence Section 285 of the Companies Act, 1956 and provisions of clause 49 pertaining to Board Meeting are not identical, as the companies Act does not specify the maximum gap between two Board Meeting.

Answer 1(a)(v)

Incorrect

Indian Depository Receipts provide an investing opportunity for Indian investors to invest in foreign equity. They are meant for foreign companies who intend to raise money in India.

Answer 1(b)

Company Secretaries must take adequate care while issuing Compliance Certificate. It is based on this certificate that confidence of the company, Government and trade and industry will build-up vis-a-vis our profession. Any failure or lapse on the part of a Practising Company Secretary in issuing a Compliance Certificate may not only attract penalty for false statement under Section 628 and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his negligence in issuing the Compliance Certificate. Therefore, it becomes imperative for the Practising Company Secretary that he exercises great care and caution while issuing the Compliance Certificate and also adheres to the highest standards of professional ethics and excellence in providing his services.

Section 628 of the Companies Act, 1956 deals with penalty for false statements. According to said Section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purpose of any of the provisions of the Act, any person makes a statement

- (a) which is false in any material particular, knowing it to be false, or
- (b) which omits any material fact, knowing it to be material;

he shall, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

In view of this, a Practising Company Secretary will be attracting the penal provisions of Section 628, for any false statement in any material particular or omission of any material fact in the Compliance Certificate. However, a person will be penalised under Section 628 in case he makes a statement, which is false in any material particular, knowing it to be false, or which omits any material fact knowing it to be material.

Answer 1(c)

The company has to issue various types of securities to meet its requirement of funds. The issuance of any kind of security is again subject to the compliances of various Acts, Rules, Regulations and Guidelines. Once the securities have come into existence, the transactions in the securities are also governed by various Acts, Rules, and Regulations. Not only the issuer of the securities but also the holder of the securities are required to comply with the statutory provisions to transact in the securities of the company.

The concept of securities management and compliances thus signifies and includes in its ambit examination, verification or checking of registers, records, forms, returns and documents relating to securities issued by a company and certification of timely and proper compliance of all statutory provisions related to securities applicable to a company.

Thus, securities management and compliances, can provide an umbrella mechanism to ensure better compliances of all the statutory provisions relating to securities by the companies.

The company secretary has a big role to play because it is he who has to ensure the management of securities issued by the company, timely compliance of relevant provision of law applicable to the securities so issued and maintain all records and documents relating to securities issued by the company under the Companies Act, 1956 and other regulations.

Question 2

- (a) *Choose the most appropriate answer from the given options in respect of the following :*
 - (i) *According to SEBI guidelines relating to issue of capital, the draft prospectus is required to be filed with SEBI at least —*
 - (a) *30 days prior to the filing of prospectus with the Registrar of Companies*

- (b) 45 days prior to the filing of prospectus with the Registrar of Companies
 - (c) 60 days prior to the filing of prospectus with the Registrar of Companies
 - (d) 90 days prior to the filing of prospectus with the Registrar of Companies.
- (ii) Retail individual shareholder means a shareholder whose shareholding is not more than —
 - (a) Rs. 1,000
 - (b) Rs.10,000
 - (c) Rs.1,00,000
 - (d) Rs.99,000.
- (iii) Under the Employees' Stock Option Scheme, a director is not eligible to participate in the scheme if he is directly or indirectly holding the equity shares in that company more than —
 - (a) 1% of the issued capital of the company at the time of issuance
 - (b) 2% of the issued capital of the company at the time of issuance
 - (c) 5% of the issued capital of the company at the time of issuance
 - (d) 10% of the issued capital of the company at the time of issuance.
- (iv) The stock exchange may delist such companies which have been suspended for non-compliance with the listing agreement for a minimum period of —
 - (a) 1 month
 - (b) 2 months
 - (c) 3 months
 - (d) 6 months.
- (v) Out of the following, which is not required to be credited to the Investor Education and Protection Fund —
 - (a) Application money received by the company for allotment of any securities and due for refund
 - (b) Matured deposits with the company
 - (c) Matured debentures with the company
 - (d) Matured loans with the company.
- (vi) Section 295 of the Companies Act, 1956 deals with —
 - (a) Appointment of sole selling agents
 - (b) Loans to directors
 - (c) Remuneration to directors
 - (d) Disclosure of interest by directors.

(1 mark each)

- (b) State the circumstances when a company is —
- (i) required to file the return of allotment with the Registrar of Companies; and
 - (ii) not required to file the return of allotment. (2 marks each)
- (c) Distinguish between any two of the following :
- (i) 'Compliance certificate' and 'secretarial audit'.
 - (ii) 'Technical collaboration' and 'financial collaboration' involving foreign investment in India.
 - (iii) 'Global depository receipts' (GDRs) and 'Indian depository receipts' (IDRs). (3 marks each)

Answer 2(a)(i)

- (a) 30 days prior to the filing of prospectus with the Registrar of Companies

Answer 2(a)(ii)

- (c) Rs. 1,00,000

Answer 2(a)(iii)

- (d) 10% of the issued capital of the company at the time of issuance.

Answer 2(a)(iv)

- (d) 6 Months

Answer 2(a)(v)

- (d) Matured loans with the company

Answer 2(a)(vi)

- (b) Loans to director

Answer 2(b)(i)

The return of allotment in e-Form No. 2 has to be filed with the Registrar of Companies within 30 days from the date of allotment in the following cases:

- (a) The company has made any allotment of its shares. If shares were allotted at a discount then relevant documents also to be attached.
- (b) Shares were issued for consideration other than cash.
- (c) Issue of bonus shares
- (d) Allotment in pursuance of the order of the court under section 391/394.

Answer 2(b)(ii)

The return of allotment is not required to be filed:

- (a) In case the allotment of forfeited shares

- (b) Allotment to the subscribers to the Memorandum & Articles of Association.
- (c) Issue of debentures.

Answer 2(c)(i)**Compliance Certificate and Secretarial Audit**

As per Section 383A read with Rule 2 of the Companies (Appointment and Qualifications of Secretary) Rules, 1988, every company having a paid up share capital of rupees 10 lakhs or more and not required to appoint a whole-time Secretary is required to file with the Registrar of Companies, a compliance certificate from a company secretary in practice and also attach a copy of that certificate with the Board's Report. In terms of proviso to Section 383A(1), the Central Government has prescribed the Companies (Compliance Certificate) Rules, 2001 for issue of Compliance Certificate by a practicing company secretary.

Secretarial Audit is wider in ambit and denotes a check on numerous legal compliances and also the process carried out by concerned company. The scope of Compliance Certificate would comprise of certification of the compliance of various requirements under the Companies Act, 1956 where as Secretarial Audit is a much wider term. Secretarial Audit Report should set out in detail the scope of the work, his observations on irregularities noticed, weakness in the policies and procedures etc. Secretarial audit is voluntarily adopted by companies, as a good governance practice.

Answer 2(c)(ii)**Technical collaboration and financial collaboration**

Foreign investment can be taken in the form of technical collaboration/financial collaboration. Financial Collaboration involves Foreign Direct investments in the form of Equity, FCCBs etc. Technical collaboration involves transfer of technology and payment of royalty, technical know-how fee etc. Both forms of investment may take place under automatic route where post facto approval of RBI is obtained when the investment/ payments are within the limits. When it exceeds the specified limits, it requires prior approval of central government.

Answer 2(c)(iii)

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

Global Depository Receipts (GDRs) are negotiable securities issued outside India by a Depository Bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian Bank in India.

Question 3

- (a) *You are working as the whole-time Company Secretary in a large listed company.*

Draft a note to the Audit Committee of the Board highlighting the need for the appointment of Secretarial Auditor in the company. (6 marks)

(b) A foreign company engaged in automobile manufacturing activities is interested in setting-up a branch office in India. As a Company Secretary, advise the foreign company the purposes for which a branch office can be set-up under the Foreign Exchange Management Act, 1999. (6 marks)

(c) Explain the following terms used in takeovers and acquisitions :

(i) Conglomerate merger.

