

**PROFESSIONAL PROGRAMME EXAMINATION**

JUNE 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 of the following :*

- (i) A Board resolution for appointment of 'occupier' of a factory premises.*
- (ii) A resolution to get exemption from the Central Government under section 212(8).*
- (iii) A notice under section 640B for the Central Government's approval to increase remuneration of the managing director.*
- (iv) A resolution for approval of annual accounts.*
- (v) A resolution for appointment of a relative of a director carrying a monthly remuneration of Rs.60,000. (5 marks each)*

**Answer 1(i)**

**Board resolution for appointment of Occupier of a factory premises**

RESOLVED THAT Shri ....., Executive Director, of the company be and is hereby entrusted with ultimate control over the affairs, of the company's factory at ..... and by virtue of the ultimate control over the affairs of the said factory being vested in him he be the "occupier" of the said factory.

FURTHER RESOLVED THAT Mr ..... be and is hereby vested with the following powers and authorities:

..... the powers may be specified here.

FURTHER RESOLVED THAT, as the "occupier" of the company's factory at ..... Shri ....., will ensure compliance with the general duties, obligations and requirements of all applicable laws, in particular the Factories Act, 1948, including those enumerated in section 7A of the said Act in so far as the company's factory at ..... is concerned, and submit a monthly report to the Managing Director indicating whether there has been such compliance.

**Answer 1(ii)**

**Board resolution to get exemption from the Central Government under sub-section (8) of section 212**

"RESOLVED that an application be made to the Central Government seeking an direction under section 212(8) of the Companies Act, 1956, exempting the Company from the requirements of section 212 in relation to the subsidiaries which is required to be stated in the Balance Sheet of the Company under the section.

FURTHER RESOLVED THAT Mr. ...., Company Secretary be and is hereby authorized to submit an application to the Central Government and to do such other things, acts and deeds in connection with the application as may be necessary or required”.

**Answer 1(iii)**

**Notice under section 640B for Central Government’s approval to increase Managing Director’s remuneration**

.....Limited

Notice is hereby given pursuant to Section 640B of the Companies Act, 1956 (the Act) that the company intends to make an application to the Central Government for its approval under Section 310 of the Act to increase in the remuneration payable to Shri....., Managing director of the Company.

Registered Office:

For.....Limited

.....

.....

.....

Company Secretary

Dated.....

**Answer 1(iv)**

*Kind of Meeting : Annual General Meeting*

*Type of Resolution : Ordinary Resolution*

**Resolution for approval of annual accounts**

“RESOLVED that the audited Balance Sheet of the Company as at 31st March 2009 and the Profit and Loss Account of the Company for the financial year ended on that date, together with the Schedules and Notes attached thereto, along with the Reports thereon of the Directors and the Auditors, as circulated to the Members and laid before the Meeting, be and are hereby approved and adopted.”

**Answer 1(v)**

**Resolution for appointment of a relative of Director**

*Kind of Meeting : General Meeting*

*Type of Resolution : Special Resolution*

“ RESOLVED pursuant to Section 314(1B) of the Companies Act 1956 and subject to the approval of the Central Government that Mr..... a relative of Mr..... a director of the company, be and is hereby appointed as General Manager (Production) of the company at a monthly remuneration of Rs. 60,000.”

“ FURTHER RESOLVED THAT the remuneration payable to Mr..... as aforesaid will be subject to such modification as may be required by the Central Government.”

**Question 2**

- (a) Choose the most appropriate answer from the given options in respect of the following :
- (i) On incorporation of a company, the Registrar of Companies in addition to the certificate of incorporation, issues a unique identification number called—
    - (a) Unique corporate number
    - (b) Corporate identification number
    - (c) Company identification number
    - (d) Unique identification number.
  - (ii) The appointment of a statutory auditor under section 224A is with reference to 25% of —
    - (a) Paid-up capital
    - (b) Issued capital
    - (c) Subscribed capital
    - (d) Only equity capital.
  - (iii) Non-executive directors of a public company may get remuneration on quarterly basis if such basis of payment is approved by/under —
    - (a) Articles of association of the company
    - (b) General meeting of the company
    - (c) Central Government
    - (d) Schedule XIII to the Companies Act, 1956.
  - (iv) Annual return of a company having share capital is to be filed with the Registrar of Companies in e-form —
    - (a) 20A
    - (b) 20B
    - (c) 25A
    - (d) 25B.
  - (v) On striking off the name of a company considered defunct, the Registrar of Companies is required to —
    - (a) Publish notice thereof in the official gazette
    - (b) Inform the State Government
    - (c) Inform the Central Government
    - (d) Inform the Ministry of Corporate Affairs.
  - (vi) A member of the ICSI in practice shall be deemed to be guilty of professional misconduct if he issues compliance certificates/signs annual returns in aggregate in a calendar year for more than —
    - (a) 20 Companies
    - (b) 50 Companies

(c) 80 Companies

(d) 100 Companies.

(1 mark each)

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

(i) Form 23AA relating to keeping of books of account at a place other than the registered office is required to be filed within \_\_\_\_\_ days with the Registrar of Companies.

(ii) Approval of the \_\_\_\_\_ is required to be taken for changing the name of the company under section 21.

(iii) A copy of the order passed by the Company Law Board is required to be filed with the Registrar of Companies in e-form No. \_\_\_\_\_ .

(iv) It is the situation of the \_\_\_\_\_ of the company that decides the jurisdiction of the court in that company's matters.

(v) \_\_\_\_\_ policy adopted by a company is to prevent the misuse of confidential information in the context of insider trading.

(vi) On the basis of the report of the \_\_\_\_\_, the Central Government may appoint a competent person as inspector under section 235(1).

(1 mark each)

(c) What is directors' responsibility statement ?

(4 marks)

**Answer 2(a)**

- (i) (b) Corporate identification number
- (ii) (c) Subscribed capital
- (iii) (c) Central Government
- (iv) (b) 20B
- (v) (a) Publish notice thereof in the official gazette
- (vi) (c) 80 Companies

**Answer 2(b)**

- (i) Form 23AA relating to keeping of books of account at a place other than the registered office is required to be filed within **7** days with the Registrar of Companies.
- (ii) Approval of the **Central Government** is required to be taken for changing the name of the company under section 21.
- (iii) A copy of the order passed by the Company Law Board is required to be filed with the Registrar of Companies in e-form No. **21** .
- (iv) It is the situation of the **registered office** of the company that decides the jurisdiction of the court in that company's matters.
- (v) **Chinese Wall** policy adopted by a company is to prevent the misuse of confidential information in the context of insider trading.

- (vi) On the basis of the report of the **Registrar**, the Central Government may appoint a competent person as inspector under section 235(1).

### Answer 2(c)

#### Directors' Responsibility Statement

In terms of Section 217 (2AA) of the Companies Act, 1956, the Board's report shall also include a Directors' Responsibility Statement, indicating therein:

- (a) that in the preparation of the annual accounts, the applicable accounting standards have been followed along with proper explanation relating to material departures;
- (b) that the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the Company at the end of the financial year and of the profit and loss of the Company for that period;
- (c) that the Directors have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the Company and for preventing and detecting fraud and other irregularities;
- (d) that the Directors have prepared the annual accounts on a going concern basis.

### Question 3

- (a) *Bring out the distinctive features of the following :*
  - (i) 'Charge', 'mortgage' and 'pledge'.
  - (ii) 'Adjournment' and 'postponement' of a meeting. (3 marks each)
- (b) *State, with reasons in brief, whether the following statements are correct or incorrect:*
  - (i) *An article in the articles of association can be amended by the members of the company by passing a special resolution.*
  - (ii) *A company may get exemption from the provisions of section 212.*
  - (iii) *The eligibility criteria to apply for seeking relief under section 397, etc., inter alia, provide for holding not less than 20% of the issued share capital of the company.*
  - (iv) *No stamp duty on transfer of shares in electronic form (demat mode) is payable.*
  - (v) *It is mandatory to constitute audit committee in all public limited companies.* (2 marks each)

### Answer 3(a)(i)

#### Charge

A charge is a right created by any person including a company referred to as "the borrower" on its assets and properties, present and future, in favour of a financial institution

or a bank, or other person referred to as “the lender”, which has agreed to extend financial assistance.

Section 124 of the Companies Act, 1956 states that “charge” includes “mortgage”. A charge may be fixed or floating depending upon its nature. It is a security for repayment of the amount borrowed. Every charge created by a company should be registered with the Registrar of Companies within 30 days after the date of its creation.

### **Mortgage**

A mortgage is a legal process whereby a person, who borrows money from another person and secures the repayment of the borrowed money and also the payment of interest at the agreed rate, by creating a right or charge in favour of the lender on his movable and immovable property. A mortgage involves transfer of the interest in the property.

### **Pledge**

Pledge is a bailment of personal property as security for some debt or engagement, redeemable on certain terms, and with an implied power of sale on default. Pledge can not be a subject of charge under the Companies Act.

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

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

Adjournment of meeting is a different from postponement of a meeting. To adjourn means to defer or suspend the meeting to a future time with no appointed date or indefinitely (sine die) or as decided by the members present at the scheduled time of the meeting. To postpone of a meeting means to put off for the time being. A meeting can be postponed at any time before it is held. A postponed meeting needs not be held again and for its reconvening, the complete procedure is to be complied with.

The adjourned meeting is merely the continuation of the original meeting and unless the Articles provide otherwise, a fresh notice of the adjourned meeting is not necessary, if it is not adjourned beyond 30 days or sine die. At the adjourned meeting, only the unfinished business of the original meeting should be considered.

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

**Correct.** Vide section 31 of the Companies Act, 1956, an article in the articles of association can be amended by the members of the company by passing a special resolution.

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

**Correct.** Under section 212(8) of the Companies Act, 1956, a company may get exemption from the compliance of the provisions of section 212 of the Act directing that in relation to any subsidiary section 212 shall not apply or shall apply to the extent as directed.

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

**Incorrect.** The eligibility criteria to apply for seeking relief under section 397 etc.

inter alia provide for holding not less than 10% of the issued share capital of the company. [vide Section 399(1)(a)].

**Answer 3(b)(iv)**

**Correct.** No stamp duty on transfer of shares in electronic form (demat mode) is payable. [Vide Depositories Act, 1996].

**Answer 3(b)(v)**

**Incorrect.** It is not mandatory to constitute Audit Committee in all public limited companies. It is mandatory for those public companies having paid-up capital of 5 crores or more. [vide section 292A(1)]. Further, all listed companies are mandatorily required under Clause 49 of Listing Agreement to constitute an Audit Committee.

**Question 4**

- (a) *Explain the external reporting requirements by Compliance Officer as laid down under the SEBI (Prohibition of Insider Trading) Regulations, 1992. (4 marks)*
- (b) *Regulation 168 of the Company Secretaries Regulations, 1982 prohibits a Company Secretary in Practice from engaging in any business or occupation other than the profession of Company Secretary unless it is permitted by a general or specific resolution of the Council of the Institute of Company Secretaries of India. Comment. (4 marks)*
- (c) *“In securities market, information is money.” Comment. (4 marks)*
- (d) *In respect of listed companies, certain additional items are required to be considered by the Board at its meeting. Explain. (4 marks)*

**Answer 4(a)**

Following are the external reporting requirements by a compliance officer as laid down under SEBI (Prohibition of Insider Trading) Regulations, 1992. The compliance officer of a company is required to –

- (i) disclose within 2 working days of receipt of the information received by the company under Regulation 13(1), 13(2), 13(3) and 13(4) to all Stock Exchanges on which the company is listed.
- (ii) inform the SEBI about the violations, if any observed, of the SEBI (Prohibition of Insider Trading) Regulations, 1992, by the company/compliance officer.

As per Regulation 13(1), any person who holds more than 5% shares or voting rights in any listed company is required to disclose to the company in Form A, the number of shares or voting rights held by such person, on becoming such holder, within 2 working days of :—

- (a) the receipt of intimation of allotment of shares; or
- (b) the acquisition of shares or voting rights, as the case may be.

As per Regulation 13(2), any person who is a director or officer of a listed company is required to disclose to the company in Form B the number of shares or voting rights held and positions taken in derivatives by such person and his dependents, within two working days of becoming a director or officer of the company.”

As per Regulation 13(3), any person who holds more than 5% shares for voting rights in any listed company is required to disclose to the company in Form C the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5%, if there has been change in such holdings from the last disclosure and such change exceeds 2% of total shareholding or voting rights in the company.

As per Regulation 13(4), any person who is a director or officer of a listed company, is required to disclose to the company and the stock exchange where the securities are listed in Form D, the total number of shares or voting rights held and change in shareholding or voting rights, if there has been a change in such holdings of such person and his dependents from the last disclosure and the change exceeds Rs. 5 lakh in value or 25,000 shares or 1% of total shareholding or voting rights, whichever is lower.

As per Regulation 13(5), the disclosure mentioned in sub-regulations (3) and (4) of Regulation 13 shall be made within 2 working days of the receipts of intimation of allotment of shares, or the acquisition or sale of shares or voting rights, as the case may be.

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

Regulation 168 of CS Regulations, 1982 prohibits a Company Secretary in practice from engaging in any business or occupation other than the profession of Company Secretary unless it is permitted by a general or specific resolution of the ICSI. Members have been permitted to practice/engage in the following business or occupation under Regulation 168 of Company Secretaries Regulations, 1982:

#### **Permission granted generally**

- (i) Private tutorship.
- (ii) Authorship of books and articles.
- (iii) Holding of Life Insurance Agency Licence for the limited purpose of getting renewal commission.
- (iv) Holding of public elective offices such as M.P, M.L.A., M.L.C.
- (v) Honorary office-bearership of charitable, educational or other non-commercial organisations.
- (vi) Acting as Justice of Peace, Special Executive Magistrate and the like.
- (vii) Teaching assignment under the Coaching Organisation of the Institute or any other organisation, so long as the hours during which a member in practice is so engaged in teaching do not exceed average four hours in a day irrespective of the manner in which such assignment is described or the remuneration is receivable by the member in practice for such assignment.
- (viii) Valuation of papers, acting as a paper-setter, head examiner or a moderator, for any examination.
- (ix) Editorship of professional journals.
- (x) Acting as ISO lead auditor.



- (xi) Providing Risk Management Services for non-life insurance policies except marketing or procuring of policies.
- (xii) Acting as Recovery Consultant in the Banking Sector.
- (xiii) Becoming non-executive director/promoter/promoter director/subscriber to the Memorandum and Articles of Association of a company the objects of which include areas, which fall within the scope of the profession of Company Secretaries irrespective of whether or not the practising member holds substantial interest in that company.
- (xiv) Becoming non-executive director/promoter/promoter director/subscriber to the Memorandum and Articles of Association of a company which is engaged in any other business or occupation provided that the practising member does not hold substantial interest in the company.

#### **Permission to be granted specifically**

Members of the Institute in practice may engage in the following categories of business or occupation, after obtaining the specific and prior approval of the Executive Committee of the Council in each case:

- (i) Interest or association in family business concerns provided that the member does not hold substantial interest in such concerns.
- (ii) Interest in agricultural and allied activities carried on with the help, if required, of hired labour.
- (iii) Editorship of journals other than professional journals.

#### **Answer 4(c)**

In the securities market, information is money because its timely gathering, analysis and dissemination are essential for efficient operation in the market. The balance in bargaining power obviously shifts favourably towards the person possessing insider/sensitive information. Hence it leads to unfairness in the market as it violates the belief that there must be a parity in the bargaining power of all the players.

The wrongful obtaining and use of such information by insiders is unfair and adversely affects the incentive to invest in such securities. Therefore, a failure to control this practice would not only result in unfairness permeating into the market but another obvious result would be a loss of public confidence in the institution as a whole as it undermines the honesty that underlie public confidence in securities market of a country. In order to govern the conduct of the Insiders and connected persons on matters relating to Insider trading, Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 were enacted by SEBI.

#### **Answer 4(d)**

In accordance with Clause 49 of Listing Agreement, amongst others, the under mentioned items should be made available to the Board and considered at its meeting:

1. Annual operating plans and budgets and any updates.
2. Quarterly results for the company and its operating divisions or business segments.

3. Minutes of meetings of audit committee and other committees of the board.
4. The information on recruitment and remuneration of senior officers just below the board level, including appointment or removal of Chief Financial Officer and the Company Secretary.
5. Details of any joint venture or collaboration agreement.
6. Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business.
7. Non-compliance of any regulatory, statutory or listing requirements and shareholders service such as non-payment of dividend, delay in share transfer etc.

**Question 5**

- (a) *Outline the procedure for removal of the statutory auditor.* (8 marks)
- (b) *Enumerate the procedure for conversion of a public company into a private company.* (8 marks)

**Answer 5(a)****Procedure for Removal of Statutory Auditor**

1. Convene a Board Meeting and place an item on agenda for removal of the existing statutory auditor of the company with reasons thereof. After deliberation, pass a resolution authorising the officers to make application to the Regional Director for obtaining approval of the Central Government. [Section 224(7) of the Act].
2. File e-Form 24A with the Regional Director. Attach the application explaining in detail the grounds for removal of the existing auditor of the company and the particulars of the company's auditor along with following documents –
  - Copy of ordinary resolution
  - Copy of special notice under section 225(2)
  - Copy of the representation, if any, made by the statutory auditor
3. Simultaneously, deliver a copy of the application with all enclosures to the concerned Registrar of Companies for information and comments/ recommendation, as may be required.
4. Follow up, explain, submit further details/particulars/documents and obtain approval from the Regional Director.
5. On receipt of the approval, convene a Board meeting of the company. Place the approval of the Regional Director so received and decide about (i) new auditor to be appointed in place of the existing auditor of the company; (ii) obtain certificate in writing from the new auditor to the effect of his eligibility to act as auditor if appointed; (iii) fix date, day, time and place of general meeting; and (iv) approve draft notice of the general meeting, specifying therein the resolutions (ordinary or special, as the case may be for removing and appointing Auditor).