(ii) Reverse merger. (2 marks each)

Answer 3(a)

To

The Audit Committee of the Board of Directors
XYZ Ltd

Need for appointment of Secretarial Auditor

Secretarial audit not only acts as an effective mechanism to ensure that the legal and procedural requirements are duly complied with but also instills professional discipline in the working of the company besides building up the necessary confidence in the state of affairs of the company.

Several industrial and corporate laws need to be complied with by companies, non-compliance of which attracts prosecution. Secretarial Audit has a capability to provide an in-built mechanism for ensuring corporate compliance generally and will specifically help restore this confidence of investors through greater transparency.

Secretarial audit extends professional help to the company in carrying out effective compliances and establishment of proper systems with appropriate checks and balances. Secretarial Audit is inherently useful, especially to small and medium sized companies and in particular, to the professional/nominee directors.

It relieves the company and its directors including the independent/nominee directors, from the consequences of unintended non-compliances of the provisions of the Companies Act and other important corporate laws. It further curbs the tendency on the part of the smaller companies to short cut the procedural requirements which is primarily due to ignorance or lack of professional support. Secretarial audit essentially acts as a pre-emptive check to monitor compliance with requirements of the Companies Act and other important corporate laws.

Secretarial audit also assists the government in ensuring better compliance of law and reduces litigation.

Further, with the growing reliance of companies on institutional finance/working capital from All-India and State level financial corporations and banks, it has become imperative for such agencies to know that the company has complied with the core legislations. Secretarial audit provides the much needed case due to proper maintenance of statutory records and compliance with the legal and procedural requirements.

Secretarial audit not only ensures that the company has complied with the provisions of various laws but also extends professional help to the company in carrying out effective compliance and establishment of proper systems with appropriate checks and balances.

In order to ensure better self-regulation on the part of companies and due compliance with the provision of law, secretarial audit of those companies which are not subject to the production of compliance certificate, is an imperative necessity.

Considering the above facts, it is felt that the appointment of Secretarial auditor is necessary as it would be an effective mitigation measure of regulatory risks.

Answer 3(b)

Purposes for which a branch office can be set up.

Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India for the following purposes:

- Export/Import of goods
- Rendering professional or consultancy services
- Carrying out research work, in which the parent company is engaged.
- Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
- Representing the parent company in India and acting as buying/selling agents in India.
- Rendering services in Information Technology and development of software in India.
- Rendering technical support to the products supplied by the parent/ group companies.
- Foreign Airline/Shipping Company

It may be noted that retail trading activities of any nature is not allowed for a branch office in India.

Answer 3(c)(i)

A conglomerate merger involves coming together of two companies in different industries i.e., the businesses of the two companies are not related to each other, neither horizontally nor vertically. They lack any uniformity either in their end product, or in the rendering of any specific type of service to the society. This is the type of merger of companies which are neither competitors, nor complementaries nor suppliers of a particular raw material nor consumers of a particular product or consumable.

Answer 3(c)(ii)

Reverse merger takes place when a healthy company amalgamates with a financially weak company. In the context of the provisions of the Companies Act, 1956, there is no difference between regular merger and reverse merger. It is like any other amalgamation.

Question 4

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

- (i) _____ is a process of conversion of physical certificates into electronic balances.
- (ii) The orders of SEBI under the securities laws are appealable before _____ .
- (iii) A _____ is a product whose value is derived from the value of underlying asset, index, etc.
- (iv) When a charge on the assets of the company is satisfied, the fact is intimated in Form No. _____ to the Registrar of Companies.
- (v) At the time of opening of a new demat account, the _____ should ensure that the application form has been filled in all respects and the client has been introduced by a well-known person.
- (vi) A company cannot register a transfer unless _____ duly stamped and executed by both the transferor and transferee is delivered to the company. (1 mark each)

(b) While carrying out the secretarial audit of Daisy Ltd., you have found that a resolution was passed by the shareholders authorising the company to buy-back its shares. Intimation regarding the buy-back was also given to the recognised stock exchange in due course. However, no further steps were taken by the company in this regard. Meanwhile, a notice has been received by the company from the Securities and Exchange Board of India holding it guilty for not implementing the resolution of buy-back. Decide whether the company is bound to implement the resolution of buy-back of its shares. (5 marks)

(c) What do you mean by an 'independent director' ? Mention the criteria for considering a director as an independent director ? (5 marks)

Answer 4(a)

- (i) **Dematerialization** is a process of conversion of physical certificates into electronic balances.
- (ii) The orders of SEBI under the securities laws are appealable before **Securities Appellate Tribunal** .
- (iii) A **Derivative** is a product whose value is derived from the value of underlying asset, index, etc.
- (iv) When a charge on the assets of the company is satisfied, the fact is intimated in Form No. **17/e form 17** to the Registrar of Companies.
- (v) At the time of opening of a new demat account, the **Depository Participant** should ensure that the application form has been filled in all respects and the client has been introduced by a well-known person.

- (vi) A company cannot register a transfer unless **Proper instrument of transfer** duly stamped and executed by both the transferor and transferee is delivered to the company.

Answer 4(b)

As per the provisions of Section 77 A and the relevant provisions of the buy-back regulations, it is clear that a company is under no obligation to buy-back its securities even if its shareholders have passed a special resolution authorizing it to buy-back on the terms and conditions mentioned in the resolution. Section 77 A is only an enabling provision and all that it mandates is that no company shall buy-back its own securities unless it is authorized by its Articles and also by its share holders. The next step on the part of the company is to make a public announcement if it wanted to buy-back and the public announcement would then have been the offer which the company would have made to its shareholders. From the Question it seems that it did not come out with a public announcement and consequently, no offer to buy-back was made to the shareholders. It may be noted that failure if any to complete buy-back has to be reported in the Board's report with reasons thereof. Accordingly the same has to be reported in Directors' Report.

Answer 4(c)

Independent Directors are known to bring an objective view in board deliberations. They bring a valuable outside perspective to the deliberations.

'Independent director' means a non-executive director of the company who:

- (a) apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
- (b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
- (c) has not been an executive of the company in the immediately preceding three financial years;
- (d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
 - (i) the statutory audit firm or the internal audit firm that is associated with the company, and
 - (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;
- (f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares.
- (g) is not less than twenty one years of age.

Question 5

- (a) *Jai Hind Ltd. made a public issue of 12 crore shares @ Rs.260 per share. 3 crore shares were offered to retail category of investors. Response of public to the issue was overwhelming and the entire issue was oversubscribed by 4.5 times whereas for the retail category the oversubscription was 6 times. The allotment procedure was finalised as per the SEBI guidelines. Three retail investors Ramesh, Suresh and Tushar who applied for 80 shares, 64 shares and 40 shares respectively, are interested in ascertaining the number of shares likely to be allotted to them. As per the issue document, applications could be made for a minimum of 8 shares and in multiples thereof. What will be their respective actual entitlements ? Explain with reasons. (5 marks)*
- (b) *State the compliances required under the listing agreement regarding publication of financial results in newspapers. (5 marks)*
- (c) *As a Practising Company Secretary, prepare a check-list for the purpose of compliance certificate under section 383A of the Companies Act, 1956 with regard to declaration, payment and transfer of dividend. (6 marks)*

Answer 5(a)

As per allotment procedure, the allotment to retail individual investors would be on proportionate basis i.e. at 1/6 of the total number of shares applied for. The actual entitlement shall be as follows:

<i>Name of Investor</i>	<i>Number of shares applied</i>	<i>Total number of shares eligible to be allotted (No. of shares applied for/6)</i>
R	80	$80/6 = 13.33 =$ rounded off to 13 shares
S	64	$64/6 = 10.66$ rounded off to 11 shares
T	40	$40/6 = 6.66$ rounded off to 7 shares (application of T is liable to be rejected because the entitlement is less than the minimum application size)

Allotment shall be on proportionate basis within specified categories, rounded off to the nearest integer subject to a minimum allotment being equal to the minimum application size as fixed and disclosed by the issuer.

Answer 5(b)

The company shall, within 48 hours of conclusion of the Board or Committee meeting at which the financial results were approved, publish a copy of the financial results which were submitted to the stock exchange in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated.

Where the company has opted to submit audited financial results, it shall also publish the qualifications or reservations, if any, expressed by the auditor together with the audited results.

Where the company has submitted consolidated financial results in addition to stand-alone financial results, it shall have an option to publish either stand-alone financial results or consolidated financial results in the newspapers, subject to the following:

- (i) It shall intimate the stock exchange in the first quarter of the financial year or within such extended period as may be specified by SEBI in this regard and shall not change the same during the financial year;
- (ii) In case the company changes its option in any subsequent year, it shall furnish comparable figures for the previous year in accordance with the option exercised for the current year;
- (iii) It shall give a reference in the newspaper publication, to the places, such as the company's website and stock exchanges' websites, where the standalone results of the company are available.

Answer 5(c)

Checklist for Declaration, payment and transfer of dividend

Check whether:

- (i) dividends were declared out of profits after providing for depreciation according to the provisions of Section 205(2) (unless an exemption in this regard was obtained);
- (ii) specified minimum amount has been transferred to reserves according to the Companies (Transfer of Profits to Reserves) Rules, 1975;
- (iii) board resolution recommending dividend has been passed;
- (iv) the Board has authorised the opening of a separate Bank Account for payment of dividend;
- (v) the amount of dividend including interim dividend was deposited in the separate Bank Account within 5 days from the date of declaration of such dividend;
- (vi) register of members was closed as per the provisions of Section 154;
- (vii) interim dividend, if any, declared by the Board of directors has been confirmed/ noted at the annual general meeting;
- (viii) dividend recommended by the Board was declared at the annual general meeting;
- (ix) dividend warrants were printed, signed and despatched to the registered shareholders within 30 days of declaration;
- (x) permission of Reserve Bank of India, if required was obtained before dividend was remitted to foreigners/non resident Indians;
- (xi) stock exchanges were duly intimated, in case of listed company;
- (xii) voluntary transfer to reserves, if any, was made according to the Companies (Transfer of Profits to Reserves) Rules, 1975;
- (xiii) in case of inadequacy of profits, the Companies (Declaration of Dividends out of Reserves) Rules, 1975, were complied with or previous approval of the

Central Government was obtained, before such declaration by (e-filing) of form pursuant to such rules, duly precertified;

- (xiv) dividends were paid in accordance with Section 206 only to the registered shareholder or his order or to his bankers. In case of a share warrant, dividend has been paid to the bearer of such warrant or to his bankers;
- (xv) unpaid or unclaimed dividend was transferred to the unpaid dividend account within 7 days after the expiry of 30 days from the date of declaration (Section 205A);
- (xvi) amount of dividend remaining unpaid and unclaimed for seven years from the date they became due for payment has been transferred to the Investor Education and Protection Fund, established by the Central Government pursuant to Section 205C and while transferring the amount, the company furnished a statement in the prescribed form under Section 205A(6).
- (xvii) where duplicate dividend warrants were issued, whether indemnity in lieu of dividend warrants lost/defaced were obtained.

Question 6

- (a) *A member of Rosy Ltd. is interested in inspecting and taking copies of minutes of Board meetings and of the annual general meeting held in the year 2008. Draft a suitable reply to be sent to the member. (6 marks)*
- (b) *You are in the process of preparing compliance certificate of Konzept Ltd. You find that a Board resolution has been passed to grant a loan of Rs.80 lakh to another company, Rocket Ltd. The information about Konzept Ltd. as on 31st March, 2009 is as under :*

	<i>Rs. in Lakhs</i>
<i>Paid-up share capital :</i>	
<i>— Equity</i>	50
<i>— Preference</i>	10
<i>General reserves</i>	100
<i>Debentures redemption reserve</i>	5
<i>Loans already given to :</i>	
<i>— Xel Ltd.</i>	5
<i>— Yetin Ltd.</i>	10

Konzept Ltd. has already given a guarantee of Rs.10 lakh to Zohar Ltd.

Prepare a note commenting on the decision of the Board and indicating whether it has complied with the relevant provisions of the Companies Act, 1956. (6 marks)

- (c) *Janta Power Ltd. was incorporated on 30th November, 2008. The certificate of commencement of business was issued by the Registrar of Companies on 31st December, 2008. Explain the provisions of the Companies Act, 1956 regarding holding of statutory meeting by the company. (4 marks)*

Answer 6(a)

The reply would be in the following lines:

The shareholders have no right to see and seek copies of minutes of Board Meeting. However, they can have access to the minutes of general meetings.

Minutes book of general meetings are kept open at the registered office of company during business hours for inspection of members that too without any charge, subject to such reasonable restrictions as the company may by Articles or in general meeting impose.

The copies of minutes of general meetings are to be furnished within 7 days of the receipt of request on payment of Re. 1 for every 100 words or fractional part thereof or such other fee as may be prescribed.

Answer 6(b)

According to Section 372 A of the Companies Act, 1956, a company cannot grant any loans or inter-corporate investment exceeding 60% of its paid up capital and free reserves or 100% of its free reserves, whichever is more.

In the given situation, the position is as under:

Paid up Capital (50+10)	60 Lakh
General Reserves	100 Lakh
Total	<u>160 Lakh</u>

60% of Rs. 160 lakh = Rs. 96 Lakh

100% of Reserves & surplus = 100 Lakh

Therefore, higher of the two i.e. Rs. 100 Lakh will be the overall limit of inter-corporate loans.

The existing loans of the company amount to Rs. 25 lakh (Xel Ltd. 5 lakh, Yetin Ltd. 10 Lakh and Konzept Ltd. Rs. 10 Lakh for guarantee). Hence only upto 75 lakh (100-25 Lakh) can be granted as loan by the company.

If the company wants to give loan as proposed i.e. of Rs. 80 Lakh to another company, it has to pass special resolution in company's general meeting as required under Section 372 A of the Companies Act.

Thus Board of Directors should have complied with the said provisions for grant of loan to another company by passing special resolution.

Answer 6(c)

A company limited by shares and a company limited by guarantee and having a share capital shall, within a period of not less than one month and not more than six months from the date of obtaining certificate of commencement of business hold a

general meeting of the members of the company. This meeting is called the statutory meeting.

The Board of directors shall, at least twenty-one days before the day on which the meeting is held, forward the statutory report to every member of the company. The Act obligatory that the Statutory Report be certified by at least two directors, including the managing director, if there is one, and also by the company's auditors in so far as the report relates to the shares allotted by the company, cash received in respect of the shares and the receipts and payments of the company. The Board of directors must file a copy of the Statutory Report duly certified, with the Registrar of Companies for registration, after copies thereof have been sent to the shareholders of the company.

Further, in accordance with the provisions of Section 171 of the Act, notice for calling every general meeting of a company, including a statutory meeting, must be given at least twenty-one clear days before the meeting unless consent is accorded to a shorter notice by members, holding not less than 95% of such paid-up capital as gives right to vote or not less than 95% of the total voting power exercisable at the meeting. The notice convening the meeting should state it to be the statutory meeting. The Board shall cause a list showing the names, addresses and occupations of the members of the company and the number of shares held by them respectively, to be produced at the commencement of the Statutory meeting. The list shall remain open and accessible to any member of the company during the continuance of the meeting

Failure to hold such a meeting renders the company liable to be wound up under Section 433 (b)

Question 7

(a) Write notes on any two of the following :

- (i) *CEO/CFO certification under listing agreement.*
- (ii) *Pledge of shares held in dematerialised form and the role of depository participant.*
- (iii) *Search and status report on the position of borrowings made by a company. (4 marks each)*

(b) Distinguish between any two of the following :

- (i) *'Friendly takeover' and 'hostile takeover',*
- (ii) *'Share transfer audit' and 'statutory audit',*
- (iii) *'Audit committee' and 'remuneration committee'. (4 marks each)*

Answer 7(a)(i)

As per clause 49(IV)(F) of the listing agreement details the following provisions regarding CEO/CFO certification.