6. Issue notice to the members of the company, at least clear 21 days before the date of the meeting alongwith relevant explanatory statement and place the documents including Letter of Approval of the Regional Director for inspection of the Registered Office of the company. It is to be noted that for appointing a person other than the retiring auditor or to provide that the retiring auditor shall not be reappointed, a special notice has to be given and a copy thereof is to be sent to retiring auditor. The retiring auditor has a right to make representations in writing to the company and where practicable to call upon the company to send copy of representation to every member of company.
7. Hold the general meeting and pass the resolutions as set out in the notice with or without modification.
8. Intimate the new auditor with a certified copy of the resolution passed within seven days.
9. Also intimate the auditor removed with a certified copy or the resolution passed along with a copy of the approval of the Regional Director.
10. File e-form 23 with certified copy of the special resolution and explanatory statement relating thereto with requisite filing fees within thirty days from the date of passing of special resolutions together with a copy of the approval letter with the concerned Registrar of Companies.

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

#### **Conversion of Public Company into a Private Company**

For conversion of a public company to a private company, a company is required to take the following procedural steps:

1. Hold a meeting of its Board of directors to consider and approve the proposal for conversion of public company into private company.

The following resolutions must be passed at the meeting:

- (i) To approve the proposal for conversion of the company into private company.
- (ii) To fix time, date and venue for holding an extraordinary general meeting of the company.
- (iii) To approve notice for the general meeting along with the explanatory statement as required under Section 173 (2) of the Act. The notice of the general meeting must contain text of the following resolutions; which will be required to be passed at the meeting:
  - (a) special resolution for altering the articles of the company, as required under Section 31 of the Companies Act, 1956, so as to include therein restrictions, limitation and prohibition specified in Section 3(1)(iii) of the Act converting the public company into a private company.
  - (b) special resolution for changing the name of the company as required under proviso to Section 21 of the Act.
  - (c) special resolution for altering the memorandum of association (name clause) of the company in accordance with Section 16 of the Act.

- (iv) To authorise the company secretary to issue the notice of the general meeting on behalf of the Board.
- 2. Hold general meeting and have the aforementioned special resolutions passed.
- 3. Within thirty days of passing of the special resolutions, file e-form 23 with copy of resolution along with explanatory statement under Section 173 and amended copy of Articles of Association as attachment along with prescribed filing fee.
- 4. If the number of members of the company is above fifty, appropriate steps should be taken to reduce the number to fifty or below.
- 5. In accordance with the proviso to Sub-section (1) of Section 31 of the Companies Act, 1956, no alteration made in the articles of association of a company shall be effective, which has the effect of converting a public company into a private company, unless such alteration has been approved by the Central Government. Therefore, an application in e-form 1B, along with the attachments and prescribed application fee, will have to be made, within three months from the date of passing of the special resolution for alteration of the articles.
- 6. After the alteration of the articles has been approved by the Central Government, a printed copy of the altered articles of the company should be filed with the concerned Registrar of Companies within one month of the date of receipt of the order of approval [Section 31(2A)].
- 7. Surrender to the Registrar, the Certificate of Incorporation of the company in order to obtain fresh Certificate of Incorporation consequent upon change of name on conversion of the company into a private company [Section 23(1)].
- 8. Issue a general notice in newspapers informing members and public at large that the company has been converted into a private limited company and its name has been changed from ..... Limited to ..... Private Limited with effect from .....

#### Question 6

- (a) Describe the basic features of limited liability partnership (LLP) and distinguish it from normal partnership. (8 marks)
- (b) State the important features of electronic filing of documents under the Companies Act, 1956. (5 marks)
- (c) Mention against the following e-forms, the subject matter for which these forms are meant :
  - (i) e-form-3
  - (ii) e-form-4C
  - (iii) e-form-24B. (1 mark each)

#### Answer 6(a)

Limited Liability Partnership Act, 2008 provides for the formation and regulation of limited liability partnerships and for matters connected therewith or incidental thereto.

The basic features of LLP are as under:

- LLP is an alternative corporate business vehicle that would give the benefits of limited liability but would allow its members the flexibility of organizing their internal structure as a partnership based on an agreement.
- LLP is a separate legal entity, liable to the full extent of its assets, the liability of the partners would be limited to their agreed contribution in the LLP.
- LLP is a body corporate and a legal entity separate from its partners. It will have perpetual succession.
- An LLP is under obligation to maintain annual accounts reflecting true and fair view of its state of affairs.
- The mutual rights and duties of partners of an LLP inter se and those of the LLP and its partners shall be governed by an agreement between partners or between the LLP and the partners subject to the provisions of the Act. It provides flexibility to devise the agreement as per their choice. In the absence of any such agreement, the provisions of law shall govern the mutual rights and duties.

The difference between “LLP” and “Partnership Firm” is as under:

<i>S. No.</i>	<i>Points of Distinction</i>	<i>LLP</i>	<i>Partnership</i>
1.	Governing Act	Limited Liability Partnership Act, 2008	Indian Partnership Act, 1932
2.	Who can Incorporate	Any two or more persons may start a LLP by subscribing their names to the Incorporation document which is to be filed with the Registrar of Companies	Any two or more persons willing to start a business may do so by entering into an agreement
3.	Form of name	The LLP Act stipulates that the partnership name must be approved by the Registrar and the last words must be “Limited Liability Partnership” or the acronym LLP	There is no mandatory provision as to name of a partnership firm
4.	Charter	Limited Liability Partnership Agreement or Schedule I of the LLP Act	Partnership Deed
5.	Alteration in the Charter	Alteration can be made only in accordance with the procedure laid down in the Schedule / LLP Agreement	Alteration can be made only with the consent of all the partners
6.	Separate Entity	A LLP on being registered acquires a legal status separate from its partners	A partnership firm being a sum total of individuals does not acquire a legal personality

**Answer 6(b)**

The Central Government amended the Companies (Central Government's) General Rules and Forms 1956 vide notification dated 10th February, 2006 and notified e-forms to enable electronic filing of documents.

To support the provisions of e-filing, the Central Government under section 610A and 610E of the Companies Act have enacted the Companies (electronic filing and authentication of documents) Rules, 2006.

Important feature of electronic filing of documents are:

— *Director Identification Number (DIN)*

All existing and any person intending to be appointed as a director are required to obtain the Director Identification Number (DIN).

— *Corporate Identity Number (CIN)*

Every company is being allocated a Corporate Identity Number (CIN).

— *Digital Signature Certificate (DSC)*

The e-forms are required to be authenticated by the authorized signatories using digital signatures as defined under the Information Technology Act, 2000. A digital signature is the electronic signature duly issued by a certifying authority that shows the authority of the person signing the same. It is an electronic equivalent of a written signature. Every user who is required to sign an e-form for submission with MCA is required to obtain a Digital Signature Certificate.

— *Pre-certification by professionals in whole time practice*

Amongst other, Form Nos. 2, 3, 5, 10, 17, 18, 23, 24AB, 25C, 32 are to be pre-certified by a Chartered Accountant or a Cost Accountant or a Company Secretary in whole time practice.

— *Mode of payment*

MCA-21 system provides for the facility of payment of statutory fees through multiple modes i.e. (i) Off-line payment through a challan generated by the system and payment of fees at the counter of the notified bank branches through DDs/Cash; (ii) on-line payments through Internet Banking and Credit Cards [Master Card/VISA].

— *Service Request Number (SRN)*

Each transaction under e-filing is uniquely identified by a Service Request Number. On filing of an e-form, the system generates and provides a Service Request Number. A user can check the status of the document/transaction, by entering the SRN.

**Answer 6(c)**

- (i) **e-form 3** - Particulars of contract relating to shares allotted as fully or partly paid-up otherwise than in cash.

- (ii) **e-form 4C** - Return in respect of buy Back of Shares.
- (iii) **e-form 24B** - Form of application to the Central Government for obtaining prior consent for holding of any office or place of profit in the company by certain persons

### Question 7

- (a) *You are a Practising Company Secretary. One of your clients abroad wants to establish a place of business in India for a company incorporated abroad in which he is a Whole-time Director. Prepare a note for his information indicating the procedure involved to set-up a place of business in India. (8 marks)*
- (b) *Draft the minutes of annual general meeting of Happy Ltd. at which besides adoption of accounts, declaration of dividend, appointment of auditors and the appointment of additional director as regular director featured for consideration and decision. (8 marks)*

### Answer 7(a)

If Whole-time Director of foreign company desires to establish a place of business within India, then pursuant to section 592 of the Companies Act, 1956 e-form 44 is required to be delivered to Registrar of Companies within thirty days of the establishment of the place of business, for its registration. In such e-form, some of the important details like address and state of principal place of business in India, date of its establishment, full address of principal office of foreign company, type of office and main division of business activity, details of persons resident in India and authorized to accept on behalf of company service of process and any notices needs or documents to be served on the company. The following documents are required to be attached—

- Charter, statutes or memorandum and articles of association or other instrument constituting or defining the constitution of the company. If the documents are not in English language then it should be translated copy in English language.
- Details of directors (individuals as well as bodies corporate).
- Approval letter from Reserve Bank of India for the setting up of business in India,
- Power of attorney or board resolution in favour of the authorised representatives.

The form is required to digitally signed by the authorized representative of the foreign company.

The details of directors, Secretary and body corporate should contain the following particulars:

- (a) with respect to each director—
  - (i) in the case of an individual, his present name, former name (if any) and surname, his usual residential address, his nationality of origin, (if other than nationality) and his business occupation, if any, or if he has no business occupation but holds any other directorship or directorships, particulars of that directorship or of some one of those directorships; and

- (ii) in the case of a body corporate, its corporate name and registered or principal office; and the full name, address, nationality and nationality of origin, (if different from that nationality) of each of its directors;
- (b) with respect to the secretary, or where there are joint secretaries with respect to each of them—
  - (i) in the case of an individual, his present name, former name (if any) and surname, and his usual residential address; and
  - (ii) in the case of a body corporate, its corporate name and registered or principal office.

*Provisions under FEM (Establishment in India of Branch or Office or other place of business) Regulations, 2000*

A foreign company or individual planning to set up business operations in India can do so through a Liaison Office / Representative Office, Project Office or a Branch Office. The FEM (Establishment in India of Branch or Office or other place of business) Regulations, 2000 govern the opening and operation of such offices.

Accordingly, Companies incorporated outside India, desirous of opening a Liaison/ Branch office in India have to make an application in form FNC-1. It may be noted that RBI has authorized AD Category I bank to forward FNC-1 along with the necessary enclosures along with the comments and recommendations to

The Chief Manager-in-charge,  
Reserve Bank of India  
Foreign Exchange Department  
Foreign Investment Division  
Central Office, Mumbai-400 001.

**Answer 7(b)**

**Minutes of Eighth Annual General Meeting of the Members of Happy Ltd. held on \_\_\_\_\_ (Date) at \_\_\_\_\_ AM (Time) at the Registered office of the Company**

The following were present:

1. Mr. ....
2. Mr. ....
3. Mr. ....
4. Mr. ....
5. Mr. ....

**Chairman**

In accordance with Article \_\_\_\_\_ of the Articles of Association, Mr. ..., Chairman of the Board of Directors, took the Chair.

The Chairman welcomed the Members and introduced the Directors seated on the dais.



The Chairman declared that the requisite Quorum was present and called the Meeting to order.

The Register of Directors' shareholdings was placed at the Meeting and was available for inspection.

With the consent of the Members present, the Notice convening the Annual General Meeting of the Company was taken as read. The Chairman requested the Company Secretary to read the Auditors' Report.

After the Auditor's Report had been read, the Chairman delivered his speech.

The business of the Meeting as per the Notice thereof was thereafter taken up item wise.

1. *Adoption of Accounts*

The Chairman proposed the Ordinary Resolution for the adoption of the Accounts for the year ended 31st March 2009 and Mr. \_\_\_\_\_ seconded the Ordinary Resolution:

"RESOLVED that the audited Balance Sheet of the Company as at 31st March 2009 and the Profit and Loss Account of the Company for the financial year ended on that date, together with the Schedules and Notes attached thereto, along with the Reports thereon of the Directors and the Auditors, as circulated to the Members and laid before the Meeting, be and are hereby approved and adopted."

The resolution was put to vote.

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried by the requisite majority.

2. *Declaration of Dividend*

Mr. \_\_\_\_\_ proposed the following Resolution as an Ordinary Resolution:

"RESOLVED that the dividend @ Rs. 2 per share on \_\_\_\_\_ equity shares of Rs. 10 each, fully paid-up, aggregating to Rs. \_\_\_\_\_ be and is hereby declared for payment, to those Members whose names appear on the Company's Register of Members on \_\_\_\_\_(day), \_\_\_\_\_(date)".

The Resolution was seconded by Mr. \_\_\_\_\_, and was put to the vote as an Ordinary Resolution.

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

3. *Appointment of Director*

Proposed by : Mr. \_\_\_\_\_

Seconded by : Mr. \_\_\_\_\_

The following Resolution having been proposed and seconded by the aforementioned two Members, was put to the vote as an Ordinary Resolution:

"RESOLVED that, pursuant to Section 256 of the Companies Act, 1956, Mr. ..., who retires by rotation and, being eligible for re-appointment, offers himself for

re-appointment, be and is hereby re-appointed as a Director of the Company and that his period of office be liable to determination by retirement of Directors by rotation.”

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

4. *Appointment of Auditors*

Proposed by : Mr. \_\_\_\_\_

Seconded by : Mr. \_\_\_\_\_

The following Resolution having been proposed and seconded by the aforementioned two Members, was put to the vote as an Ordinary Resolution:

“RESOLVED that M/s. \_\_\_\_\_, Chartered Accountants, \_\_\_\_\_, be and are hereby re-appointed as Auditors of the Company to hold office from the conclusion of this Meeting until the conclusion of the next Annual General Meeting of the Company on a remuneration of Rs. \_\_\_\_\_, plus applicable service tax and other out of pocket expenses incurred for the purposes of the audit”.

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

**Special Business**

5. *Appointment of Director*

Proposed by : Mr. \_\_\_\_\_

Seconded by : Mr. \_\_\_\_\_

The following Resolution having been proposed and seconded by the aforementioned two Members, was put to the vote as an Ordinary Resolution:

“RESOLVED that Mr. ... who was appointed as an Additional Director by the Board under Section 260 of the Companies Act, 1956 and Article \_\_\_ of the Articles of Association of the Company and who holds office only upto the date of this Annual General Meeting and in respect of whom the Company has received a Notice in writing, under Section 257 of the Companies Act, 1956, from a Member signifying his intention to propose Mr. ... as a candidate for the office of a Director of the Company , be and is hereby appointed a Director of the Company liable to retire by rotation.”

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

**Vote of Thanks**

The Meeting terminated with a vote of thanks to the Chair.

\_\_\_\_\_  
CHAIRMAN

Date : \_\_\_\_\_

**Question 8**

- (a) *Bring out the salient aspects of Secretarial Standard-3 on dividends in respect of (i) interim dividend; and (ii) unpaid/unclaimed dividend.* (4 marks)
- (b) *Which type of companies are subject to audit by Comptroller and Auditor General of India ? Is there any need for having statutory audit by professional auditors? State the legal position in this regard.* (6 marks)
- (c) *Certain information is required to be mandatorily reviewed by the audit committee. Discuss.* (6 marks)

**Answer 8(a)**

The salient aspects of Secretarial Standard on Dividend (SS-3) on Interim Dividend and unpaid/unclaimed are as follow:

(i) *Interim Dividend*

- Interim Dividend, if declared, is payable out of estimated profit for the period for which Interim Dividend is to be declared, after taking into account depreciation for the full year and arrears of depreciation, Dividend at the contracted rate on preference shares, if any, appropriations and transfers to statutory reserves, taxation and the provisions of the Companies (Transfer of Profits to Reserves) Rules, 1975. (Clause 1.1.5)
- Where a company has issued equity shares with differential rights as to Dividend, Interim Dividend may, at the option of the Board, be declared on all or any one or more of the classes of such shares in accordance with the terms of issue. (Clause 1.1.6)
- Interim Dividend should be declared by the Board, at a meeting of the Board. (Clause 1.1.7)

The following clauses also apply to interim dividend:

Dividend should be paid out of the profit of the company for the financial year or out of profit(s) for the previous financial year(s) which have not been transferred to reserves, or out of both, only after providing for depreciation for the year and arrears of depreciation, if any. (Clause 1.1.1)

Before declaring Dividend out of profit for the year, any loss for the previous year(s) or the amount of depreciation for the previous year(s), whichever is less, should be set off against such profit. (Clause 1.1.2)

Dividend should not be declared out of the Securities Premium Account or the Capital Redemption Reserve Account or Revaluation Reserve or Amalgamation Reserve or out of profit on re-issue of forfeited shares or out of profit earned prior to the incorporation of the company. (Clause 1.1.3)

If redeemable preference shares have not been redeemed on the due date, no Dividend should be declared on equity shares until such preference shares are redeemed. (Clause 2.5)

Clauses 3.1, 3.3, 3.4, 4.1, 5.1 to 5.7, 6.1 to 6.4, 7.1, 8.1, 9.1 to 9.3 shall also apply to interim dividend.