The CEO, i.e. the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e. the whole-time Finance Director or any other

person heading the finance function discharging that function shall certify to the Board that:

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
 - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 - (ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- (d) They have indicated to the auditors and the Audit committee
 - (i) significant changes in internal control over financial reporting during the year;
 - (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
 - (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

Answer 7(a)(ii)

The shares held in dematerialized form can be pledged by clients for the purpose of obtaining loans from banks. For the purpose of creating pledge the Depository Participant should ensure that: (a) an application is submitted by the client (b) notice of pledge should be noted in the records if sufficient balances are available for pledge and forward the application to Depository (c) Depository Participants should inform the pledger as well as pledgee about creation of pledge, on intimation from the depository and (d) The participant shall make note in its records about invocation of pledge.

Answer 7(a)(iii)

Search involves physical inspection of documents and status comprises of reporting of the information as made available by the search. A search report prepared by the company secretary in practice enables the Bank/Financial Institution to evaluate

the extent up to which the company has already borrowed moneys and created charges on the security of its movable and immoveable properties. This information is very vital for considering the company's request for grant of loans and other credit facilities. The search report enables the Bank/Financial Institution to study the credit-worthiness of the borrowing company.

Answer 7(b)(i)

A friendly take over is with the consent of taken over company. There is an agreement between the management of two companies through negotiations and the take over bid may be with the consent of majority or all shareholders of the target company. On the other hand when an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues its efforts to gain control against the wishes of existing management, such acts of acquirer are known as take over raids or hostile take over bids.

The main distinction between a friendly take over and hostile take over is whether there is a mutual understanding between the acquirer and the taken over company. Where there is mutual understanding, it is friendly take over otherwise it is termed as hostile take over.

Answer 7(b)(ii)

Registration of transfer of shares is one area where investors have interaction with the company and also judge its functioning. A company cannot register a transfer unless a proper instrument of transfer duly stamped and executed both by the transferor and transferee is delivered to the company within the time limit laid down in Section 108 of the Companies Act, 1956. SEBI has laid down guidelines to be followed by the listed companies in the matter of processing of transfers and norms for objection to transfer the shares. Share transfer audit involves checking of all the said Acts and guidelines and the said work can be performed by a secretarial auditor who need not be a statutory auditor. On the other hand statutory audit can only be performed by a statutory auditor appointed by the company in the general meeting as provided in Section 224 of the Companies Act, 1956. The statutory auditor has to submit his report to the shareholders of the company in the manner provided in Section 227 of the Act.

Answer 7(b)(iii)

As per clause 49 of the listing agreement, all listed companies shall have a qualified and independent audit committee. The said committee shall meet at least four times in a year and not more than four months shall elapse between two meetings. The audit committee shall have minimum of three directors as members. Two thirds of the members of audit committee shall be independent directors. The Chairman of the Audit Committee shall be an independent director and shall be present at annual general meeting to answer shareholders queries. The company secretary shall act as the secretary to the audit committee. The audit committee shall have powers to investigate any activity within its terms of reference and review the financial statements of the company.

The Board of Directors may set up a remuneration committee to determine on behalf of the board and the shareholders about the remuneration package payable to

the executive directors. The remuneration committee should normally consist of at least three directors all of whom should be non-executive directors. The constitution of remuneration committee is recommendatory under Clause 49.

Question 8

Critically examine and comment on any four of the following :

- (i) *All listed companies are required to ensure minimum level of public shareholding of 25% of the total number of issued shares of a class/kind for the purpose of continuous listing on a recognised stock exchange.*
- (ii) *While the newly inserted provision under section 383A(1) has opened much awaited area of practice for Company Secretaries, it casts onerous responsibility and poses a great challenge to the profession.*
- (iii) *Company Secretary of a listed company, in addition to complying with the provisions of Companies Act, 1956, is also expected to perform certain activities relating to securities laws and compliances.*
- (iv) *Public announcement is not required for inter-se transfers.*
- (v) *The objectives of a legal due diligence exercise may vary from case to case.*
(4 marks each)

Answer 8(i)

All listed company are required to ensure minimum level of public shareholding at 25% of the total member of issued shares of a class or kind for the purpose of continuous listing. However, where the company offers or has in the past offered a particular class or kind of its shares to the public to the extent of at least 10% of the issue size in terms of Rule 19(2)(b) of the Securities Contracts (Regulations) Rules, 1957, it has to maintain on a continuous basis, public shareholding of at least 10% of the total number of issued shares of such class or kind. Further, where the number of outstanding listed shares of any class or kind of the company are two crore or more and the market capitalization of such company in respect of shares of such class or kind is Rs. 1000 crore or more, it has to maintain on a continuous basis, public shareholding of at least 10% of the total number of issued shares of such class or kind

Answer 8(ii)

As per Section 383 (A)(1) Companies having paid up capital of 10 lacs or more are not required to appoint whole time secretary should obtain compliance certificate as to compliance of provisions of the Companies Act from a Practising Company Secretary.

While issuing the certificate the Company Secretary should exercise great diligence and care. Any failure or lapse on the part of the company secretary will:

- (a) attract penalty under Section 628 of the Companies Act for false statement omission of material particulars involve imprisonment which may extend to 2 years and fine.
- (b) attract disciplinary action for professional misconduct under Company Secretaries Act 1980
- (c) make him liable to third parties for injury caused to them due to negligence.

Answer 8(iii)

As Compliance Officer, the company secretary of a listed Company is liable to perform certain activities relating to securities laws and compliances in addition to the Companies Act, 1956, as a Compliance officer. It includes maintenance, examination, verification of registers, records, returns and other documents relating to securities issued by a company and ensuring of timely and proper compliance various Acts and Regulations. Company Secretary has to do certain activities like:

- Publication of financial results
- Compliance with SEBI & Listing Agreement
- Intimations/Disclosures to Stock Exchanges/SEBI.
- Implementation of Employees Stock Option Scheme
- Cautious about takeovers
- Watch on Stock Price Movements
- Watch on Insider Trading
- Take steps to prevent money laundering
- As Compliance Officer certify to stock exchanges.

Answer 8(iv)

SEBI (SAST) Regulations, 1997 requires the acquirer to make a public announcement and a public offer on acquisition of a certain percentage of shares or voting rights in a company. However, certain circumstances have been provided in regulation 3, subject to which if an acquirer acquires the specified percentage of shares or voting rights, he would be exempted from the requirement of making an open offer to the existing shareholders of the company. It exempts inter se transfer of shares amongst certain specified groups.

Answer 8(v)

A legal due diligence is scrutiny of all, or specific parts, of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision, with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters. It also improves the buyer's bargaining position and ensures that necessary precautions are taken in relation to the transaction proposed.

The objectives of a legal due diligence exercise may vary from case to case. However some of the common objectives in most of the cases would be as follows:

1. Gathering of information from the target company.
 2. Uncovering of the risks of target company through a SWOT analysis.
 3. Improving the bargaining position.
 4. Cost benefit analysis.
 5. Effect of risk and liability on the cost of the transaction.
 6. Mapping of compliance requirements of the target company and the actual status.
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GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

PART A

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

Question 1

- (a) *In United Kingdom, the Combined Code on Corporate Governance of 2008 is the result of studies made from time to time by various committees to prevent the recurrence of scandals and financial collapses experienced in 1980s and early 1990s, when Cadbury Committee was first set-up in 1992 which gave a new dimension to the Corporate Governance.*

List out the three important recommendations made by Cadbury Committee and outline atleast five major landmarks in the historical development since the setting-up of the Cadbury Committee for improvement in the Corporate Governance. (10 marks)