(ii) *Unpaid/unclaimed Dividend*

- The amount of Dividend which remains unpaid or unclaimed after thirty days from the date of declaration should be transferred to a special Dividend account to be called the “Unpaid Dividend Account” within seven days from the date of expiry of the thirty days period provided for payment of Dividend. (Clause 6.1)
- Any amount in the Unpaid Dividend Account of the company which remains unclaimed and unpaid for a period of seven years from the date of transfer of such amount to the Unpaid Dividend Account should be transferred to the Investor Education and Protection Fund. (Clause 6.2)
- Before transferring any amount to the Investor Education and Protection Fund, the company should give individual intimation to the Members in respect of whose unclaimed Dividend the amount is being transferred, at least six months before the due date of such transfer. (Clause 6.3)
- Any interest earned on the Unpaid Dividend Account should be transferred to the Investor Education and Protection Fund. (Clause 6.4)

**Answer 8(b)**

Section 619 of the Act provides that the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor-General of India provided that the limits specified in Sub-section (1B) and (1C) of Section 224 apply to such auditor.

Government company as defined under section 617 means any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary of a Government company as thus defined.

The following companies are also required to comply the provisions of 619 i.e. CAG Audit:

A company in which not less than fifty-one per cent of the paid-up share capital is held by one or more of the following or any combination thereof, as if it were a Government company, namely:—

- (a) the Central Government and one or more Government companies;
- (b) any State Government or Governments and one or more Government companies;
- (c) the Central Government, one or more State Governments and one or more Government companies;
- (d) the Central Government and one or more corporations owned or controlled by the Central Government;
- (e) the Central Government, one or more State Governments and one or more corporations owned or controlled by the Central Government;
- (f) one or more corporations owned or controlled by the Central Government or the State Government;
- (g) more than one Government company.

Statutory audit is required to be done by professional auditors. Section 226 contains provision as regards qualifications and disqualifications of auditors. These apply to all companies whether public or private or Section 25 companies or a Government company.

Section 226 provides that only a Chartered Accountant within the meaning of Chartered Accountants Act, 1949 can act as an auditor of a limited company. Though the auditor should be a Chartered Accountant, only Chartered Accountants in practice can act as auditors of companies.

**Answer 8(c)**

As per Section 292A (6) of the Companies Act, 1956:

- Discussions with the Auditors periodically about internal control system;
- The scope of audit including the observations of the auditors;
- Review of half –yearly and annual financial statements before submission to the Board; and
- to ensure compliance of internal control systems

As per Clause 49 of Listing Agreement, the Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
  2. Statement of significant related party transactions (as defined by the audit committee), submitted by management;
  3. Management letters / letters of internal control weaknesses issued by the statutory auditors;
  4. Internal audit reports relating to internal control weaknesses; and
  5. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee
-

## **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 :*

- (i) Define 'document'. Explain various kinds of deeds.*
- (ii) What are the important points that should be taken into consideration while drafting contracts ?*
- (iii) What are the pre-requisites of 'arbitration' ? Draft the specimen of an arbitration agreement to refer dispute to an arbitral tribunal.*
- (iv) Define the following :*
  - (a) Contract of guarantee*
  - (b) Hypothecation agreement*
  - (c) Lease*
  - (d) Licence*
  - (e) Mortgage.*
- (v) Draft a specimen of memorandum of mortgage by deposit of title deeds.*  
*(5 marks each)*

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

#### **Document**

Document as per Section 31(18) of General Clauses Act, 1894 means any matter expressed or described upon any substance by means of letters, figures or marks, or by the more than one of those means, intended to be used, or which way 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 place 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.

#### **Various kinds of Deeds**

1. A good deed is one which conveys a good title, not one which is good merely in form.
2. A good and sufficient deed is marketable deed; one that will pass a good title to the land it purports to convey.
3. An inclusive deed is one which contains within the designated boundaries lands which are expected from the operation of the deed.
4. A latent deed is a deed kept for twenty years or more in man's escritoire or strong box.
5. A lawful deed is a deed conveying a good or lawful title.
6. A pretended deed is a deed apparently or prima facie valid.

## **DRAFTING, APPEARANCES AND PLEADINGS**

*Time allowed : 3 hours*

*Maximum marks : 100*

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

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  - (e) Mortgage.*
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*(5 marks each)*

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

#### **Document**

Document as per Section 31(18) of General Clauses Act, 1894 means any matter expressed or described upon any substance by means of letters, figures or marks, or by the more than one of those means, intended to be used, or which way 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 place 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.

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4. A latent deed is a deed kept for twenty years or more in man's escritoire or strong box.
5. A lawful deed is a deed conveying a good or lawful title.
6. A pretended deed is a deed apparently or prima facie valid.

7. A voluntary deed is one given without any “valuable consideration”,
8. A warranty deed is a deed containing a covenant of warranty.

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

#### **Important points in regard to drafting of contracts**

1. *Description of Parties to the Contract* : Parties to the contract should properly be defined by giving their names, status and address.
2. *Legal Nature of the Contract* : In the title or in the introductory part of the contract, the parties should clearly indicate the legal nature of the contract as to whether it is a sale/purchase contract or a contract for technical assistance, etc. so as to avoid any doubt as regards the nature of the contract and the legal position of the parties thereunder.
3. *Licences and Permits* : Provision in international trade contracts as to which party would be responsible for obtaining export/import licences and the effects of delay, refusal or withdrawal of a license by Government authority, etc.
4. *Taxes, Duties and Charges* : A provision regarding the responsibility for payment of taxes, duties and other charges, if any, may also be included in the contract. In international contracts, it is generally provided that the seller would be responsible for taxes, duties and charges levied in the country of export and the buyer with such charges levied in the country of import.
5. *Quality, Quantity and Inspection of Goods* : Quality of the goods is very important to the buyer in a sale-purchase contract and it is in this area that a number of disputes arise and, therefore, it is necessary to include a suitable provision relating to the description and inspection of the quality and quantity of the goods in the contract.
6. *Packing* : A proper stipulation regarding packaging of the goods according to the nature of the merchandise should be included in the contract.
7. *Shipment of the Goods* : It is desirable to stipulate precise particulars regarding the rights and duties of the parties towards shipment of the goods, i.e., the time, date and port of shipment, name of the ship and other ship particulars.
8. *Insurance* : A provision regarding insurance of the merchandise is also made in the contract.
9. *Documentation* : If the goods are of scientific or technical nature, a provision in the contract may be made as to whether the technical documentation supplied by the seller will become the property of the buyer or it has to be returned to the seller after a stipulated time.
10. *Guarantee* : A guarantee clause may be provided to make the seller responsible for the defects appearing in the goods during the period of the guarantee.
11. *Passing of the Property and Passing of the Risks* : It is very important to provide for the exact point of time when the title or the property in the goods and the risk will pass from the seller to the buyer.



12. *Amount, Mode and Currency of Payment* : Provision is to be made for the amount, mode and currency in which the price for the goods has to be paid.
13. *Force Majeure* : Another very important provision witnessed in modern commercial contracts relates to force majeure or excuses for non-performance. This provision defines as to what particular circumstances or events beyond the control of the seller would entitle him to delay or refuse the performance of the contract, without incurring liability for damages.
14. *Proper Law of Contract* : Provision stipulating the proper law of contract in international contracts.
15. *Settlement of Disputes and Arbitration* : Provision regarding settlement of disputes under the contract by arbitration or otherwise has to be stipulated. A suitable arbitration clause may be provided by the parties by mutual agreement.

### Answer 1(iii)

#### Pre-requisites of Arbitration

Every arbitration must have the following three pre-requisites:

- (i) a dispute between parties to an agreement, requiring a settlement;
- (ii) its submission for a settlement to a third person; and
- (iii) a decision by such third person according to his own judgement based on the facts and circumstances of the dispute, which is binding on both the parties.

#### Specimen of an arbitration agreement to refer the dispute to an arbitral Tribunal

THIS AGREEMENT is made at..... this..... day of..... between Mr. X..... of..... residing at..... hereinafter referred to as the Party of the First Part and Mr. Y..... of..... residing at..... hereinafter referred to as the Party of the Second Part.

WHEREAS by an Agreement dated..... 2008 entered into between the parties hereto, the Party of the First Part entrusted the work of constructing a building on his plot of land situated at..... to the Party of the Second Part on the terms and conditions therein mentioned.

AND WHEREAS disputes have arisen between the parties hereto regarding the said contract and the parties could not mutually settle the matter

AND WHEREAS the said agreement provides that in the event of any dispute or difference arising between the parties the same shall be referred to arbitration if agreed upon and the Arbitration shall be governed by the provisions of the Arbitration & Conciliation Act, 1996.

AND WHEREAS the parties have agreed to refer all the disputes regarding the said contract to Mr..... Architect, as common Arbitrator and have proposed to enter into this Agreement for reference of the disputes to the sole arbitration of the said Mr.....

NOW IT IS AGREED BETWEEN THE PARTIES HERETO AS FOLLOWS:

1. That the following points of dispute arising out of the said agreement dated... are hereby referred to the sole arbitration of the said Mr..... for his decision and award.

The points of dispute are:

- (a)
- (b)
- (c)
- (d)
- (e)
2. The said Arbitrator shall allow the parties to file their respective claims and contentions and to file documents relied upon by them within such reasonable time as the Arbitrator may direct.
3. The said Arbitrator shall give hearing to the parties either personally or through their respective Advocates but the Arbitrator will not be bound to take any oral evidence including cross examination of any party or person.
4. The said Arbitrator shall make his Award within a period of four months from the date of service of a copy of this agreement on him by any of the parties hereto provided that, the Arbitrator will have power to extend the said period from time to time with the consent of both the parties.
5. The Arbitrator will not make any interim award.
6. The award given by the Arbitrator will be binding on the parties hereto.
7. The Arbitrator will have full power to award or not to award payment of such costs of and incidental to this arbitration by one party to the other as he may think fit.
8. The Arbitration shall be governed by the provisions of the Arbitration & Conciliation Act, 1996.

IN WITNESS WHEREOF the parties herein under have set their hands the day and year hereinabove mentioned.

Signed by the within named

Signed by the within named

Mr. X ..... in the presence of

Mr. Y..... in the presence of

**Answer 1(iv)**

- (a) **Contract of guarantee** : A “contract of guarantee” is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the “surety”; the person in respect of whose default the guarantee is given is called the “principal debtor”; and the person to whom the guarantee is given is called the “creditor”. A guarantee may be either oral or written. (Section 126 of the Indian Contract Act, 1872)

**(b) Hypothecation agreement** : Hypothecation is a form of transfer of property in goods. Hypothecation agreement is a document by which legal property in goods passes to the person who lends money on them, but the possession does not pass. This form of transfer is not regulated in India by any statute. Neither the Transfer of Property Act, 1882, nor the Indian Contract Act, 1872, nor the Sale of Goods Act, 1930, recognize the non-possessory hypothecation of immovables, and the rights and remedies of the parties are regulated by the courts according to the general law of contract.

In hypothecation, there must be an intention of the parties to create a security on the property on which the money has been lent. If that intention can be established, equity gives effect to it.

**(c) Lease** : A lease of immovable property is a transfer of a right to enjoy the property for a certain time in consideration for a price paid or promised. The price paid is called "rent".

**(d) Licence** : Licence has been defined in Section 52 of the Indian Easements Act, 1882 as under:

"where one person grants to another, or to a definite number of other persons, a right to do, or continue to do, in or upon the immovable property of the grantor, something which would, in the absence of such right, be unlawful and such right does not amount to an easement or an interest in the property, the right is called a license".

**(e) Mortgage** : A mortgage as per Section 58 of the Transfer of Property Act, 1882 is a transfer of interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of a loan, existing or future debt or the performance of an acknowledgement, which may give rise to pecuniary liabilities

The transferor in the case of a mortgage is called a 'mortgagor' and the transferee as 'mortgagee', the principal money and interest of which payment is secured for the time being are called the 'mortgage money' and the instrument, if any, by which a transfer is effected is called a "mortgage deed".

### Answer 1(v)

#### Memorandum of Mortgage by Deposit of Title Deeds

Memorandum that this..... day of..... 2009, 'AB' of, etc. (the mortgagor), as beneficial owner, has deposited with 'CD' of, etc. (the mortgagee), the original title deeds comprised in the Schedule A hereto, relating to the premises belonging to the said 'AB' and situate at .....etc., described in Schedule B with intent to create a charge thereon for securing repayment to the said 'CD' of the sum of Rs..... this day lent and advanced by the said 'CD' to the said 'AB' on demand with interest for the same from this date at the rate of Rs..... per cent per annum.

The said 'AB' do hereby undertake as and when required by the said 'CD' to execute and register at the costs of the said 'AB' a legal mortgage in such form and containing such covenants and provisions as he may reasonably require.

Dated this..... day of..... 2009.

*The Schedule A above referred to  
Description of the Title Deeds deposited.  
The Schedule B above referred to  
Description of the Property.*

Signature of the Mortgagor.

**Question 2**

- (a) Write short notes on any two of the following :
- (i) *Del credere agency*
  - (ii) *Usufructuary mortgage*
  - (iii) *Power of attorney and letter of authority.* (3 marks each)
- (b) Choose the most appropriate answer from the given options in respect of the following :
- (i) *A deed kept for twenty years or more in man's escritoire or strong box is called —*
    - (a) *Pretended deed*
    - (b) *Lawful deed*
    - (c) *Warranty deed*
    - (d) *Latent deed.*
  - (ii) *A 'guarantee' guaranteeing an employer against the misconduct of an employee or to answer for the debt or default of another is called —*
    - (a) *Performance guarantee*
    - (b) *Bank guarantee*
    - (c) *Counter guarantee*
    - (d) *Fidelity guarantee.*
  - (iii) *In English law, mortgage by deposit of title deed is called as —*
    - (a) *Usufructuary mortgage*
    - (b) *English mortgage*
    - (c) *Equitable mortgage*
    - (d) *Anomalous mortgage.*
  - (iv) *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*
    - (b) *Special power of attorney*
    - (c) *Particular power of attorney*
    - (d) *Revocable power of attorney.*
  - (v) *In case of a company, mortgage of the property should be duly authorised—*
    - (a) *By objects clause of the memorandum of association and approved by a resolution of the Board*

(b) Only by objects clause of the memorandum of association

(c) Only by a resolution passed in the meeting of the Board

(d) By articles of association. (1 mark each)

(c) Mention the procedure to be followed for carrying through a compromise or arrangement under section 391 of the Companies Act, 1956. (5 marks)

### Answer 2(a)(i)

#### Del Credere Agency

There is a special type of agency, which combines agency with guarantee. This is known as del credere agency. A del credere agent is one who, for an extra remuneration undertakes the liability to guarantee the due performance of the contract by the buyer. By reason of his charging a del credere commission he assumes responsibility for the solvency and performance of the contract by the vendee and thus indemnifies his principal against loss. He, therefore, gives an additional security to the seller, but he does not shift the responsibility of payment from the buyer to the seller. A commission del credere is the premium or price given by the principal to the agent for guarantee, which presupposes a guarantee.

A *del credere* agent like any other agent, is to sell according to the instructions of his principal, to make such contracts as he is authorised to make for his principal and be bound, as soon as he receives the money, to hand it over to the principal. He is distinguished from other agents simply in this that he guarantees that those persons to whom he sells perform the contracts which he makes with them.

### Answer 2(a)(ii)

#### Usufructuary Mortgage

In this mortgage, the mortgagor delivers possession of the mortgaged property to the mortgagee who retains the possession until the satisfaction of the debt. The mortgagee will take the usufruct in lieu of the interest or part payment of the principal or partly in payment of interest or partly in part payment of the principal. The mortgagor is not personally liable to pay the debt and the mortgagee is not entitled during the term of the mortgage to demand his mortgage money.

### Answer 2(a)(iii)

#### Power of Attorney and Letter of Authority

**Power of Attorney** : Section 2(21) of the Indian Stamp Act, 1899 defines power of attorney as follows:

“Power of Attorney” includes any instrument (not chargeable with fee under the law relating to Court fees for the time being in force) empowering a specified person to act for and in the name of the person executing it”.

In terms of Section 1A of the Powers-of-Attorney Act, 1882 as amended by the Powers-of-Attorney (Amendment) Act, 1982, a power of attorney 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.