- (b) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *All non-executive directors are independent directors.*
 - (ii) *Compliance Management Committee is compulsory under clause 49 of the listing agreement.*
 - (iii) *The Sarbanes-Oxley Act, 2002 is applicable to listed companies in India.*
 - (iv) *Enron debacle led to the appointment of Naresh Chandra Committee in 2002.*
 - (v) *Shareholders activism played a major role in eradicating apartheid in South Africa through divestment. (1 mark each)*
- (c) *Choose the most appropriate answer from the given options in respect of the following :*
- (i) *The mechanism for employees to report certain events to the management, like—unethical behaviour, suspected fraud or violation of the company's code, is known as —*
 - (a) *Whistle Blower Policy*
 - (b) *Surveillance action*
 - (c) *Market abuse*
 - (d) *Snap investigation.*
 - (ii) *Out of the following, which is an institutional investor group —*
 - (a) *Foreign Institutional Investors*
 - (b) *Mutual funds*
 - (c) *Banks and financial institutions*
 - (d) *All the above.*

- (iii) *Out of the following, which is a Corporate Social Responsibility (CSR) reporting framework —*
- (a) *CSR 1982*
 - (b) *SA 8000*
 - (c) *MCA-21*
 - (d) *SA 800.*
- (iv) *A person can hold office of director of the public companies at the same time in —*
- (a) *Not more than 20 companies*
 - (b) *Not more than 11 companies*
 - (c) *Not more than 15 companies*
 - (d) *Any number of companies.*
- (v) *Remuneration Committee is appointed for the purpose of recommending remuneration of —*
- (a) *Chief Executive Officer*
 - (b) *Managing Director*
 - (c) *Whole-time Director*
 - (d) *All the above.*
- (1 mark each)*

Answer 1(a)

Historical developments in the UK for the improvement in corporate governance since the setting of Cadbury Committee are as under:

- (i) The Cadbury Report 1992;
- (ii) The Greenbury Report, 1995;
- (iii) The Hampel Report 1998
- (iv) The Turnbull Report;
- (v) Higgs Report
- (vi) Smith Report;
- (vii) The Tyson Report
- (viii) The combined code on Corporate Governance as revised in 2003;
- (ix) The combined Code of Corporate Governance, 2006, and;
- (x) The combined Code on Corporate Governance 2008;
- (i) *The Cadbury Report 1992*

Due to several scandals and financial collapses in the UK in the late 1980s and early 1990s, London Stock Exchange set up the Cadbury Committee in May 1991 to raise the standard of corporate governance for preventing such scandals

and financial collapses in future. This Committee, in its report known as 'Cadbury Report, recommended mainly :

- Separating the role of CEO and Chairman of the Board
- Balanced composition of Board of Directors with executive and non-executive directors.
- Selection process for non-executive directors.

(ii) *The Greenbury Report 1995*

The Confederation of British Industry set up a group under the Chairmanship of Sir Richard Greenbury to examine the remuneration of the directors. It recommended the formation of Remuneration Committee composed of non-executive directors. Its recommendations were incorporated in the Listing Rules of the London Stock Exchange.

(iii) *The Hampel Report 1998*

The Hampel Committee was set up to review the implementation of Cadbury and Greenbury Reports and to see that their purposes were being achieved. The recommendations of this committee coupled with further consultations by the London Stock Exchange resulted in a Combined Code on Corporate Governance – the original Combined Code, 1998.

(iv) *The Turnbull Report*

A working group under the chairmanship of Nigel Turnbull recommended the Internal Control Guidance for Directors which were included in the combined code.

(v) *Higgs Report*

The Combined Code was reviewed in July 2002 by Derek Higgs about the role and effectiveness of non-executive directors.

(vi) *Smith Report*

A group under the chairmanship of Sir Robert Smith was set up to develop Guidance for Audit Committee in the Combined Code.

(vii) *The Tyson Report*

The Tyson Report was commissioned on the recruitment and development of non-executive directors.

(viii) *The Combined Code on Corporate Governance as revised in 2003*

On the basis of recommendations of all the reports the Combined Code was revised in 2003

(ix) *The Combined Code on Corporate Governance 2006*

The Combined Code on Corporate Governance was again revised in 2006.

(x) *The Combined Code on Corporate Governance 2008*

The Combined Code on Corporate Governance 2008 sets out standards of good practice in relation with shareholders. All companies incorporated in the UK and listed on the London Stock Exchange are required to report in their annual reports and accounts about the implementation of the combined code on Corporate Governance .

Answer 1(b)(i)

Incorrect

Non-executive directors may or may not be independent directors

Answer 1(b)(ii)

Incorrect

Corporate Compliance Committee is not amongst the mandatory committees which have to be constituted by a listed entity to which clause 49 of the Listing Agreement is applicable. The mandatory committees are, Audit Committee and Shareholders Grievance Committee.

Answer 1(b)(iii)

Incorrect

This Act was passed in the United States and is applicable to companies listed in the US.

Answer 1(b)(iv)

Correct

The Enron debacle of 2001 involving the hand-in-glove relationship between the auditor and the corporate client, the scams involving the fall of the corporate giants were some important factors which led the Indian Government to wake up and in the year 2002, Naresh Chandra Committee was appointed to examine and recommend inter alia amendments to the law involving the auditor-client relationships and the role of independent directors.

Answer 1(b)(v)

Correct

Shareholder activism played a major role in eradicating apartheid in South Africa through divestment.

Answer 1(c)(i)

(a) Whistle Blower Policy.

Answer 1(c)(ii)

(d) All the above.

Answer 1(c)(iii)

(b) SA 8000.

Answer 1(c)(iv)

- (c) Not more than 15 companies.

Answer 1(c)(v)

- (d) All the above.

Question 2

- (a) Write short notes on the following :

- (i) *Rules vs. principles*
(ii) *Parties to corporate governance.*

(3 marks each)

- (b) Expand the following abbreviations :

- (i) *OECD*
(ii) *NFCG*
(iii) *COSO*
(iv) *ASSOCHAM.*

(1 mark each)

- (c) Draw a comparison between section 292A of the Companies Act, 1956 and clause 49 of the listing agreement with regard to composition of the audit committee.

(5 marks)

Answer 2(a)(i)***Rules v. Principles***

Rules are written prescriptions for conduct or action and are absolute. Principles, on the other hand, provides a guidance of acceptable actions that are fair and equitable.

Under rules-based governance, companies must comply with a specific set of procedural requirements, a checklist of what to do and what not to do. Under a principles-based regime, however, corporate behavior is guided by a focus on end results. This approach emphasizes “doing the right thing,” by whatever means the company’s leadership feels most appropriate.

Rules are typically thought to be simpler to follow than principles, demarcating a clear line between acceptable and unacceptable behaviour. Rules also reduce discretion on the part of individual manager or auditors.

Hon’ble Supreme Court of India in a case of Bajaj Auto Limited, defined the discretion as proper adoption of the rules.

In practice rules can be more complex than principles. They may be ill equipped to deal with new types of transaction not covered by the Code. Moreover, where clear rules are followed one can still find a way to circumvent their underlying purpose. This is harder to achieve if one is bound by broader principles.

Principles are a form of self regulation. They allow the respective sector to determine what standards are acceptable or unacceptable. It also pre-empts over zealous legislations that might not be practical.

Answer 2(a)(ii)**Parties to corporate governance**

The Board of Directors play a central role in ensuring good governance in a corporate. In a business context, those who have a “stake” or claim in some aspect of a company’s products, operations, markets, industry, and outcomes are known as stakeholders. The various stakeholders of a corporate are all parties to corporate governance. The stakeholders of a corporate include its employees, shareholders, suppliers, vendors, customers, creditors, regulators, government/s and the community at large. These groups are influenced by business, and they also have the ability to affect the business.

Answer 2(b)(i)

OECD – Organisation for Economic Co-operation and Development.

Answer 2(b)(ii)

NFCG – National Foundation for Corporate Governance.

Answer 2(b)(iii)

COSO – Committee of Sponsoring Organization of the Tread way Commission.

Answer 2(b)(iv)

ASSOCHAM – Associated Chambers of Commerce and Industry.