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

**Answer 2(b)(i)**

- (d) Latent deed

**Answer 2(b)(ii)**

- (d) Fidelity guarantee

**Answer 2(b)(iii)**

- (c) Equitable mortgage

**Answer 2(b)(iv)**

- (a) General Power of Attorney

**Answer 2(b)(v)**

- (a) By objects clause of the Memorandum of Association and approved by a resolution of the Board of Directors

**Answer 2(c)**

The following procedure shall be followed for carrying through a compromise or arrangement under Section 391 of the Act:

1. To prepare a scheme of compromise or arrangement with the concerned parties.
2. To apply to court by summons in Form No. 33 appended to the Companies (Court) Rules, 1959 for an order to convene a meeting of the creditors and or members or any class of them, supported by an affidavit in Form No. 34 of the Rules. The court may give such directions as it may think fit in respect of holding and conducting the meeting or meetings.
3. To hold the meeting or meetings and let the result be reported to the court. The court appoints a chairman for the meeting and where there are separate meetings, for each such separate meeting. The chairman of the meeting, or of each meeting, must report the result thereof to the court within the time fixed by the court, or where no time has been fixed within seven days after the conclusion of the meeting.
4. When the proposed compromise or arrangement is agreed to, with or without modification, as provided by Section 391(2) to apply to the court for confirmation of the compromise or arrangement. The petition must be made by the company (if the company is in liquidation; by its liquidator) within seven days of the filing of the report by the chairman. The petition shall be made in Form No. 40 of the said Rules.

Where a compromise or arrangement is proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies, or for the amalgamation of any two or more companies, the petition must pray

for appropriate orders and directions under Section 394 for facilitating the reconstruction or amalgamation of the company or companies.

The application under Section 391 is normally made by the company but any creditor or member also may make the application. It would, therefore, seem that a scheme could be started even if the company did not wish it, but the court will, it seems, refuse to convene the meetings if the company, either through its Board or simple majority of its members in a general meeting, has not approved the proposed scheme. This would be an exercise of the court's discretion and not a limit on its powers.

Before an application is made by a company under Section 391, it is usual for the Chairman of the Board of the company which is to be reconstructed or where an amalgamation between two or more companies is proposed, for the Chairman of the Board of each of these companies, to send a circular letter to the members of the company or companies and when the creditors are affected, to them also, explaining the scheme of reconstruction or amalgamation, as the case may be, and the reasons which prompted the preparation of the scheme. The circular letter should specify how the scheme will affect the shareholdings of the members, and when applicable, the claims of the creditors, including debenture holders.

### Question 3

(a) *Distinguish between the following :*

(i) *'Conveyance' and 'contract'.*

(ii) *'Instrument' and 'deed'.*

(iii) *'Partnership' and 'trust'.*

*(4 marks each)*

(b) *Write a short note on 'retirement and expulsion of partners'.*

*(4 marks)*

### Answer 3(a)(i)

#### Conveyance and Contract

1. Contract remains to be performed and its specific performance may be sought but conveyance passes on the title of property to another person. Conveyance does not create any right of any action but at the same time it alters the ownership of existing right.
2. Contracts are governed by provisions of the Indian Contract Act, 1872 whereas the cases of transfer of immovable property are governed by the Transfer of Property Act, 1882.
3. A contract to mortgage or sale would not amount to actual transfer of interest in the property but the deed of mortgage or sale would operate as conveyance of such interest. In other words, once the document transferring immovable property has been completed and registered as required by law, the transaction becomes conveyance. Any such transaction would be governed under the provisions of the Transfer of Property Act, 1882.

**Answer 3(a)(ii)****Instrument and Deed**

*Instrument* : The word “instrument” includes every document by which any right or liability is, or purports to be, created, transferred, modified, limited, extended, suspended, extinguished or recorded.

*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.

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. Deeds are in writing, signed sealed and delivered. Deeds are instruments, but all instruments are not deeds.

**Answer 3(a)(iii)****Partnership and Trust**

*Partnership* : Partnership is an association of two or more like minded persons formed with a common objective to establish a lawful business house of their choice with the idea of earning profits.

Partnership is defined in Section 4 of the Indian Partnership Act, 1932 as the relation between persons who have agreed to share profits of business carried on by all or any one of them acting for all.

*Trust* : A trust is defined under Section 3 of the Indian Trusts Act, 1882 as an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another or of another and the owner.

**Answer 3(b)****Retirement and Expulsion of Partners**

Sections 32 and 33 of the Partnership Act, 1932 make provisions for retirement and expulsion of partners.

A partner may retire from a firm with the consent of all the other partners. If the terms of the agreement so provide, a partner may retire by notice to the other partners. In a partnership at will also, a partner can retire by giving notice in writing to all the other partners of his intention to retire. A partner can be expelled from a firm by a majority of the partners where such a power is conferred by the agreement between the partners and the power is exercised in good faith.

**Question 4**

- (a) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *Drafting is first thinking and second composing.*
  - (ii) *If a document is not properly stamped, it is rendered inadmissible in evidence.*



- (iii) *Testimonium is the clause in the first part of the deed. (2 marks each)*
- (b) *“Practising of good professional etiquettes is necessary for professional success in the emerging business scenario.” Discuss. (4 marks)*
- (c) *Bharat requests Ajay to sell and deliver to him goods on credit. Ajay agrees to do so, provided Chandan guarantees the payment of the price of the goods. Is this a sufficient consideration for Chandan’s promise and is this arrangement a valid contract of guarantee ? Discuss. (6 marks)*

**Answer 4(a)(i)**

*Correct* : The process of drafting operates in two planes: the conceptual and the verbal. Besides seeking the right words, the draftsman seeks the right concepts. Drafting, therefore, is first thinking and second composing.

**Answer 4(a)(ii)**

*Correct* : The draft of document is required to be approved by the parties. The document after approval is engrossed i.e. copied fair on the non-judicial stamp-paper of appropriate value as may be chargeable as per the Indian Stamp Act. If a document is not properly stamped, it is rendered inadmissible in evidence nor it will be registered with the Registrar of Assurances.

**Answer 4(a)(iii)**

*Incorrect* : Testimonium is the clause in the last part of the deed. Testimonium signifies that the parties to the document have signed the deed. This clause marks the close of the deed and is an essential part of the deed.

**Answer 4b)**

Etiquette is the fine art of behaving in front of others. It is a set of practices and forms which are followed in a wide variety of situations. Many people consider it to be a branch of decorum, or general social behavior. Each society has its own distinct etiquette, and various cultures within a society also have their own rules and social norms.

In today’s world of business, professionals need to know how to conduct themselves within the corporate 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 demeanor, and the ability to converse appropriately with business colleagues and clients. Though academic knowledge and skills of a professional may be spectacular, but not knowing proper etiquette required to be successful in the professional career could be a roadblock preventing him to achieve success in the professional life and business relationships. Good professional etiquette indicates to potential employers that the person they are hiring is a mature, responsible adult who can aptly represent their company.

**Answer 4(c)**

This is a sufficient consideration for Chandan’s promise and this arrangement is a valid contract of guarantee.

Section 127 of the Indian Contract Act, 1872 defines consideration for guarantee as “Anything done, or any promise made, for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee”.

**Question 5**

(a) *Explain in detail the general principles of drafting and conveyancing and other writings.* (12 marks)

(b) *Write a short note on ‘covenants and undertakings’.* (4 marks)

**Answer 5(a)**

Drafting of legal documents is a skilled job. A draftsman, in the first instance, must ascertain the names, description and addresses of the parties to the instrument. He must obtain particulars about all necessary matters which are required to form part of the instrument. He must also note down with provision any particular directions or stipulations which are to be kept in view and to be incorporated in the instrument. The duty of a draftsman is to express the intention of the parties clearly and concisely in technical language. With this end in view, he should first form a clear idea of what these intentions are.

When the draftsman has digested the facts, he should next consider as to whether those intentions can be given effect to without offending against any provision of law. A corporate executive, therefore, must note down the most important requirements of law which must be fulfilled while drafting complete instrument on the subject. Knowledge of law of the land in general and knowledge of the special enactments applicable in a particular situation is an essential requirement for a draftsman to ensure that the provisions of the applicable law are not violated or avoided. As for instance, in cases where a deed to be executed by a limited company, it is necessary to go into the question as to whether the company has got power or authority under its memorandum to enter into the transaction. A limited company can do only that much which it is authorised by its memorandum. Further, a company being a legal entity, must necessarily act through its authorised agents. A deed, therefore, should be executed by a person duly authorised by the directors by their resolution or by their power of attorney.

It is also to be ensured that the format of documents adopted adheres to the customs and conventions in vogue in the business community or in the ordinary course of legal transactions. For any change in the form of such document, use of juridical and technical language should invariably be followed. The statements of negatives should generally be avoided. The order of the draft should be strictly logical. Legal language should be, to the utmost possible extent, precise and accurate. The draft must be readily intelligible to laymen.

Document should be supported by the schedules, enclosures or annexures in case any reference to such material has been made in that.

**Answer 5(b)**

**Covenants and Undertakings**

The term covenant has been defined as an agreement under seal, whereby parties stipulate for the truth of certain facts. In Whasten’s Law Lexicon, a covenant has been

explained as an agreement or consideration or promise by the parties, by deed in writing, signed, sealed and delivered, by which either of the parties, pledged himself to the other than something is either done or shall be done for stipulating the truth of certain facts. Covenant clause includes undertakings also. Usually, covenant is stated first. In some instances the covenants and undertakings are mixed, i.e. can not be separated in that case, they are joint together, words put for this as “The Parties aforesaid hereto hereby mutually agree with each other as follows:” Such covenants may be expressed or implied.

### Question 6

*Attempt any four of the following :*

- (i) *What is meant by ‘pre-incorporation contracts’ ? Can a company ratify a contract entered into by the promoters on its behalf before its incorporation ? Explain with reasons. (4 marks)*
- (ii) *Mention important guidelines which are required to be followed while entering into a foreign collaboration agreement. (4 marks)*
- (iii) *Draft an affidavit of creditor in proof of his debt in proceeding for the liquidation of a company. (4 marks)*
- (iv) *Define the following :*
  - (a) *Appeal*
  - (b) *Affidavit*
  - (c) *Articles of Association*
  - (d) *Rejoinder. (1 mark each)*
- (v) *What is ‘compounding of offences’ ? How does compounding of offences take place under the Code of Criminal Procedure, 1973 ? (4 marks)*

### Answer 6(i)

#### Pre-incorporation contracts

The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated, such contracts are called preliminary or pre-incorporation contracts.

The promoters generally enter into such contracts as agents for the company about to be formed. The legal position is that since presence of two consenting parties is necessary for a contract, and the company before incorporation is a non-entity, the promoters cannot act as agents for the company, which has yet to come into existence. As such, the company is not liable for the acts of the promoters done before its incorporation.

Similarly, the company, after incorporation, cannot enforce any contract made before its incorporation, which means the company cannot sue the other party to the contract if the other party fails to carry out the contract. Promoters remain personally liable on the contract.

A company also cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit

of the contract purporting to have been made on its behalf before it came into existence, as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at the time of the contract by the agent. Where a contract is made on behalf of principal known to both parties to be non-existent, the contract is deemed to have been entered into personally by the actual maker, i.e. the agent. The company may, if it desires, enter into a new contract, after its incorporation, with the other party which is known as novation of promoter's contracts; and if it makes a fresh contract in terms of the preliminary contract, the liability of the promoters comes to an end and if it does not make a fresh contract within a limited, period of time, either of the parties may rescind the contract.

The pre-incorporation agreements entered into by the promoters acting on behalf of the intended company with third party cannot always be avoided for various reasons. These agreements affect the operations of the incorporated company.

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

#### **Guidelines for entering into Foreign Collaboration Agreements**

These guidelines cover the following aspects of foreign collaboration agreements:

1. *Investment* : Where in a foreign collaboration agreement, equity participation is involved, the value of the shares to be acquired should be brought in cash.
2. *Lump sum payment* : The amount agreed to be paid by an Indian party to a foreign collaborator for technology transfer should be paid in three instalments as follows:
  - (i) one-third to be paid after the agreement has been approved by the Central Government;
  - (ii) one-third on transfer of the technical documents; and
  - (iii) one-third on the commencement of commercial production.
3. *Royalty* : Royalty payable to a foreign collaborator has to be calculated on the basis of net ex-factory selling price of the product less excise duties and cost of imported components. The normal rate of royalty may be three per cent to five per cent. This rate will depend upon the nature and extent of the technology involved.
4. *Duration of agreement* : The period is approved by the Government usually for five years from the date of the agreement in the first instance or five years from the date of commencement of commercial production; the total period, however, not exceeding eight years from the date of the agreement.
5. *Renewal or extension of agreement* : The Central Government may consider an application for renewal of a foreign collaboration agreement or for extension of its period on merit.
6. *Sub-licensing* : An agreement shall not normally impose any restriction on the sub-licensing of the technical know-how to other Indian parties. Sub-licensing is, however, subject to the Central Government's approval.
8. *Exports* : No foreign collaboration agreement shall be allowed to contain any restriction on the free export to all countries, except in a case where the foreign

collaborator has licensing arrangements in which case the countries concerned shall be specified.

9. *Procurement of capital goods etc.* : There should be no restriction on procurement of capital goods, components, spares, raw materials etc. by the Indian party.
10. *Training* : Provision shall be made in the agreement for adequate facilities for training of Indian technicians for research and development.
11. *Exploitation of Indian patents* : Where any item of manufacture is patented in India, the payment of royalty or lump sum to the foreign collaborator should make provision for compensation for use of such patent until its expiry.
12. *Brand Name* : There should be no insistence on the use of foreign brand names on products for sale in India. There can, however, be no objection for use of foreign brand name on products to be exported to other countries.
13. *Indian Laws* : All collaboration agreements shall be subject to Indian laws.
14. *Approval of Central Government* : Every foreign collaboration agreement shall be approved by the Central Government.

While drafting a collaboration agreement, care should be taken that it is in strict compliance with the guidelines as detailed above. Every collaboration agreement must contain one or more clause to the effect: "The agreement shall be subject to Indian laws. The agreement shall be subject to the approval of the Government of India".

### **Answer 6(iii)**

#### **Affidavit of creditor in proof of his debt in proceeding for the liquidation of a company**

IN THE (HIGH) COURT OF.....

The matter of the Indian Companies Act, 1956.

And

The matter of the liquidation of..... Company Limited.

I, AB, aged..... years, son of Shri..... resident of....., do hereby on oath (or on solemn affirmation) state as follows:

1. That the abovenamed company was on the..... day of..... 2009, the date of the order for winding up the same, and still is justly and truly indebted to me in the sum of Rupees..... (Rs.....) only in account of (describe briefly the nature of the debt).
2. That in proof of the aforesaid debt I attach hereto the documents marked A, B and C.
3. That I have not, nor have any person or persons by my order or to my knowledge or belief for my use, received the aforesaid sum of Rupees..... or any part thereof, or any security or satisfaction for the same or any part thereof except the sum or security (state the exact amount of security).

4. That this my affidavit is true, that it conceals nothing and no part of it is false.

Sd/-

AB

Dated..... 2009

Deponent

*Verification*

I, the abovenamed deponent, verify that the contents of paragraphs 1 to 4 of this affidavit are true to my personal knowledge.

Sd/-

AB

Dated..... 2009

I, ..... s/o..... r/o..... declare, from a perusal of the papers produced by the deponent before me that I am satisfied that he is Shri AB

Sd/-.....

Solemnly affirmed before me on this.....day of..... 2009 of..... (time) by the deponent.

Sd/-.....

(Oath Commissioner)

**Answer 6(iv)**

- (a) *Appeal* : Any application by a party to an appellate Court, asking it to set aside or revise a decision of a subordinate Court, is an "appeal".
- (b) *Affidavit* : A statement or declaration on oath by the deponent is called Affidavit. The consequences of a false affidavit are serious. Therefore, great care is required in drafting it.
- (c) *Articles of Association* : Articles of Association is another equally important document for incorporation of a limited company. Articles are rules and regulations for management of internal affairs of the company. It constitute a contract between the company and its members and members inter se. It is framed with the object of carrying out aims and objects of the company as contained in Memorandum and if necessary it may clarify anything contained in Memorandum. Section 36 of the Companies Act, 1956 emphasises its importance as to its contractual force. Articles should be in conformity with the provisions of Memorandum and the Companies Act.
- (d) *Rejoinder* : A written statement/reply of the plaintiff/petitioner by way of defense to pleas' raised in the counter affidavit/written statement from the defendant/respondent, is termed as a rejoinder or replication. Such statements are subsequent pleadings as contemplated in Order 8, Rule 9 of the Civil Procedure Code. Under Rule 9, leave of the court is essential before any party can present a further pleading after the written statement has been filed.

**Answer 6(v)****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 saves the parties from the hassle of spending a lot of money, time and energy in lengthy legal proceedings. In a country like India where there are thousands of cases pending in the court 'compounding' is a good way of settling disputes or matters.

**Compounding of Offences under the Code of Criminal Procedure** : Section 320 of the Criminal Procedure Code, 1973 permits compounding of various offences under Indian Penal Code. Such compounding can be done either before or after institution of prosecution. It may be pointed out here that a crime is essentially a wrong done to society; therefore a compromise between the accused (wrong-door) and the individual victim should not be enough to absolve the accused from criminal responsibility. However, where the offences are essentially of a private nature and relatively not quite serious, the Code considers it expedient to recognize some of them as compoundable offences [see the table given in Section 320(1)] and some others as compoundable only with the permission of the court [see the table given in Section 320(1)]. After payment of such composition amount, prosecution will not be launched, or if it was launched, it will be withdrawn.

**Question 7**

- (a) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
- (i) *Outsourcing is the contracting out of a company's non-core, non-revenue producing activities to a \_\_\_\_\_.*
  - (ii) *The present day system of pleadings in our country is based on the provisions of the \_\_\_\_\_ supplemented from time to time by rules in that behalf by the High Courts of the States.*
  - (iii) *\_\_\_\_\_ is an application by any party to an appellate court asking it to set aside or revise a decision of a subordinate court.*
  - (iv) *\_\_\_\_\_ compels courts to act within their jurisdiction when a tribunal acts without or in excess of jurisdiction or in violation of the rules or law.*
  - (v) *In compounding of offences, \_\_\_\_\_ make a joint application to the court that the parties have come to terms and the case may not be proceeded with. (1 mark each)*
- (b) *State the general guidelines of drafting notices under the Companies Act, 1956. (5 marks)*
- (c) *What is meant by a 'consent order' ? What remedies are available with the*

*Securities and Exchange Board of India if the consent order is violated by a party ?* (6 marks)

**Answer 7(a)**

- (i) Outsourcing is the contracting out of a company's non-core, non-revenue producing activities to a **specialist**.
- (ii) The present day system of pleadings in our country is based on the provisions of the **Civil Procedure Code, 1908** supplemented from time to time by rules in that behalf by the High Courts of the States.
- (iii) **An appeal** is an application by any party to an appellate court asking it to set aside or revise a decision of a subordinate court.
- (iv) **Writ of prohibition** compels courts to act within their jurisdiction when a tribunal acts without or in excess of jurisdiction or in violation of the rules or law.
- (v) In compounding of offences, **the accused and the complainant** make a joint application to the court that the parties have come to terms and the case may not be proceeded with.

**Answer 7(b)**

**General Guidelines for Drafting of Notices**

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 7(c)**

#### **Consent Order**

Consent Order means an order settling administrative or civil proceedings between the regulator and a person (party) who may prima facie be found to have violated securities laws. Here, Administrative/Civil enforcement actions include issuing directions, suspension or cancellation of certificate of registration, imposition of monetary penalty, pursuing suits and appeals in Courts and Securities Appellate Tribunal (SAT). It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. A Consent Order may or may not include a determination that a violation has occurred.

Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

Remedies available with SEBI in case of violation: Violation of consent order by a party (i.e. failure to obey) would invite appropriate action, including for violating SEBI orders, besides revival of the pending action. In this context, any proceeding which had been kept in abeyance pending the consent process will begin from such stage at which it was suspended.

**Question 8**

- (a) Explain the guidelines for professional dress of Company Secretaries. (6 marks)
- (b) Why is art of advocacy important ? What are the important factors which Company Secretaries should keep in mind while making written pleadings ? (10 marks)

**Answer 8(a)****Guidelines for Professional Dress of Company Secretaries**

In professional life it is important to look presentable because personal appearance counts. How you look can be a major factor in how you are perceived by others. Getting dressed for work is to project a professional and competent image. It has been observed that the professionals who do not take the time to maintain a professional appearance or those who have never learned how to dress properly for their chosen field of work, are not being taken seriously by co-workers and present the image of not being able to perform satisfactorily on the job.

To enhance the visibility and brand building of the profession and ensuring uniformity, the Council of the Institute of Company Secretaries of India has prescribed the following guidelines for professional dress for members while appearing before judicial/quasi-judicial bodies and tribunals:

- (a) The professional dress for male members will be Navy Blue suit and white shirt with a tie (preferably of the ICSI) or navy blue buttoned-up coat over a pant or a navy blue safari suit.
- (b) The professional dress for female members will be saree or any other dress of a sober colour with a Navy Blue jacket.
- (c) Members in employment may wear the dress/uniform as specified by the employer for all employees or if allowed the aforesaid professional dress.
- (d) Practising Company Secretaries appearing before any tribunal or quasi-judicial body should adhere to dress code if any prescribed for appearing before such tribunal or quasi-judicial body or if allowed the aforesaid professional dress.

It may be pointed out that any person whether a lawyer, pleader or authorized representative representing a litigant before any court of law or a tribunal or any other authority discharging the functions of a court/a quasi judicial authority, should comport himself in a manner befitting his status as an officer of the court, a privileged member of the community and a gentleman.

**Answer 8(b)****Art of Advocacy**

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.

For winning a case, art of advocacy is important which in essence means to convince the judge and others that my position in the case is the proper interpretation. Advocacy/ court craft is learned when we enter the practising side of the profession. The aim of advocacy is to make judge prefer your version of the truth.

Apart from the legal side of the profession, advocacy is often useful and sometimes vital, in client interviewing, in negotiation and in meetings, client seminars and public lectures. It is a valuable and lifelong skill worth mastering.

Technical and legal knowledge about the area in which Company Secretaries are acting is essential. Better their knowledge, the better their advocacy skills and the greater their impact. Good advocacy or negotiating skills will not compensate for lack of appropriate knowledge.

### **Points to be kept in mind while drafting written pleadings**

Pleadings could be both written and oral. Mastering both the kinds of pleadings is a must for effective delivery of results to the clients. Some of the important factors which may be borne in mind while making written pleadings are as under:

- Quote relevant provisions in the petition and excerpts of observations made by the Courts relevant to the point;
- Draft prayers for interim relief in such a manner which though appears to be innocuous but satisfy your requirements;
- Do not suppress facts;
- Highlight material facts, legal provisions and Court decisions, if any;
- State important points at the outset together with reference to relevant provisions/ judgements.

### **If you are opponent**

- File your reply to the petition at the earliest opportunity;
- Take all possible preliminary contentions together with reference to relevant law point and judgements;
- Submit your reply to each paragraph of the petition.

### **If you are for the petitioner**

- File your rejoinder upon receiving the reply at the earliest opportunity;
  - Meet clearly with the specific points raised by the opponent in the reply affidavit.
-

## PROFESSIONAL PROGRAMME EXAMINATION

JUNE 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) Failure of a firm is technical if it is unable to meet its current obligations.
- (ii) In addition to transaction motive, more motives force corporate to hold inventory.
- (iii) CAPM is a tool to workout cost of equity.
- (iv) 'Counter party risk' is faced in forward transactions.
- (v) The function of treasury management is concerned with both macro and micro facets of the economy. (5 marks each)

#### Answer 1(i)

Failure of a firm is technical if it is unable to meet its current obligations. The failure could be temporary and might be remediable. When liabilities exceed assets i.e. the net worth becomes negative, bankruptcy as commonly understood, arises. The technical bankruptcy can be ascertained by comparing current assets and current liabilities i.e. working out current or/and quick ratios. If the amount of current assets is not sufficient to meet the current liabilities, it is known as technical failure of firm. However, this type of failure is related to short term only and firm can recover from such situation in long-term.

#### Answer 1(ii)

A company may hold inventory with transaction motives in order to facilitate the smooth & uninterrupted production and sales operations. The other motives that force corporate to hold inventory are as follows:

1. *Precautionary motives* – To guard against the risk of unpredictable changes in demand and supply forces, short supply, lengthy processes involved in imports etc.
2. *Speculative motive* – To gain advantage in terms of quantity discounts connected with bulk purchases or anticipated price rises.

#### Answer 1(iii)

#### CAPM – Capital Asset Pricing Model

CAMP helps to work out required rate of return required by investors in the form of

equity investment. It establishes a linear relationship between the required rate of return of a security and its  $\beta$ .

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

$\beta$  = Beta of Security

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

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

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

This  $R_i$  can be used to find out the price of the share which depends on Dividend and  $R_i$ , and can be calculated as follows:

$$P_0 =$$

$$D_1 = \text{Dividend expected in next year}$$

$$K_e = R_i$$

$$G = \text{Growth rate in dividend}$$

#### Answer 1(iv)

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

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

There is a counterparty risk in forward transactions because these transactions are bilateral and not exchange traded. Both the parties are subject to the risk of default by the other party.

#### Answer 1(v)

Treasury management is concerned with both macro and micro facets of the economy. At the macro level, the inflows and outflows of cash, credit and other financial instruments are the functions of the government and the business sectors. These inflows are arranged by them as borrowing from the public. The micro units utilize these inflows and build up their capacities for production of output. These leads to establishment of a production system which logically leads us to the natural consequence, i.e. the establishment of distribution and consumption systems. Once the production, distribution and consumption systems are in place at the micro level, the generation of surpluses at the units begins. These surpluses are channeled back into the macro system as outflows from the micro system. The inflows are the taxes paid to the government and repayment of loans made to the banks and financial institutions. These inflows into the macro level have to be managed by the treasury managers at the macro level.

**Question 2**

(a) The following financial data relates to XYZ Ltd. :

Year	Earnings Per Share (Rs.)	Dividend Per Share (Rs.)	Share Price (Rs.)
2004	42	17	252
2005	46	18	184
2006	51	20	255
2007	55	22	275
2008	62	25	372

A firm of market analysts which specialises in the industry in which XYZ Ltd. operates has recently re-evaluated the company's future prospects. The analysts estimate that XYZ Ltd.'s earnings and dividend will grow at 25% for the next three years. Thereafter, earnings are likely to increase at a lower rate of 10%. If this reduction in earnings growth occurs, the analysts consider that the dividend payout ratio will be increased to 50%.

XYZ Ltd. is all equity financed and has 10 lakh ordinary shares in issue. The tax rate of 33% is not expected to change in the foreseeable future. Calculate the estimated share price; and the P/E ratio by using dividend valuation model. For this purpose, you can assume a constant post-tax cost of capital of 18%.

(12 marks)

(b) An investor buys a NIFTY futures contract for Rs.2,80,000 (lot size 200 futures). On the settlement date, the NIFTY closes at 1,378. Find out his profit or loss, if he pays Rs.1,000 as brokerage. What would be the amount of profit or loss, if he has sold the futures contract ?

(4 marks)

(c) Ankush Ltd. has a plan to raise an amount of Rs.50 crore for a period of 3 months, 6 months from now. The current rate of interest is 9% but it may rise in 6 months time. The company wants to hedge itself against the increase in interest rate. Bank of India has quoted a forward rate agreement (FRA) at 9.1% per annum.

Find out the effect of FRA and actual interest cost to Ankush Ltd., if the actual rate after 6 months happens to be 9.5% or 8.5%.

(4 marks)

**Answer 2(a)**

(i) Dividend valuation model :  $P_0 = \frac{\text{Dividend}_1}{K_e - g}$

**Projection of Dividends**

Year	EPS	DPS	$PV_1$ @ 18%	Discounted DPS
2009	77.50	31.25	0.8475	26.48
2010	96.88	39.06	0.7182	28.05
2011	121.10	48.82	0.6086	29.71
				84.24

Dividend for year 2012:

$$D_{2012} = \text{Rs. } 121.10 \times 1.10 \times 50\% = \text{Rs. } 66.60$$

Therefore, the perpetuity value, assuming 10% growth rate:

$$P_{2011} = \frac{66.60}{0.18 - 0.10} = \text{Rs. } 832.50$$

Today's price of share :	<i>Rs.</i>
PV of Dividend of 2009 to 2011	84.24
Add. PV of $P_{2011}$ ( $832.50 \times 0.6086$ )	506.66
	<u>590.90</u>

(ii) P/E Ratio

$$\begin{aligned} \text{P/E Ratio} &= \text{PV of } P_{2011} / \text{EPS}_0 \\ &= 590.90 / 62 = 9.53 \end{aligned}$$

### Answer 2(b)

(a) In this case, the total value is Rs.2,80,000 and lot is 200, So, the NIFTY Futures on the transaction date is 1400 (i.e. 2,80,000/200). Now on the settlement date, the NIFTY is 1378 therefore, it has reduced by 22 points. The loss to the investor is—

$$\begin{aligned} \text{Loss} &= (1400 - 1378) \times 200 + 1000 \\ &= 4400 + 1000 \\ &= 5400 \end{aligned}$$

In case, he has sold the futures contract, his profit would have been—

$$\begin{aligned} \text{Profit} &= (1400 - 1378) \times 200 - \text{Rs. } 1000 \\ &= 4400 - 1000 = 3400 \end{aligned}$$

**Assumption : The brokerage of Rs.1000 would be payable in both the cases.**

### Answer 2(c)

**If actual rate is 9.5%.**

In this case, the bank, shall pay a differential of 0.4% (9.5%-9.1%). The cash flow is—

$$\text{Cash Flow} = 50 \text{ Crores} \times 0.4\% \times 0.25 = \text{Rs. } 5,00,000$$

This amount is paid up front to Ankush Ltd., which can invest it @9.5% for 3 months period at 6 months from now. Total accumulation is—

$$\text{Total amount} = \text{Rs. } 5,00,000 \times \left(1 + \frac{0.095}{4}\right) = \text{Rs. } 5,11,875$$

At the end of the borrowing period Ankush Ltd. will pay interest @9.5% on Rs.50 Crores

$$\begin{aligned} \text{Interest} &= \text{Rs. } 50 \text{ Crores} \times 0.095 \times .25 \\ &= \text{Rs. } 1,18,75,000 \end{aligned}$$

$$\text{Net Cost to XYZ} = \text{Rs. } 1,18,75,000 - \text{Rs. } 5,11,875 = \text{Rs. } 1,13,63,125$$

This is 9.1% of the total borrowing for a period of 3 months. So, by entering into Forward Rate Agreement (FRA), Ankush Ltd. has restricted its cost at 9.1% p.a.

**If actual rate is 8.5%**

If the rate is 8.5%. Ankush Ltd. will be required to pay up front 0.6% to the bank i.e. the amount of Rs.7,50,000. On the due date, interest on Rs.50 Crores is payable @8.5% i.e. Rs.1,06,25,000. The total cost to Ankush Ltd. is Rs.1,13,75,000 which is 9.1% of total funds. It may be noted that the amount of Rs.7,50,000 is to be borrowed at 8.5% p.a. for a period of 3 months. This will be paid to the bank. The borrowing of Rs.7,50,000 will be repaid as Rs.7,65,938 after 3 months inclusive of interest.

**Question 3**

- (a) *The management of Laxmi Ltd. has called for a statement showing the working capital needed to finance a level of activity of 6,00,000 units of output for the year 2009. The cost structure for the company's product for the abovementioned level is given as under :*

	<i>Cost Per Unit (Rs.)</i>
<i>Raw materials</i>	<i>20</i>
<i>Direct labour</i>	<i>5</i>
<i>Overheads</i>	<i>15</i>
<i>Total costs</i>	<i>40</i>
<i>Profit</i>	<i>10</i>
<i>Selling price</i>	<i>50</i>

*Past trends indicate that raw materials are in stock on an average for three months.*

*Work-in-progress will approximate to half a month's production. Finished goods remain in warehouse on an average for two months. Suppliers of materials extend one month's credit.*

*Two months' credit is normally allowed to debtors. A minimum cash balance of Rs.1,00,000 is expected to be maintained. The production pattern is assumed to be even during the year.*

*You are required to prepare the statement of working capital determination.*

*(12 marks)*



- (b) You sold Hong Kong \$1,00,00,000 value spot to your customer at Rs.5.70/HK \$ and covered yourself in London market on the same day, when the exchange rates were :

US \$1=HK \$7.5880 and HK \$7.5920.

Local inter-bank market rates for US\$ were –

Spot US \$1=Rs.42.70 and Rs.42.85.

Calculate — (i) cover rate; and (ii) ascertain profit or loss in transaction. Ignore taxation. (4 marks)

- (c) “Discounted cash flow is very close to economic value added.” Comment. (4 marks)

### Answer 3(a)

#### Statement showing Working Capital Determination

Item	Cost per Unit (Rs.)	Amount for 600000 Units of output (Rs.)
Raw Materials	20.00	1,20,00,000
Direct labour	5.00	30,00,000
Overheads	15.00	90,00,000
Total Cost	40.00	2,40,00,000
Profit	10.00	60,00,000
Sales	50.00	3,00,00,000

#### Calculation of Working Capital Requirement –

(i) Raw Materials		
(Stock for three months) – Rs.3/12 x 1,20,00,000)	=	30,00,000
(ii) Work-in-progress ½ months productions		
(1/2 month total cost = 1/24 x 2,40,00,000)	=	10,00,000
(iii) Finished good remain in warehouse for two months		
(2/12 x 2,40,00,000)	=	40,00,000
Total Inventory	=	80,00,000
Debtors – 2 months sales (on cost basis)		
2/12 x 2,40,00,000	=	40,00,000
Cash Balance (minimum)	=	1,00,000
Total Current Assets		1,21,00,000
(-) Creditors = (1/12 x 1,20,00,000)	=	10,00,000
Required Working Capital	=	1,11,00,000

Note : Debtors can also be calculated on Sales Basis.

**Answer 3(b)**

In this case, the cover rate can be calculated as the Cross Rate between Rs. and HK \$ in the London market. The cross rates in the London Market can be stated as follows:

$$\begin{aligned}\frac{\text{Rs.}}{\text{HK\$}} &= \frac{\text{Rs.}}{\text{\$}} \times \frac{\text{\$}}{\text{HK\$}} \\ &= \frac{\text{Rs.}}{\text{\$}} \times \frac{1}{\text{HK\$ / \$}} \\ &= 42.85 \times \frac{1}{7.5880} \\ &= \text{Rs.}5.64707\end{aligned}$$

As the rate in London is less, the HK\$ can be bought in London and the Profit is:

$$\begin{aligned}\text{Profit} &= 1,00,00,000 \times (5.70 - 5.64707) \\ &= \text{Rs. } 5,29,300\end{aligned}$$

**Answer 3(c)**

Discounted cash flow is very close to economic value-added (EVA), with the discount rate being the cost of capital.