Answer 2(c)**Comparison between Clause 49 and Section 292A of the Companies Act, 1956**

<i>Requirements of Clause 49</i>	<i>Requirements of Section 292A of Companies Act</i>
Applicable to all listed companies with paid-up capital of more than Rs.3 Cr or Networth greater than Rs. 25 Cr at any time in the history of the company and to companies seeking listing	Applicable to public companies with paid-up capital greater than Rs.5 Cr
2/3rd of the directors shall be independent directors	Members shall be other than managing or whole-time directors i.e. members shall be non-executive directors.
All members shall be financially literate and at least one member shall have accounting expertise	No corresponding requirement
“independent” director can be Chairman	Any member of Audit Committee can be Chairman
Auditors, internal auditor & director-finance or other executives may be present as invitees	Auditors, internal auditor & the director-finance shall attend & participate at meetings of Audit Committee but shall not vote
Company secretary to be secretary of the Audit Committee	No corresponding requirement

Question 3

- (a) *What are the major legislations/regulations/guidelines dealing with transparency and disclosures by companies ?* (5 marks)
- (b) *Discuss in brief some of the main Corporate Social Responsibility (CSR) Reporting Frameworks.* (5 marks)
- (c) *What is 'risk management process' ? What are the four steps in risk management?* (5 marks)

Answer 3(a)

The following are some of the major legislations on transparency and disclosure:

1. Companies Act, 1956

In terms of Companies Act, 1956 the aspect of disclosure and transparency spans over several sections. Some of the major disclosures contemplated in terms of Companies Act include the Balance sheet, profit and loss account, Board's Report, Auditor's Report, Annual Return and the various filings with ROC.

With the e-filing of forms with the Registrar of Companies, The Ministry of Corporate Affairs has put in place a mechanism that is imaginative, technologically savvy and stakeholder friendly. Through the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance, the MCA aims at moving from paper based to nearly paperless environment.

2. Listing Agreement In terms of the Listing Agreement several clauses deal with disclosure. The following are some of the clauses dealing with disclosure – Clauses 19, 22, 29, 30, 31, 32, 35, 36, 41. Clause 49 of the listing agreement deals with Corporate Governance and mandates various disclosures like remuneration to directors, directors' attendance in board, committee and Annual General Meetings, Management Discussion and Analysis Report, etc.
3. (Erstwhile) SEBI (DIP) Guidelines 2000 (now Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.
4. SEBI (SAST) Regulations, 1997.
5. SEBI (Prohibition of Insider Trading) Regulations, 2002.
6. Securities Contract (Regulations) Act, 1956.

Answer 3(b)

The following are some of the main standards for social, ethical and environmental reporting currently in use internationally:

The AA 1000 - framework developed by the Institute of Social and Ethical Accountability provides a standard for social and ethical accounting, auditing and reporting, including mandatory external verification and stakeholder engagement.

The Social Accountability - SA 8000 is an international standard for social accountability initiated by Council on Economic Priority Accreditation Agency (CEPAA) conventions, the Universal Declaration on human rights and the Child. SA 8000 seeks to provide transparent, measurable and verifiable performance standards in the areas of child labour; forced labour; health and safety; compensation; working hours; discrimination; discipline; free association and collective bargaining; and management systems.

The Good Corporation - global standard of corporate social responsibility developed by the Institute of Business Ethics. This covers fairness to employees, suppliers, customers and providers of finance; contributions to the community; and protection of the environment. Company performance is assessed annually by an independent verifier.

The UN Global Compact

The Global Compact is a voluntary corporate citizenship initiative with two objectives:

“Making the Global Compact and its principles part of business strategy and operations.”

“Facilitating cooperation among key stakeholders and promoting partnerships in support of U.N. goals.”

The Global Compact's ten principles in the areas of human rights, labour, the environment and anti-corruption.

The OECD Guidelines for Multinational enterprises - set out recommendations for responsible business conduct in employment and industrial relations; human rights; the environment; information disclosure; competition; taxation; science and technology; combating bribery; and protection of consumer interests. They are not legally binding and there is no requirement for reporting or external measurement. (www.oecd.org/daf/investment/guidelines)

Answer 3(c)

Risk Management Process

Risk management is a structured, consistent and continuous process, applied across the organisation for the identification and assessment of risks, control assessment and exposure monitoring.

The objectives of the Company's risk management framework comprises the following:

- To identify, assess, prioritize and manage existing as well as new risks in a planned and coordinated manner.
- To increase the effectiveness of internal and external reporting structure.
- To develop a risk culture that encourages employees to identify risks and associated opportunities and respond to them with appropriate actions.

Steps in Risk Management

The process of risk management consists of four logical and sequential steps as under:

- (i) Identification of risk.
- (ii) Evaluation/measurement of risks.
- (iii) Handling of risks.
- (iv) Implementation of risk management decisions.

Question 4

(a) *What are the legal remedies available in India for the redressal of the following complaints :*

- (i) *Delay in refund of application money;*
- (ii) *Delay in transfer of securities;*
- (iii) *Insider trading of shares;*
- (iv) *Delay in payment of dividend; and*
- (v) *Delay in re-payment of deposits.*

(5 marks)

(b) *Discuss briefly the role of directors in the good corporate governance.*

(5 marks)

(c) *What are the principles of corporate governance as evolved by the ICSI ?*

(5 marks)

Answer 4(a)(i)**Delay in refund of excess application money or allotment letters**

Section 73 of the Companies Act, 1956 provides for payment of interest for the period beyond 70 days from the closure of subscription list @ 15 percent

Answer 4(a)(ii)**Delay in Transfer of Shares**

Section 113 of the Companies Act, 1956 provides a time limit of 60 days provided for effecting transfer. If default is made every officer of the company who is in default shall be liable to fine which may extend to Rs.5000 for every day during which the default continues.

As per listing agreement the time limit is 30 days.

Answer 4(a)(iii)

Insider Trading, rigging and other mal practices

Investors can make complaints to SEBI for the violation of SEBI (Prohibition of Insider Trading) Regulations, 1992

Answer 4(a)(iv)

Section 207 of the Companies Act, 1956 casts an obligation on the company to pay dividend within 30 days from its declaration. In case of default every director who is party to the default is punishable with imprisonment and fine of Rs.1000/- for each day the default continues.

Answer 4(a)(v)

In terms of Section 58A (9) of the Companies Act, 1956 where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of its acceptance, the Company Law Board may on its own motion or an application by a depositor direct the company to make the repayment of the deposit.

In terms of Section 58AAA any offence arising out of acceptance of deposit is a cognizable offence under Code of Criminal Procedure 1973.

Answer 4(b)

The Board of Directors play a pivotal role in ensuring good governance. The contribution of directors on the Board is critical to the way a corporate conducts itself. The responsibilities of the directors and the Board derive from law, custom, tradition and current practice. In the present times, transparency, disclosure, accountability, issues of sustainability, corporate citizenship, globalization are some of the concerns that the Boards interlocks. The Boards today have to respond to the explosive demands of the marketplace. The contribution of directors on the Board of companies is critical for ensuring appropriate directions with regard to leadership, vision, strategy, policies, monitoring, supervision, accountability to shareholders and other stakeholders, and to achieving greater levels of performance on a sustained basis as well as adherence to the best practices of corporate governance.

Directors have the ultimate responsibility for the longer-term prosperity of the company. They are required in law to apply skill and care in exercising their duty to the company and are subject to fiduciary duties. If they are in breach of their duties or act improperly, directors may be made personally liable in both civil and criminal law.

Directors are accountable to the shareholders for the company's performance and can be removed from office by them or the shareholders can pass a special resolution requiring the Directors to act in a particular way. Directors act as "Fiduciaries" of the shareholders and should act in their best interests but also taking into account the best interests of the company as a whole (as a separate legal entity) and the other stakeholders.

Directors have a key role in the determination of the value and ethical position of the company.

Answer 4(c)

The principles of corporate governance evolved by the ICSI are as under:

- Sustainable development of all stakeholders – to ensure growth of all individuals associated with or affected by the enterprise on sustainable basis.
- Effective management and distribution of wealth – to ensure that enterprise creates maximum wealth and judiciously uses the wealth so created for providing

maximum benefits to all stakeholders and enhancing its wealth creation capabilities to maintain sustainability.