There are two key components to EVA. The net operating profit after tax (NOPAT) and the capital charge, which is the amount of capital times the cost of capital. In other words, it is the total pool of profits available to provide cash return to those who provided capital to the firm. The capital charge is the product of the cost of capital times the capital tied up in the investment. In other words, the capital charge is the cash flow required to compensate investors for the riskiness of the business given the amount of capital invested. On the one hand, the cost of capital is the minimum rate of return on capital required to compensate debt and equity investors for bearing risk-a cut-off rate to create value and capital is the amount of cash invested in the business, net of depreciation. In formula form,

$$\text{EVA} = (\text{Operating Profit}) - (\text{A Capital Charge})$$

$$\text{EVA} = \text{NOPAT} - (\text{Cost of Capital} \times \text{Capital})$$

**Question 4**

*Distinguish between **any four** of the following :*

- (i) *'Financing of current assets' and 'financing of fixed assets'.*
- (ii) *'Financial derivatives' and 'commodity derivatives'.*
- (iii) *'Interest rate parity' and 'purchasing power parity'.*
- (iv) *'Capital structure' and 'financial structure'.*
- (v) *'Liquidity management' and 'treasury management'. (5 marks each)*

**Answer 4(i)****'Financing of Current Assets' and 'Financing of Fixed Assets'**

The more of the funds of a business are invested in working capital, lesser is the return in term of profitability and less amount is available for investing in long-term assets such as plant and machinery, etc. Therefore, the corporate enterprise has to minimize investment in working capital and to concentrate on investment of resources in fixed assets.

Fixed assets financing is different from current assets financing. In fixed assets investment is made in building, plant and machinery which remains blocked over a period of time and generates funds through the help of working capital at a percentage higher than the return on investment in current assets. Working capital financing or current assets financing is done by raising short-term loans or cash credits limits but fixed assets financing is done by raising long-term loans or equity.

**Answer 4(ii)****'Financial Derivatives' and 'Commodity Derivatives'**

Derivative contracts can be entered into for different types of commodities such as sugar, jute, pepper, gur castor seeds etc. In India, futures contracts in commodities are available at different commodities exchanges. MCX, NMCEX and NCDEX offer futures contracts in several agricultural commodities and metals.

On the other hand, the derivative in currencies, gilt-edged securities, shares, shares indices, etc. are known as financial derivatives. These are transacted at different exchanges all over the world. Financial derivatives can be broadly classified into currency derivatives, interest rate derivatives and stock and stock index derivatives. In India, Stock Index Futures, Stock Index Options, Stock Options and Stock Futures can be traded at BSE or NSE. Interest rate Derivatives have also been allowed by the Government.

**Answer 4(iii)****'Interest Rate Parity' and 'Purchasing Power Parity'**

*Interest Rate Parity*: According to interest rate parity principle, the forward premium (or discount) on currency of a country vis-à-vis the currency of another country will be exactly offset by the interest rate differential between the countries. The currency of the country with lower interest rate is quoted at a forward premium and vice versa.

*Purchasing Power Parity*: According to the Purchasing Power Parity (PPP) Principle, the currency of a country will depreciate vis-à-vis the currency of another country on the basis of differential in the rates of inflation between them. The rate of depreciation in the currency of a country would roughly be equal to the excess inflation rate in the country over the other country.

**Answer 4(iv)****'Capital Structure' and 'Financial Structure'**

- Capital structure relates to long term capital sources for creation of long term assets. Financial structure involves creation of both long term and short term sources.

- Capital structure is the core element of the financial structure. Capital structure can exist without the current liabilities and in such cases, capital structure shall be equal to the financial structure. But we can not have a situation where the firm has only current liabilities and no long term capital.
- Components of the capital structure may be used to build up the level of current assets but the current liabilities should not be used to finance acquisition of fixed assets. This would result in an asset liability mismatch.

#### Answer 4(v)

#### 'Liquidity Management' and 'Treasury Management'

Liquidity management ensures that the right amount of cash is available, at the right time and in the right place, is firmly positioned as a pivotal task for every treasurer. Liquidity management is in fact a part of the treasury management. Over the past few years, many treasurers have made substantial progress towards increasing the visibility of their cash flow and centralizing cash within countries or regions. However, liquidity management and particularly cash flow forecasting remain the greatest challenges facing treasurers. With credit more expensive and elusive for many companies, it is now imperative to tackle these challenges effectively. Liquidity management of a financial institution or bank or company is some how different to that of other trading units. The process starts with tapping of funds at lower rate in shape of deposits/borrowing and ends with investing the same in higher rate to earn profit out of business with a margin of small portion of cash-in-hand kept to meet day to day operation.

#### Question 5

- (a) *Sumati Ltd. is considering three finance plans. Total investments required is Rs. 2,00,000.*

<i>Plan</i>	<i>Equity</i>	<i>Debt</i>	<i>Preference Shares</i>
<i>A</i>	<i>100%</i>	<i>—</i>	<i>—</i>
<i>B</i>	<i>50%</i>	<i>50%</i>	<i>—</i>
<i>C</i>	<i>50%</i>	<i>—</i>	<i>50%</i>

*Cost of debt : 8%*

*Cost of preference shares : 8%*

*Tax rate : 30%.*

*Equity shares of face value of Rs. 10 each will be issued at a premium of Rs. 10 per share.*

*Expected EBIT is Rs.80,000.*

*You are required to calculate for each finance plan —*

- (i) Earnings per share (EPS); and*
  - (ii) EBIT range among the EPS equivalency point. (6 marks each)*
- (b) *Rosa Chemicals Ltd. has outstanding 1,20,000 shares selling at Rs. 20 per share. The company hopes to make a net income of Rs.3,50,000 during the year ending 31st March, 2009. The company is thinking of paying a dividend of Rs. 2*

per share at the end of current year. The capitalisation rate for risk class of this firm has been estimated to be 15%. Assuming no taxes, answer the questions listed below on the basis of the Modigliani Miller dividend valuation model :

- (i) What will be the price of share at the end of 31st March, 2009, if – (a) the dividend is paid; and (b) the dividend is not paid ? (6 marks)
- (ii) How many new shares the company must issue if the dividend is paid and company needs Rs.9,50,000 for an approved investment expenditure during the year ? (2 marks)

**Answer 5(a)**

**(i) Computation of EPS of Sumati Ltd. under Plan A, B and C**

Plan	A	B	C
EBIT	80000	80000	80000
Less : Interest	—	8000	—
PBT	80000	72000	80000
Less : Tax (.30)	24000	21600	24000
PAT	56000	50400	56000
Less : Dividend on Preference shares	—	—	8000
= Earnings for equity	56000	50400	48000
No. of equity shares	10000	5000	5000
EPS	5.6	10.08	9.6

**(ii) EBIT Range**

Plan A & B

$$\frac{(\text{EBIT} - 0)(1 - 0.30)}{10,000} = \frac{(\text{EBIT} - 8000)(1 - 0.30)}{5,000}$$

$$\therefore \text{EBIT} = \text{Rs. } 16,000$$

EPS in both cases would be Rs. 1.12

Plan B & C

EBIT can not be calculated

Plan A & C

$$\frac{(\text{EBIT} - 0)(1 - 0.30)}{10,000} = \frac{[(\text{EBIT} - 0)(1 - 0.30)] - 8000}{5,000}$$

$$\therefore \text{EBIT} = \text{Rs. } 22,857$$

EPS in both cases would be Rs. 1.60

**Answer 5(b)**

(i) (a) Price of the share if the dividend is paid-

$$P_0 =$$

$$20 = \frac{2 + P_1}{1 + 0.15}$$

$$20(1 + 0.15) = (2 + P_1)$$

$$P_1 = 23 - 2 = 21$$

(b) Price of the share if dividend is not paid-

$$20 = \frac{0 + P_1}{1 + 0.15}$$

$$20 = \frac{0 + P_1}{1.15}$$

$$P_1 = 20(1.15)$$

$$P_1 = 23$$

Rs. 9,50,000 – (Rs. 3,50,000) = Rs. 6,00,000

(1 + K<sub>e</sub>)

21

$$\Delta N = I - (E - ND_1) / P_1$$

$$N =$$

$$= \frac{9,50,000 - 1,10,000}{21}$$

$$= 8,40,000 / 21 = 40,000 \text{ Shares}$$

**Question 6**

An iron ore company is considering investing in a new processing facility. The company extracts ore from an open pit mine. During a year, 1,00,000 tons of ore is extracted. If the output from the extraction process is sold immediately upon removal of dirt, rocks and other impurities, a price of Rs. 1,000 per ton of ore can be obtained. The company has estimated that its extraction costs amount to 70% of the net realisable value of the ore.

As an alternative to selling all the ore at Rs. 1,000 per ton, it is possible to process further 25% of the output. The additional cash cost of further processing would be Rs. 100 per ton. The processed ore would yield 80% final output and can be sold at Rs. 1,350 per ton.

For additional processing the company would have to install equipments costing Rs. 100 lakh. The equipment is expected to have a useful life of 5 years with no salvage value. The company follows the straight line method of depreciation. Additional

working capital requirement is estimated at Rs. 10 lakh. The company's cut-off rate for such investments is 15%. Assume corporate tax rate 30% (including surcharge and education cess).

Should the company install the equipment for further processing of the iron ore ?  
(20 marks)

**Answer 6**

<i>Cash Outflows</i>	<i>(Rs.)</i>
Cost of equipment	1,00,00,000
+ Additional working capital	10,00,000
	<u>1,10,00,000</u>

*Cash Inflows (operating) years (1-5)*

<i>Particulars</i>		<i>Amount (Rs.)</i>
Incremental revenue (350 x 20,000)		70,00,000
(-) Incremental Costs -		
Processing costs(100 x 25,000 tons)	25,00,000	
Depreciation (1,00,00,000 / 5)	<u>20,00,000</u>	<u>45,00,000</u>
Earnings before taxes		25,00,000
(-) Taxes @ 30%		<u>7,50,000</u>
		17,50,000
+ Depreciation		<u>20,00,000</u>
Earnings / Cash Flow After Tax		<u>37,50,000</u>

## NPV

<i>Particulars</i>	<i>Year</i>	<i>Amount (Rs.)</i>	<i>PVF at 15%</i>	<i>Total PV (Rs)</i>
Cash outflows	t = 0	(1,10,00,000)	1.000	(1,10,00,000)
Operating CFAT	t = 1-5 (Annuity)	37,50,000	3.3522	1,25,70,750
Recovery of WC	t = 5	10,00,000	0.4972	<u>4,97,200</u>
	NPV			<u>20,67,950</u>

*Recommendations* - The company is advised to install the equipment for further processing of Ore, as it promises a positive Net Present Value.

**Question 7**

Write notes on **any four** of the following :

- (i) *Participating preference shares*
- (ii) *Credit investigation factors*
- (iii) *Transfer pricing*
- (iv) *Risks in forex market*
- (v) *Financial distress.*

(5 marks each)

**Answer 7(i)****Participating preference shares**

Preference shareholders are entitled to a fixed dividend which has been indicated as part of the terms of issue, even in a year in which the company has made huge profits. Subject to provision in the terms of issue these shares can be entitled to participate in the surplus profits left, after payment of dividend to the preference and the equity shareholders to the extent provided therein. So, participative preference share may be entitled, in a particular year, to two dividends i.e. first their fixed dividends and second, their additional dividend out of surplus profit.

**Answer 7(ii)****Credit investigation factors**

Factors influencing the nature of further credit investigations are—

- Types of customers, i.e. new or existing
- The customer business line & related issues involved in his business
- The nature of the product, i.e. perishable or seasonal
- Company's credit policies & practices.

Company maintain separate file for each customer, and compile the information & reports of the same. Credit investigation involves cost. However, as it assists the firm in reducing bad debt losses, the credit investigation should be carried on as long as its savings exceed cost.

**Answer 7(iii)****Transfer Pricing**

Transfer Pricing: It is a rate at which goods and services are transferred through intra-firm transactions. It can be applied to transactions between the parent firm and its subsidiaries or between strong currency and weak currency subsidiaries. Subject to the demands of competition, a parent may charge higher prices to its weak currency subsidiary, thereby increasing its own profit and reducing that of the subsidiary. The taxable income of the subsidiary comes down. Recovering higher level of operating charges from the subsidiaries also serves the same purpose.



**Answer 7(iv)****Risks in forex market**

- (i) Credit risk arising out of lending to a foreign borrower whose credit rating is not known for certainty.
- (ii) Exchange Rate risk of trading in a currency whose stability and strength is known to fluctuate.
- (iii) Country risk involved in dealing in the currency of a country whose political and economic stability is uncertain.
- (iv) Solvency risks due to mismatch between current assets and liabilities of dealers and resultant default in meeting forward commitments.

**Answer 7(v)****Financial distress**

Generally the affairs of a firm should be managed in such a way that the total risk – business as well as financial – borne by equity holders is minimized and is manageable, otherwise, the firm would obviously face difficulties. If cash inflow is inadequate, the firm will face difficulties in payment of interest and repayment of principal. If the situation continues long enough, the firm would find itself in a situation called financial distress. It may have to sell its assets to discharge its obligations to outsiders at prices below their economic values i.e. resort to distress sale. So when the sale proceeds are inadequate to meet outside liabilities, the firm is said to have failed or become bankrupt or (after due processes of law are gone through) insolvent.

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## 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) (i) ABC Ltd. has 700 creditors (in number) representing total value of Rs.100 crore as per its balance sheet. In a creditors meeting called under section 391 for considering proposed scheme of amalgamation with XYZ Ltd., out of total 700 creditors, only 150 creditors representing value of Rs.45 crore were present. Out of said 150 creditors present at the said meeting, only 140 creditors representing value of Rs.40 crore voted in favour of the resolution, while 10 creditors representing value of Rs.5 crore cast their dissenting vote against the scheme. Whether the motion proposing the scheme of amalgamation should be treated as approved or not ? Explain with reference to relevant provisions of law and case law, if any. (5 marks)
- (ii) In a scheme of arrangement made under section 391, a company proposes to transfer one of its undertakings to its subsidiary and also to reduce its share capital. Is the scheme valid ? Explain with relevant provisions of law and relevant cases. (5 marks)
- (b) State whether the following statements are true or false citing briefly relevant provisions of the law :
- (i) There is a bar on a company amalgamating with a newly incorporated company.
- (ii) A non-profit making company licensed under section 25 can be merged with a profit making company.
- (iii) High Court can sanction a scheme of merger of a sick industrial company when a revival scheme is pending before BIFR.
- (iv) An appeal can be preferred to the Supreme Court of India against the order passed under section 391/394 sanctioning a scheme of amalgamation.
- (v) The court can modify 'transfer date' proposed in a scheme of amalgamation. (2 marks each)
- (c) Explain the provisions relating to buy-back of shares through book-building route. (5 marks)

#### Answer 1(a)(i)

**Yes**, the motion proposing the scheme of amalgamation shall be treated as passed.

According to Section 391 (2) of the Companies Act, 1956, the resolution relating to the approval of amalgamation has to be approved by a twin majority i.e.

- A simple majority of members or creditors, as the case may be, who are present and voting at the general meeting, whether in person or through proxy; and

- A majority representing three-fourths in value of the votes of or the value of debt of, members or creditors, respectively, present and voting either in person or by proxy.

In the given case, out of 150 creditors who were present and voting, 140 have voted in favour which means that the first of the twin criteria has been satisfactorily met. In terms of value, those who voted in favour were commanding a value of Rs. 40 Crores as against the value of those who voted against who commanded a value of Rs.5 Crores. In other words, more than three-fourths in value of the votes of the creditors present and voting have voted in favour indicating clearly that the second of the twin criteria has also been satisfactorily met. Thus the resolution approving the amalgamation has been duly passed in accordance with the requirements of Section 391(2) of the Companies Act, 1956.

A full bench of the Punjab and Haryana High Court in *Hind Lever Chemicals Limited and Another* [2005] 58 SCL 211 (Punj&Har) held that in our view, the language of Section 391(2) of the Act is totally unambiguous and a plain reading of this provision clearly shows that the majority in number by which a compromise or arrangement is approved should represent three-fourth in value of the creditors/shareholders who are 'present and voting' and not of the total value of the shareholders or creditors of the company.

Similarly, in *Re: Kirloskar Electric Company Ltd.*, [2003] 116 Com Cas 413 (Kar), the Karnataka High Court held that the three-fourth majority required under sub-section (2) of Section 391 of the Act was of the value represented by the members who were not only present but who had also voted. In fact, it went a step further to hold that the creditors who were present and had even voted but whose votes had been found to be invalid, could not be said to have voted because casting an invalid vote is no voting in the eyes of law. Thus, it was held that "the proper construction to be placed in calculating whether any resolution is approved or passed by a three-fourth majority present and voting necessarily mean the value of the valid votes and out of the same whether the resolution has been passed with three-fourth the majority".