- Discharge of social responsibility – to ensure that enterprise is acceptable to the society in which it is functioning.
- Application of best management practices – to ensure excellence in functioning of enterprise and optimum creation of wealth on sustainable basis.
- Compliance of law in letter and spirit – to ensure value enhancement for all stakeholders guaranteed by the law for maintaining socio-economic balance.
- Adherence to ethical standards – to ensure integrity, transparency, independence and accountability in dealings with all stakeholders.

PART B

(Answer ANY TWO questions from this part)

Question 5

- (a) *“Ethics in business is simply the application of moral or ethical norms to business.” Explain and discuss the advantages of business ethics. (5 marks)*
- (b) *Write notes on any two of the following :*
- (i) *Enlightened-egoism*
 - (ii) *Ethics in compliance*
 - (iii) *Social and ethical accounting. (5 marks each)*

Answer 5(a)

Business ethics is a form of applied ethics. In broad sense ethics in business is simply the application moral or ethical norms to business. Ethics is a set of principles or standards of human conduct that govern the behavior of individuals or organizations. Using these ethical standards, a person or a group of persons or an organization regulate their behavior to distinguish between what is right and what is wrong as perceived by others.

The advantages of business ethics include :

1. *Attracting and retaining talent*

People aspire to join organizations that have high ethical values. Companies are able to attract the best talent and an ethical company that is dedicated to taking care of its employees will be rewarded with employees being equally dedicated in taking care of the organization. Ethical organizations create an environment that is trustworthy, making employees willing to rely, take decisions and act on the decisions and actions of the co-employees. In such a work environment, employees can expect to be treated with respect and consideration for their colleagues and superiors. It cultivates strong teamwork and productivity and support employee growth.

2. *Investor Loyalty*

Investors are concerned about ethics, social responsibility and reputation of the company in which they invest. Investors are becoming more and more aware that an ethical climate provides a foundation for efficiency, productivity and

profits. Relationship with any stakeholder, including investors, based on dependability, trust and commitment results in sustained loyalty.

3. *Customer satisfaction*

Customer satisfaction is a vital factor in successful business strategy. Repeat purchases/orders and enduring relationship of mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company that adopts ethical practices. When a company because of its belief in high ethics is perceived as such, any crisis or mishaps along the way is tolerated by the customers as a minor aberration. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified ensuring that organizational behaviors are aligned with those values. An organization with a strong ethical environment places its customers' interests as foremost. Ethical conduct towards customers builds a strong competitive position. It promotes a strong public image.

Answer 5(b)(i)

Enlightened-egoism

This model takes into account harms, benefits and rights. Therefore, under this model an action is morally correct if it increases benefits for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company's providing the scholarship benefits the needy students, but ultimately it is in the company's self interest.

Answer 5(b)(ii)

Ethics in Compliance

Compliance is about obeying and adhering to rules and authority. The motivation for being compliant could be to do the right thing out of the fear of being caught rather than a desire to be abiding by the law. An ethical climate in an organisation ensures that compliance with law is fuelled by a desire to abide by the laws. Organisations that value high ethics comply with the laws not only in letter but go beyond what is stipulated or expected of them.

Answer 5(b)(iii)

Social and ethical accounting

It is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company's values to the development of policies and performance targets and to the assessment and communication of performance.

Social and ethical accounting has no standardized model. There is no standardized balance sheet or unit of currency. The issues are defined by the company's values and by the interests and expectations of its stakeholders, and societal norms and regulations.

With the focus on the concerns of society, the social and ethical accounting framework implicitly concerns itself with issues such as economic performance, working conditions, environmental and animal protection, human rights, fair trade and ethical trade, human resource management and community development, and hence with the sustainability of a company's activities.

Question 6

- (a) *What is the role of Board of directors in ethical management of a company ?*
(5 marks)
- (b) *Discuss 'ethics programme'. Set-out the relevant provisions in clause 49 of the listing agreement.*
(5 marks)
- (c) *What is the significance of organisation structure in business ethics ?*
(5 marks)

Answer 6(a)

The board of directors hold the ultimate responsibility for their firm's success or failure, as well as for ethics of their actions. As has been stated earlier the ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. The directors on a company's board assume legal responsibility for the firm's resources and decisions. Board members have a fiduciary duty, i.e. a position of trust and confidence. Due to globalization, the role of the media, technology are revolutionizing the nature and speed of communication, directors are feeling greater demands for accountability and transparency. This calls for ethical decision making and providing an ethical decision making framework.

The perspective and independent judgement of independent directors can be helpful in determining a company's approach towards ethical issues and stakeholder interests. Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A Report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight of ethics programme by a Board:

- Designation of a Board committee to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees' annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethics breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

Answer 6(b)

Ethics Programme

A company must have an effective ethics program to ensure that all employees understand its values and comply with the policies and codes of conduct that create its ethical climate.

Two types of control systems can be created.

Compliance Orientation Programme : A compliance orientation creates order by requiring that employees identify with and commit to specific required conduct. It uses legal terms, statutes, and contracts that teach employees the rules and penalties for non-compliance.

Values Orientation : Values Orientation strives to develop shared values. Although penalties are attached, the focus is more on an abstract core of ideals such as respect and responsibility. Instead of relying on coercion, the company's values are seen as something to which people willingly aspire.

Most companies begin the process of establishing organizational ethics programs by developing codes of conduct. **Codes of conduct** are formal statements that describe what an organization expects of its employees

Corporate codes of conduct/ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

In India, Clause 49 of the Listing Agreement requires that

- (i) The Board shall lay down a code of conduct for all Board members and senior management of the company. The code of conduct shall be posted on the website of the company.
- (ii) All Board members and senior management personnel shall affirm compliance with the code on an annual basis. The Annual Report of the company shall contain a declaration to this effect signed by the CEO.

Explanation : For this purpose, the term "senior management" shall mean personnel of the company who are members of its core management team excluding Board of Directors. Normally, this would comprise all members of management one level below the executive directors, including all functional heads.

Answer 6(c)

An organization's structure is important to the study of business ethics. In a **Centralized organization**, decision-making authority is concentrated in the hands of top-level managers, and little authority is delegated to lower levels. Responsibility, both internal and external, rests with top management. This structure is especially suited for organizations that make high-risk decisions and whose lower-level managers are not highly skilled in decision making. It is also suitable for organizations in which production processes are routine and efficiency is of primary importance.

These organizations are usually extremely bureaucratic, and the division of labour is typically very well defined. Each worker knows his or her job and what is specifically expected, and each has a clear understanding of how to carry out assigned tasks. Centralized organizations stress formal rules, policies, and procedures, backed up with elaborate control systems. Their codes of ethics may specify the techniques to be used for decision making.

Because of their top-down approach and the distance between employee and decision maker, centralized organizational structures can lead to unethical acts. If the centralized organization is very bureaucratic, some employees may behave according to “the letter of the law” rather than the spirit.

In a **decentralized organization**, decision-making authority is delegated as far down the chain of command as possible. Such organizations have relatively few formal rules, and coordination and control are usually informal and personal. They focus instead on increasing the flow of information. As a result, one of the main strengths of decentralized organizations is their adaptability and early recognition of external change. With greater flexibility, managers can react quickly to changes in their ethical environment. Weakness of decentralized organizations is the difficulty they have in responding quickly to changes in policy and procedures established by top management. In addition, independent profit centers within a decentralized organization may deviate from organizational objectives.

Question 7

- (a) *“The code of conduct of a company sets for the legal and ethical standards of conduct for its directors and its employers.” Discuss and list out the important contents of the code of conduct of a company. (7 marks)*
- (b) *Discuss briefly the Clarkson principles of stakeholder management. (4 marks)*
- (c) *Explain briefly the following :*
 - (i) *Virtue Ethics Theory*
 - (ii) *The Caux Round Table. (2 marks each)*

Answer 7(a)

Code of conduct or what is popularly known as Code of Business Conduct contains standards of business conduct that must guide actions of the Board and senior management of the Company.

The Code may include the following:

- (a) Company Values.
- (b) Avoidance of conflict of interest.
- (c) Accurate and timely disclosure in reports and documents that the company files before Government agencies, as well as in Company’s other communications.
- (d) Compliance of applicable laws, rules and regulations including Insider Trading Regulations.
- (e) Maintaining confidentiality of Company affairs.
- (f) Non-competition with Company and maintaining fair dealings with the Company.
- (g) Standards of business conduct for Company’s customers, communities, suppliers, shareholders, competitors, employees.
- (h) Prohibition of Directors and senior management from exploiting corporate opportunities for themselves or their families.

- (i) Review of the adequacy of the Code annually by the Board.
- (j) No authority of waiver of the Code for anyone should be given.

The Code of Conduct for each Company summarises its philosophy of doing business.

Although the exact details of this code are a matter of discretion, the following principles have been found to occur in most of the companies:

- Use of company's assets;
- Avoidance of actions involving conflict of interest;
- Avoidance of compromising on commercial relationship;
- Avoidance of unlawful agreements;
- Avoidance of offering or receiving monetary or other inducements;
- Maintenance of confidentiality;
- Collection of information from legitimate sources only.
- Safety at workplace
- Maintaining and Managing Records
- Free and Fair competition
- Disciplinary actions

Answer 7(b)

The Clarkson Principle of Stakeholder Management

Max Clarkson (1922-1998) founded the Centre for Corporate Social Performance and Ethics in the Faculty of Management, now the Clarkson Centre for Business Ethics & Board Effectiveness, or CC(BE) 2. The Clarkson Principles emerged from a project undertaken by the Centre for Corporate Social Performance and Ethics :

Principle 1 : Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

Principle 2 : Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

Principle 3 : Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

Principle 4 : Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

Principle 5 : Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.

Principle 6 : Managers should avoid altogether activities that might jeopardize

inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7: Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer 7(c)(i)

Virtue Ethics theory is a branch of moral philosophy that emphasizes character, rather than rules or consequences, as the key element of ethical thinking. An example of this – when a person of good standing is found possessing a valuable article belonging to someone else it will be presumed that the article was loaned to him or kept with him for safe-keeping, whereas if it were in the possession of a person of doubtful or dubious character it would be presumed that he has stolen the article.

Answer 7(c)(ii)

The Caux Round Table

The Caux Round Table (CRT) is based on the belief that the world business community should play an important role in improving economic and social conditions. As a statement of its aspirations, it developed a document that aims to express a world standard against which business behavior can be measured.

The CRT Principles for Business articulate a comprehensive set of ethical norms for businesses operating internationally or across multiple cultures. These principles are rooted in two basic ethical ideals: kyosei and human dignity. The Japanese concept of “kyosei” means living and working together for the common good enabling cooperation and mutual prosperity to coexist with healthy and fair competition.

PART C

Question 8

Attempt any four of the following :

- (i) *What is the difference between ‘sustainable development’ and ‘corporate sustainability’. List out four fundamental principles of sustainable development agreed in the United Nations Conference on Environment and Development (UNCED), 1992.*
- (ii) *Discuss the significance of ‘shareholders inclusiveness’ in sustainability reporting.*
- (iii) *Write a note on ‘Agenda-21’.*
- (iv) *Discuss briefly the principle of absolute liability with the help of rule laid down in Rylands vs. Fletcher.*
- (v) *Discuss river water pollution citing at least one decision of the Supreme Court of India.* (5 marks each)

Answer 8(i)

Sustainable development is a broad concept that balances the need for economic growth with environmental protection and social equity. It is a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations. Sustainable development is a broad concept and it combines economics, social justice, environmental science and management, business management, politics and law.

Corporate sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability describes business practices built around social and environmental considerations.

It encompasses strategies and practices that aim to meet the needs of stakeholders today while seeking to protect, support and enhance the human and natural resources that will be needed in the future.

The four fundamental Principle of Sustainable Development agreed by the United Nations Conference on Environment and Development (UNCED) are:

1. *Principle of Intergenerational equity* : need to preserve natural resources for future generation.
2. *Principle of sustainable use* : use of natural resources in a prudent manner without or with minimum tolerable impact on nature.
3. *Principle of equitable use or intergenerational equity* : Use of natural resources by any state / country must take into account its impact on other states.
4. *Principle of integration* : Environmental aspects and impacts of socio-economic activities should be integrated so that prudent use of natural resources is ensured.

Answer 8(ii)

Companies generally consider the interests of the shareholders as the foremost. However, they should take into account other stakeholders interests also.

Stakeholders are entities or individuals that can reasonably be expected to be significantly affected by the organization's activities, products and/or services. Stakeholders' actions are also reasonably expected to affect the ability of the organization to successfully implement its strategies and meet its objectives. This included entities or individuals whose rights under law or international conventions provide them with legitimate claims vis-à-vis the organization.

Stakeholders engagement activities are an important tool in this direction. These may include for example, stakeholder engagement for the purpose of compliance with internationally agreed standards, or informing ongoing organizational / business processes. Organizations can also use other means such as the media, the scientific community, or collaborative activities with peers and stakeholders.

‘The reporting organization should identify its stakeholders and explain in its report how it has responded to their reasonable expectations and interests’

The GRI guidance requires organization to document the stakeholder engagement processes. This will make the sustainability report assurable.

When stakeholder engagement processes are used for reporting purpose, they should be based on systematic or generally accepted approaches, methodologies or principles. The idea is to develop a proper understanding of the stakeholder information needs. “The reporting organization should document its approach for defining which stakeholders it engaged with, how and when it engaged with them, and how engagement has influenced the report content and the organization’s sustainability activities”

Answer 8(iii)

Agenda 21 – a blueprint for sustainable development into the 21st Century which was agreed during the “Earth Summit” at Rio in 1992, and signed by 179 Heads of State and Government.

Agenda 21 is a guide for individuals, businesses and governments in making choices for development that help society and the environment. Agenda 21 deals with

1. *Social and economic dimensions* : developing countries; poverty; consumption patterns; population; health; human settlements; integrating environment and development.
2. *Conservation and management of resources* : atmosphere; land; forests; deserts; mountains; agriculture; biodiversity; biotechnology; oceans; fresh water; toxic chemicals; hazardous radioactive and solid waste and sewage.
3. *Strengthening the role of major groups* : women; children and youth; indigenous peoples; non-governmental organisations; local authorities; workers; business and industry; farmers; scientists and technologists.
4. *Means of implementation* : finance; technology transfer; science; education; capacity-building; international institutions; legal measures; information.

Answer 8(iv)

In the past all actions for environmental torts against companies and industries were governed by the principle of strict liability. Strict liability means liability without fault i.e., without intention or negligence. In other words, the defendant is held liable without fault. Absolute liability for the escape of impounded waters was first established in England during the mid-nineteenth century in the case of *Rylands v. Fletcher*, (1868) LR 3 330.

The liability under this rule is strict and it is no defence to say that the thing escaped without that person’s willful act, default or neglect or even that he had no knowledge of its existence. The House of Lords, however, added a rider to the above statement stating that – this rule applies only to non-natural user of the land and it does not apply to things naturally established on the land or where the thing escaped due to an act of God or an act of stranger or the default of the person injured or where the thing which escapes is present by the consent of the person injured or in certain cases where there is statutory authority.

Answer 8(v)

Leather industry is one of the three major industries besides paper and textiles, consuming large quantities of water for processing of hides and skins into leather. Naturally

most of the water used is discharged as waste water containing putrescible organic and toxic inorganic materials which when discharged as such will deplete dissolved oxygen content of the receiving water courses resulting in the death of all aquatic life and emanating foul odour. The M.C. Mehta v. Union of India [AIR 1988 SC 1037] also known as the Kanpur Tanneries or Ganga Pollution case is among the most significant water pollution case. Detailed scientific investigations and the reports were produced before the Court as evidence. The alarming details given by M.C. Mehta about the extent of pollution in the river Ganga due to the inflow of sewage from Kanpur only, the Court came down heavily on the Nagar Mahapalika (Municipality) and emphasised that it is the Nagar Mahapalika of Kanpur that has to bear the major responsibility for the pollution of the river near Kanpur city.