Also in *Hindustan General Electric Corporation Ltd. in re.* (1959) 29 Comp Case 46 (Cal.); the Hon'ble Court has held that in determining whether a resolution has been passed by the requisite majority or not, the members remaining neutral or absenting from the voting need not to be counted. The same view has also been upheld in *Kaveri Entertainment Ltd., in re* (2003) 117 Comp. Case 245 (Bom).

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

**Yes**, the scheme is a valid scheme and is well within the scope of Section 391 read with Section 394 of the Act. In *Larsen & Toubro Limited* In re [2004] 60 CLA 335 (Bom) [2004], the Mumbai High Court held that a composite scheme could be made involving de-merger, of one of the undertakings of the transferor company and for the transfer of the demerged undertaking to a subsidiary company and for the reduction in the capital of the transferor-company. The Court ruled that the word arrangement is not specifically defined under the Act. It has a wide range and ambit. It includes restructuring of capital, reduction of capital and demerger. The scheme of arrangement having the ingredients of demerger and reduction of share capital and scheme of arrangements with the concerned companies and trust, cannot be said to be beyond the purview of sections of the Companies Act.

**Answer 1(b)(i)**

**False** : The Hon'ble Gujarat High Court in *Re: Apco Industries Ltd.* (1996) 86 Comp Cas 457 (Guj.) has held that there is no bar to a company amalgamating with a fifteen-day old company having no assets and business.

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

**True**, amalgamation of a company licensed under Section 25 of the Companies Act with a commercial, trading or manufacturing company could be sanctioned under Section 391/394. (*Re. Sir Mathurdas Vissanji Foundation (1992) 8 CLA 170(Bom.) Re: Walvis Flour Mill Company P. Ltd. (1996) 23 CLA 104*). There need not be unison or identity between objects of Transferor Company and Transferee Company. Companies carrying entirely dissimilar businesses can amalgamate. *Re: PMP Auto Inds. Ltd. (1994) 80 Comp. Case 291 (Bom.)*.

**Answer 1(b)(iii)**

**False**, in similar matter of *Tata Motors Ltd. v. Pharmaceuticals Products of India Ltd. and Another (2008) 144 Comp. Case 178 (SC)*, it was held High Court cannot sanction scheme proposed under section 391/394 of the Act during the pendency of the revival scheme before BIFR under SICA. In terms of Section 26 of SICA, a company court did not have jurisdiction to entertain any application of a sick industrial company for merger under s.391 to 394 of the Companies Act 1956, while the matter was pending before the BIFR or the AAIFR.

Similarly in *Ashok Organic Industries Ltd v. ARCIL*, [2008]114 Comp Cas 144 (Bom), the Bombay High Court held that once the Industrial Company makes a reference under Section 15 of the SICA, the Company Court would have no jurisdiction for sanctioning the scheme of arrangement of compromise with its creditors and shareholders and neither will it have jurisdiction to take cognisance of such an application during the pendency of the reference.

**Answer 1(b)(iv)**

**True**, as per the existing provisions of the Companies Act, 1956, an appeal can be preferred to the Supreme Court of India against the order passed under Section 391/394 sanctioning a scheme of amalgamation.

**Answer 1(b)(v)**

**True**, the Hon'ble Supreme Court in *Marshal Sons & Co. (India) Ltd. v. ITO (1977) 1 Comp LJ P.1*, observed that it is true that while sanctioning the scheme, it is open to the Court to modify the said date. But when the Court does not prescribe any specific date, the date specified in the scheme is "the transfer date".

**Answer 1(c)****Buy Back through Book Building Route**

A company can buy back its securities through the book building process as provided

under Securities and Exchange Board of India (Buy Back of Securities) Regulations, 1998 which is as under:

1. (a) The special resolution as in Regulation 5 or 5A, should specify the maximum price at which the buy back will be made.
  - (b) The company should appoint a merchant banker.
  - (c) A public announcement as referred to in Regulation 8 shall be made atleast 7 days prior to the commencement of the buy back.
  - (d) Subject to the provisions of Sub- clauses (i) and (ii), the provisions of Regulation 10 regarding escrow account are applicable –
    - (i) The deposit in the escrow account should be made before the date of the public announcement.
    - (ii) The amount to be deposited in the escrow account should be determined with reference to the maximum price as specified in the public announcement.
  - (e) A copy of the public announcement must be filed with SEBI within two days of the announcement along with the fees specified in Schedule IV to the Regulations. The public announcement shall also contain the detailed methodology of the book building process, manner of acceptance, format of acceptance to be sent by the security holders pursuant to public announcement and details of bidding centers.
  - (f) The book building process should be made through an electronically linked transparent facility.
  - (g) The number of bidding centers should not be less than thirty and there should be atleast one electronically linked computer terminal at all the bidding centers;
  - (h) The offer for buy back should be kept open to the security holders for a period of not less than fifteen days and not exceeding thirty days.
  - (i) The merchant banker and the company should determine the buy back price based on the acceptances received and the final buy back price which should be the highest price accepted should be paid to all the holders whose securities have been accepted for the buy back.
2. The provisions of Regulation 9(5) pertaining to verification of acceptances and the provisions of Regulation 11 pertaining to opening of special account and payment of consideration are applicable mutatis mutandis.

## Question 2

- (a) *Reduction of capital is one of the modes of re-organisation of capital structure of the company and to a certain extent it can be done without the sanction of the court. Explain with relevant provisions of the law. (7 marks)*
- (b) *Strategy is the very soul of any action and activity. Briefly define the strategy with 5Ps of Henry Mintzberg. (4 marks)*

(c) *In a scheme of compromise, arrangement, reconstruction or amalgamation, various types of approvals are required. Describe briefly such approvals.*

(4 marks)

**Answer 2(a)**

A company may reorganize its capital in different ways which may include: (a) reduction of paid-up capital; (b) conversion of one type of shares into another; (c) conversion of shares into debentures. There may be many other ways and manner of re-organization of capital. Re-organization of share capital may be proposed between the company and its creditors or class of creditors or members or class of members and requires confirmation of CLB under Section 391. Reduction of capital means reduction of issued, subscribed and paid up capital of the company. Section 100 provides for the reduction of share capital, if the articles of the company so authorize with the confirmation of the Court.

However in following cases, reduction of share capital can be made without sanction of court.

(a) *Surrender of Shares*

This means the surrender of shares already issued to the company by the registered holder of shares. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to reduction of capital. But if, under any arrangement such shares instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [*Collector of Moradabad v. Equity Insurance Company Limited (1948) 18 Com Cases 309: AIR 1948 Oudh 197*]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted for further liability on shares.

The Companies Act contains no provisions for surrender of shares. Thus surrender of shares is valid only when Articles of Association provide for the same and:

- (i) Where forfeiture of such shares is justified; or
- (ii) When shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. However, in the case of forfeiture it is at the initiative of the company and in the case of surrender it is at the initiative of member or shareholder.

(b) *Forfeiture of Shares*

A company may if authorized by its articles, forfeit shares for non- payment of calls and the same will not require confirmation of the court.

Where the power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. Forfeiture will be effected by means of Board resolution. The power of forfeiture must be exercised bona fide and in the interest of the company.

(c) *Diminution of Capital*

Where the company cancels shares which have not been taken or agreed to be taken by any person. [Section 94(1)(3)]

- (d) Redemption of redeemable preference shares
- (e) Purchase of shares of a member by the company under Section 402.
- (f) Buy back of its own shares under Section 77A
- (g) Reduction of capital when company is defunct.

**Answer 2(b)**

Strategy is the very soul of any action and activity and should be omni-present and therefore every executive and owner needs to be a 'strategist'. Henry Mintzberg enunciated 5 Ps of strategy which are as follows namely:

1. A Plan i.e. Strategy is consciously intended course of action which a firm chooses to follow after careful deliberations on the various options available to it.
2. A Ploy i.e. it is specific maneuver which intends to outwit an opponent or a competition. It is a trick, devise, a scheme or deception to gain advantageous position before engaging into the combat of marketing warfare.
3. A Pattern i.e. it is not one decision and one solitary action; it stands for a stream of decisions and actions to guide and tend the future course of the enterprise until it reaches its predetermined corporate objectives.
4. A Position i.e. it is a means of locating the firm in an environment full of external factors, pulls and pushes.
5. A Perspective i.e. it is an ingrained way of preceding the world around the organization and its business operations.

**Answer 2(c)**

In a scheme of compromise or arrangement, following types of approvals are required to be obtained by the transferor and transferee companies:

- (i) *Approval of the Boards of each of the Companies* : This is the first step to carry out amalgamation. Approval authorizes the director/company secretary to do everything for this purpose.
- (ii) *Approval of Shareholders/Creditors* : This approval is to be obtained at specially convened meetings as per Court's directions under Section 391(1) of the Companies Act. However, if all members consent in writing, this can be dispensed with. The unsecured / sundry creditors meetings are dispensed with subject to certain conditions.
- (iii) *Approval of Stock Exchange* : In case of companies listed with recognized stock exchange(s), a no-objection certificate under Clause 24(f) of the listing agreement is to be obtained atleast one month prior to filing it with High Court.
- (iv) *Approval from Financial Institutions/Lending Banks/Debenture trustees etc.* : If

the company has borrowed funds from the above lenders, approval is necessary from the lender and debenture trustees.

- (v) *Approval from the land holders* : If the land on which the factory is situated is the lease-hold land and the terms of the lease deed so specifies, the approval from the lessor will be needed.
- (vi) *Approval from Reserve Bank of India* : If amalgamation results to issuance of shares/cash option to the non-resident Indians, the amalgamated company has to obtain permission from Reserve Bank of India under Foreign Exchange Management (Transfer or issue of security by a person Resident outside India) Regulations, 2000.
- (vii) *Approval of Central Government under MRTP Act* : The Monopolies and Restrictive Trade Practices Act, 1969 is on the verge of being phased out with the passing of the Competition Act, 2002. Under the Competition Act, regulation of combinations as provided under Sections 5 and 6 of the Act would also be required to be complied by companies, if applicable. Under the Competition Act, 2002, reference must be made to the Competition Commission of India in certain cases depending upon the post merger size of the assets or business.
- (viii) *Sanction of the respective High Courts* : Both amalgamated/resulting companies and amalgamating companies are required to seek approval from the respective High Court(s) in which their registered offices are situated.

### Question 3

- (a) *In a buy-back of securities, a company has to pay stamp duty under the Indian Stamp Act, 1899 for physical shares. Do you agree ? Explain. (5 marks)*
- (b) *In an open offer in terms of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, what message is conveyed by the SEBI by way of 'disclaimer clause' to the shareholders of the target company ? (5 marks)*
- (c) *What do you mean by 'hostile takeover' ? Why these types of takeovers are resorted to and by whom, and what is the objective of the acquirer ? (5 marks)*

### Answer 3(a)

Any transfer of shares is liable for stamp duty under the Indian Stamp Act, 1899 vide entry No.62 in the Schedule I. For completion of transfer of shares, a company is required to register the shares in the name of the transferee. But purchase of own shares by a company cannot be registered in the name of the company. These shares are supposed to be mandatorily extinguished and the capital stands reduced to that extent. They cannot keep the bought back shares as "Treasury Stock" for reissue though such things are permissible in some western countries.

As per provisions of the Companies Act, 1956 and relevant rules, the bought back shares must be extinguished within 7 days from the closure date of said buy back and it should not be treated as "Release" under Article 55 of the Indian Stamp Act. Hence, no registration of such shares takes place in the name of the company.

The names of the members/shareholders from whom the shares are bought back, have to be struck off from the register of members of the company. Therefore, buy-



back cannot be considered as transfer and stamp duty would not be payable in a case where buy-back of shares takes place in physical form even if the shares are accompanied by an application form for transfer of shares in favour of the company.

**Answer 3(b)**

The message conveyed by SEBI by way of 'disclaimer clause' to the shareholders of the target company are as follows:

- (i) The purpose of the disclosure made in the letter is to facilitate the shareholders to take a decision in an informed way.
- (ii) The disclosures made in letter are generally adequate and are in conformity with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
- (iii) It shall not be deemed or construed that SEBI has approved or cleared or vetted the offer letter.
- (iv) SEBI does not take any responsibility either for the truthfulness or correctness of for any statement, for financial soundness of Acquirer, or of Persons Acting in Concert, or of Target Company, whose shares are proposed to be acquired or for the correctness of the statements made or opinions expressed in the Letter of Offer.
- (v) While the acquirer is primarily responsible for the correctness, adequacy and disclosure of all relevant information in the letter of offer, the Merchant Banker is expected to exercise due diligence to ensure that acquirer(s) duly discharges its responsibility adequately.

**Answer 3(c)****Hostile Takeover**

When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management, such acts of acquirer are known as 'hostile takeover'. Such takeovers are hostile on the management and are thus called hostile takeover.

This type of takeover action preferred by a competitor or a cash rich acquirer to take control over the targeted company against the wish of the existing management and controlling persons of the target company.

This type of takeover is primarily aimed for:

- (i) Elimination of competition or dilution of the degree of competition on the product/service market on the whole.
- (ii) Gaining reign/leadership in prices of the product sold/services rendered.
- (iii) Brand orientation.
- (iv) Building up or broadening the monopolistic or oligopolistic route in product market by the acquiring entity.

However Hostile Takeover is not a prohibited or illegal activity. When shares of a

company are listed in a recognized stock exchange, shares are available for being bought by anybody. Therefore acquisition per se, though hostile, cannot be banned. On the other hand, the regulations incorporate strict rules for regulating such takeover attempts so to make the process transparent and afford opportunity to a competitive process and protects interests of the investors.

#### Question 4

- (a) *Good Value Ltd. (GVL) is contemplating acquisition of Fair Value Ltd. (FVL). GVL has 3,00,000 equity shares and FVL has 2,00,000 equity shares and the market value of shares are Rs.30 and Rs. 20 and EPS is Rs.4 per share and Rs. 2.25 per share respectively. It is proposed to give one share of GVL to the shareholder of FVL for their two shares in FVL. Based on the above information, you are required to —*
- calculate EPS after the merger/acquisition of the company; and*
  - show the impact on EPS for the shareholders of both the companies.*
- (5 marks)
- (b) *X, an acquirer, fails to fulfil the offer obligation towards shareholders of target company who have lodged their shares with the acquirer. What are the remedies available to a merchant banker for discharge of the obligations especially towards shareholders who have participated in the offer as well as to deal with the escrow account ?*
- (5 marks)
- (c) *State whether any stamp duty is payable on transfer of properties under the order of amalgamation. Briefly comment with relevant case law.*
- (5 marks)

#### Answer 4(a)

##### (i) Calculation of EPS after merger/acquisition of the company

Total earnings after merger and acquisition:-

GVL	FVL	Total Earnings
3,00,000 x 4	2,00,000 x 2.25	
= Rs. 12,00,000	Rs. 4,50,000	Rs. 16,50,000

Total number of equity shares after acquisition:-

GVL	3,00,000
FVL (2,00,000 x 1/2)	1,00,000
Total no. of shares after acquisition	<u>4,00,000</u>

$$\begin{aligned}
 \text{EPS after merger} &= \frac{\text{Total earnings after acquisition}}{\text{Total number of shares after acquisition}} \\
 &= \frac{16,50,000}{4,00,000} \\
 &= \text{Rs. 4.125}
 \end{aligned}$$

**(ii) Impact of EPS for the shareholders of both the companies**

GVL	Rs.
Earnings before acquisition	12,00,000
[3,00,000 x 4]	
Earnings after acquisition	12,37,500
[3,00,000 x 4.125]	
Increase in earnings after acquisition	<u>37,500</u>
Net increase in EPS after merger	= <u>37,500</u>
	3,00,000
	= 0.125
 FVL	 Rs.
Earnings before acquisition	4,50,000
[2,00,000 x 2.25]	
Earnings after acquisition	4,12,500
[*1,00,000 x 4.125]	
Net decrease in earnings	<u>37,500</u>
Net decrease in EPS after merger	= <u>37,500</u>
	1,00,000
	= 0.375

(\*being the shares held by shareholders of FVL in GVL after merger)

Therefore, there is an increase of Rs. 37,500 in total earnings of GVL and decrease of Rs. 37,500 in total earnings of FVL after merger.

**Answer 4(b)**

The Merchant Banker is entitled to ensure realization of Escrow Account by way of foreclosure of deposit, invocation of bank guarantees and sale of the shares (if any) and distribute the proceeds after deduction of expenses, if any, of the merchant banker and the registrars to the offer in following ways:

- (i) One third of amount to the target company.
- (ii) One third to regional stock exchanges where it is listed, for credit of the investor protection fund or any other similar fund for investor education, research, grievance redressal and similar such purposes as may be specified by SEBI.
- (iii) One third to be distributed on pro-rata basis among the shareholders who have accepted the offer.

The Merchant Banker is required to ensure that the rejected documents which are kept in the custody of the Registrar/Merchant Banker are sent back to the shareholder through Registered Post.

**Answer 4(c)**

**Yes**, stamp duty is payable on transfer of properties under the order of amalgamation.

In a landmark decision of Hon'ble Bombay High Court in *Li Taka Pharmaceuticals v. State of Maharashtra* (1996) 8 SC 102 (Bom.), it was held that:

- (i) An amalgamation under the order of the Court under Section 394 of the Companies Act, is an instrument under the Bombay Stamp Act;
- (ii) States are well within their jurisdiction when they levy stamp duty on instrument of amalgamation;
- (iii) Stamp duty would be levied not on the gross assets transferred but on the "undertaking", when the transfer is on a going concern basis, i.e. on the assets less liabilities. The value for this purpose would thus be the value of shares allotted. This decision has been accepted in the Act and now stamp duty is leviable on the value of shares allotted plus other consideration paid.

**Question 5**

- (a) (i) *The court has fixed meeting of equity shareholders of Rim Zim Ltd. on Tuesday, the 9th June, 2009 at Broadway Hotel, 3, Osaka Street, Mumbai for considering the proposed scheme of amalgamation with Jhil Mil Ltd. and appointed Kabir as Chairman and Mrs. Noori as alternate Chairperson of the meeting. As a Company Secretary of Rim Zim Ltd., draft the notice of the meeting. (7 marks)*
- (ii) *After meeting of equity shareholders of Rim Zim Ltd., the proposed scheme of amalgamation of Rim Zim Ltd. with Jhil Mil Ltd. was passed. Draft the Chairman's report for onward submission to the court. (4 marks)*
- (b) *Briefly explain with relevant provisions of the Companies Act, 1956 as to when the scheme of amalgamation would become effective. (4 marks)*

**Answer 5(a)(i)****Form No. 36**

IN THE HIGH COURT OF JUDICATURE AT \_\_\_\_\_  
(ORIGINAL JURISDICTION)

In the matter of Companies Act, 1956

*And*

In the matter of Scheme of Amalgamation of Rim Zim Ltd. with Jhil Mil Ltd. Rim Zim Ltd., an existing company under Companies Act, 1956 and having its registered office at \_\_\_\_\_

Company Application No. \_\_\_\_\_ of 200 \_\_\_\_\_

Rim Zim Ltd., Applicant

**Notice Convening Meeting**

To

Equity Shareholders

TAKE NOTICE that by an order made on \_\_\_\_\_ day of \_\_\_\_\_ 200\_\_, the

Court has directed that a meeting of the equity shareholders of the company be held at Broadway Hotel, 3, Osaka Street, Mumbai on Tuesday, the 9th day of June 2009 at \_\_\_\_\_AM/PM, for the purpose of considering and, if thought fit, approving with or without modification, the Scheme of Amalgamation proposed to be made between the Applicant Company and Jhil Mil Ltd.

TAKE FURTHER NOTICE that in pursuance of the said order, a meeting of the equity shareholders of the Applicant Company will be held at Broadway Hotel, 3, Osaka Street, Mumbai on Tuesday, the 9th day of June 2009 at \_\_\_\_\_AM/PM which you are requested to attend.

TAKE FURTHER NOTICE that you may attend and vote at the said meeting in person or by proxy, provided that a proxy in the prescribed form, duly signed by you, is deposited at the registered office of the company at \_\_\_\_\_ not later than 48 hours before the meeting. The quorum of the meeting shall be five members present in person or by proxy.

The Court has appointed Mr. Kabir as the Chairman of the said meeting and Mrs. Noori as alternate Chairperson of the meeting.

A copy of each of the Scheme of Amalgamation, the statement under Section 393 of the Companies Act, 1956 and a form of proxy and attendance slip are enclosed.

Dated this \_\_\_\_\_ day of 200 \_\_\_\_\_

Sd/-

For Rim Zim Ltd.

XYZ

Company Secretary

*Note* : All alterations made in the form of Proxy should be initialled.

**Answer 5(a)(ii)**

**Form No. 39**

IN THE HIGH COURT OF JUDICATURE AT \_\_\_\_\_

(ORIGINAL JURISDCITION)

In the matter of Companies Act, 1956

And

In the matter of scheme of Amalgamation of Rim Zim Ltd. with Jhil Mil Ltd.

Rim Zim Ltd., an existing company under Companies Act, 1956 and having its registered office at \_\_\_\_\_

Company Application No. \_\_\_\_\_ of 200 \_\_\_\_\_

Rim Zim Ltd., Applicant

### Report by Chairman

I, Kabir, Advocate, the person appointed by this Hon'ble Court to act as Chairman of the meeting of the equity shareholders of the above named company, summoned by notice served individually upon them and by advertisement dated the .....day of..... 200....., and held on the 9th day of June 2009, at Broadway Hotel, 3, Osaka Street, Mumbai, do hereby report to this Hon'ble Court as follows :

1. The said meeting was attended by.....equity shareholders personally holding.....value of shares and .....equity shareholders holding..... value of shares have attended the said meeting through proxy.
2. The scheme of amalgamation was read out and explained by me to the meeting and questions raised were answered satisfactorily. The equity shareholders of the said company have approved the scheme of amalgamation submitted to the meeting and agreed thereto.
3. The said meeting was unanimously of the opinion that the scheme of amalgamation should be approved and agreed to/or. The result of the voting of the meeting are attached as per annexure A showing names and addresses of the equity shareholders, value of equity shares held by them, number of votes, approved or disapproved.

Dated this \_\_\_\_\_ day of 200 \_\_\_\_\_

Sd/-

Kabir

Chairman appointed for the meeting

(Annexure A)

### Answer 5(b)

According to the provisions of Section 391(3) and 394(3) of the Companies Act, 1956, certified copy of the order passed by the Court shall be filed with the concerned Registrar of Companies. This is required to be filed with e-form 21 which is required to be filed within thirty days of the making of the order. Date of completion of the last of the required approvals shall be treated as effective date for the scheme of amalgamation.

### PART B

(Answer ANY TWO questions from this part)

### Question 6

- (a) Explain the enforcement of security interest by a secured creditor under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. (7 marks)
- (b) Define 'securitisation' and explain the objectives of securitisation. (4 marks)
- (c) What do you mean by 'non-performing assets' under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ? (4 marks)

**Answer 6(a)**

Under section 13 of the Securitization and Reconstruction of Financial assets and Enforcement of Security Interest Act, 2002 (hereinafter Securitization Act), secured creditor can enforce his security interest 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. Secured creditors have been defined to mean any bank or financial institution or any consortium or group of banks or financial institutions and includes debenture trustees appointed by any Bank or Financial Institution or Securitization or reconstruction company or any other trustee holding securities on behalf of bank or financial institution in whose favour security interest is created for due repayment by any borrower of any financial assistance. In case of the default in repayment of installment by the borrower and debts becoming NPA, 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.

In cases of joint financing under consortium or multiple lending arrangements if 75% of the secured creditors in the value agree to initiate recovery action the same is binding on all secured creditors.

In case of a company under liquidation, the amount realized from the sale of the secured assets is to be distributed in accordance with the provisions of Section 529A of the Companies Act, 1956. If the company is being wound up after the commencement of this Act, the secured creditor of such company, who opts to realize its security instead of relinquishing its security and proving its debts under proviso to Sub-section (1) of Section 529 of the Companies Act, may retain the sale proceeds of its secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of Section 529A of that Act. In case, dues of the secured creditors could not be satisfied in full, secured creditor may file application before DRT for recovery of balance amount. Secured creditor is also entitled to proceed against the guarantor or sell the pledged assets for its recovery.

**Answer 6(b)**

According to Section 2(1) (z) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, "Securitisation" means acquisition

of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise. "Securitisation company" means any company formed and registered under the Companies Act, 1956 for the purpose of securitization [Section 2(1)(za)].

Securitisation is the issuance of marketable securities backed not by the expected capacity to repay of a private corporation or public sector entity, but by the expected cash flows from specific assets.

Simply stated securitisation is the process by which the 'originators' of assets like loans which are illiquid, are able to transfer such assets to a 'special purpose vehicle' (SPV), which, in turn, issues tradable liquid securities to the investors. These transactions can be structured with a wide variety of 'credit enhancement' to make the deals attractive for investors. The most important, however, is the 'guarantees of credit quality'.

There are two motives for Securitisation. One, the securitised assets go off the balance sheet of the originator and so the asset base is pruned down to that extent, thereby reducing the regulatory capital requirements to support the assets. Second, the asset portfolio is liquidated; releasing cash, which in turn reduces the need for demand and time liabilities that are subject to statutory reserves.

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

According to Section 2 (1) (o) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 "Non-Performing Asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset—

- (a) in case such bank or financial institution is administered or regulated by an authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;
- (b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank.

In *Srinivas Rice & Floor Mill v. Authorized Officer, State Bank of India*, [2008] 81 SCL 66 (AP), the AP High Court held that there is no statutory format, express or by necessary implication, that require the Banks to follow a particular or formal procedure or require a formal declaration as a condition precedent to classification of debt as "NPA". What section 13(2) r/w Section 2(1)(o) requires is a classification of a debt by a bank as 'NPA' within the legislative guidelines spelt out in the definition of NPA.

#### **Question 7**

- (a) *What do you understand by 'sick industrial company' ? Explain the immunities provided to a sick industrial company under the Sick Industrial Companies (Special Provisions) Act, 1985. (7 marks)*
- (b) *Though, UNCITRAL Model Law is not a substantive law, yet it recommends protection to creditors and other interested persons. Briefly describe what are the protections provided under the UNCITRAL Model Law. (4 marks)*



- (c) *The main objective of asset reconstruction company (ARC) is to act as an agent for banks and financial institutions. Briefly explain with the relevant provisions of law. (4 marks)*

**Answer 7(a)**

According to Section 3(1)(o) of the Sick Industrial Companies (Special Provisions) Act, 1985, "sick industrial company" means an industrial company (being a company registered for not less than five years), which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

*Explanation :* For the removal of doubts, it is hereby declared that an industrial company existing immediately before the commencement of the Sick Industrial Companies (Special Provisions) Amendment Act, 1993 registered for not less than five years and having at the end of any financial year accumulated losses equal to or exceeding its entire net worth, shall be deemed to be a sick industrial company.

Immunities to a sick industrial company has been granted under the provisions of Section 22 of the SICA, 1985. This Section provides that in certain circumstances, no proceedings for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or for the appointment of a receiver in respect thereof and no suit for the recovery 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 be proceeded with further, except with the consent of BIFR or, as the case may be, the Appellate Authority.

Section 22 of SICA has two limbs. The first part enacts that "no proceeding for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or for the appointment of a receiver in respect thereof ... shall lie or be proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority." The second part which is independent of the first part declares 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 be proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority."

The protection under Section 22 of SICA is a superior protection as it operates notwithstanding anything contained in the Companies Act, 1956, or any other law or the memorandum and articles of association of the industrial company or any other instrument having effect under the said Act or other law.

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.

BIFR may by order declare with respect to the sick industrial company concerned that the operation of all or any of the contracts, assurances of property, agreements, settlements, awards, standing orders or other instruments in force, applicable to the sick industrial company in question shall remain suspended or that all or any of the rights, privileges, obligations, and liabilities accruing or arising thereunder before the

said date, shall remain suspended or shall be enforceable with such adaptations and in such manner as may be specified by BIFR. Provided that such declaration shall not be made for a period exceeding two years which may be extended by one year at a time so, however, that the total period shall not exceed seven years in the aggregate. Any such declaration is valid and is protected notwithstanding anything contained in the Companies Act, 1956, or any other law or agreement or instrument or any decree or order of a court, Tribunal, officer or other authority or of any submission, settlement or standing order.

Section 22 does not grant immunity against the criminal proceedings against the company or its directors.

The apex court in *Maharashtra Tubes Limited v. State Industrial and Investment Corporation of Maharashtra Limited* [1993] 78 Comp Cas 803 (SC) held that the idea underlying Section 22(1) of SICA is that every such action (against the company or its guarantors for recovery of money or enforcement of security) should be frozen unless expressly permitted by the specified authority until the investigation for the revival of the industrial undertaking is finally determined. The apex court in *Patheja Bros. Forgings and Stamping v. ICICI Limited* AIR 2000 CLC 1492: (2000) 4 Comp LJ 9 (SC) held that the words Section 22 are clear and unambiguous and that they provide that no suit for the enforcement of a guarantee in respect of any loan or advance granted to the concerned industrial company will lie or can be proceeded with without the consent of BIFR or the appellate authority. When the words of a legislation are clear, the court must give effect to them as they stand and cannot demur on the ground that the legislature must have intended otherwise.

### **Answer 7(b)**

Under the UNCITRAL Model Law, foreign creditors have the same rights regarding the commencement of and participation in a proceeding under the laws of the enacting state relating to insolvency as creditors in the state. The Model Law contains following provisions for protection of the creditors (in particular local creditors), the debtors and other affected persons:

1. availability of temporary relief upon application for recognition of a foreign proceeding or upon recognition is subject to the discretion of the court; it is expressly stated that in granting such relief the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected (Article 22, paragraph 1);
2. the court may subject the relief it grants to conditions it considers appropriate; and
3. the court may modify or terminate the relief granted, if so requested by a person affected thereby (Article 22, paragraphs 2 and 3).

In addition to the above specific provisions, the Model Law in a general way provides that the court may refuse to take an action governed by the Model Law if the action would be manifestly contrary to the public policy of the enacting State (Article 6).

Further, the Model Law states that the courts that recognize Foreign Proceeding may, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant necessary interim or other relief as stipulated thereunder.

**Answer 7(c)**

Assets Reconstruction Company (ARC) means a company incorporated under the provisions of Companies Act, 1956 for the purpose of assets reconstruction. The problem of non-performing loans created due to systematic banking crisis world over has become acute. Focused measures to help the banking systems to realise its NPAs has resulted into creation of specialised bodies called asset management companies which in India have been named asset reconstruction companies ('ARCs'). The buying of impaired assets from banks or financial institutions by ARCs will make their balance sheets cleaner and they will be able to use their time, energy and funds for development of their business. ARCs may be able to mix up their assets, both good and bad, in such a manner to make them saleable.

The main objective of the ARC is to work as an agent of the banks and or financial institutions for the purpose of recovering their dues from the borrowers on payment of fees or charges, to act as manager of the borrowers' assets taken over by the banks or financial institution, to act as receiver of properties of any bank or financial institution or to carry on such ancillary or incidental business with the prior approval of RBI whenever necessary. If an ARC carries on any business other than the business of asset reconstruction or securitisation or the business mentioned above, it shall cease to carry on any such business within one year of doing such other business.

**Question 8**

- (a) *State the World Bank principles for effective insolvency and creditor rights systems. (7 marks)*
- (b) *On 2nd December, 1983, winding-up order was passed in respect of Heaven Ltd. On 1st December, 1989, official liquidator of Heaven Ltd. (in liquidation) initiated misfeasance proceedings against the promoter directors of the company. Directors pleaded that proceedings should be quashed being time barred. Briefly explain with support of relevant case laws, period of limitation for initiating misfeasance proceedings under the Companies Act, 1956. (4 marks)*
- (c) *Can an Indian court pass an order of amalgamation that has the winding-up effect in respect of the foreign company? Support your answer with relevant case law. (4 marks)*

**Answer 8(a)**

The World Bank Principles for effective insolvency and creditor rights system have been designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve core aspects of their commercial law systems that are fundamental to a sound investment climate, and to promote commerce and economic growth. Efficient, reliable and transparent creditor rights and insolvency systems are of key importance for reallocation of productive resources in the corporate sector, for investor confidence and forward looking corporate restructuring. These systems also play a pivotal role in times of crisis to enable a country and stakeholders to promptly respond to and resolve matters of corporate financial distress on systemic scales.

The Principles emphasize contextual, integrated solutions and the policy choices involved in developing those solutions. The Principles highlight the relationship between

the cost and flow of credit (including secured credit) and the laws and institutions that recognize and enforce credit agreements (Part A). The Principles also outline key features and policy choices relating to the legal framework for risk management and informal corporate workout systems (Part B), formal commercial insolvency law frameworks (Part C) and the implementation of these systems through sound institutional and regulatory frameworks (Part D).

The principles have broader application beyond corporate insolvency regimes and creditor rights. The Principles are designed to be flexible in their application, and do not offer detailed prescriptions for national systems. The Principles embrace practices that have been widely recognized and accepted as good practices internationally. As legal systems and business and commerce are evolutionary in nature, so too are the Principles, and it is anticipated that these will continue to be reviewed going forward to take account of significant changes and developments.

**Answer 8(b)**

**No**, proceedings are not time barred. In a similar case of *Ajay G Podar V. Official Liquidator Of JS & WM & Ors. (2008) 85 CLA 398 (SC)*, Hon'ble SC has held that section 543(2) of the Companies Act, 1956 deals with the limitation of applications/claims including misfeasance proceedings and prescribes five (5) years period of limitation from the date of the winding up order for filing an application under section 543 (1). However, section 458A of the Companies Act, 1956 provides for the concept of computation of the limitation period. Section 458A being a non obstante clause exclude the period starting from commencement of winding up proceedings till the date on which winding up order is passed and a period of one (1) year thereafter. In view of the above, misfeasance proceedings filed by the Official Liquidator are well within limitation period.

**Answer 8(c)**

**Yes**, Indian Court can pass an order of amalgamation that has the winding up effect in respect of the foreign company. Section 390 of the Companies Act, 1956 provides definition and interpretation aid for sections 391 to 393 of the Act. In the case of *Bombay Gas Co. Pvt. Ltd. v. Regional Director (1996) 21 CLA 269 (Bom.)*, it was held that Section 390(a) is applicable to a company incorporated outside India. If court has jurisdiction to wind up such a company on any of the grounds specified in the Act, court has jurisdiction to sanction scheme of amalgamation if a company incorporated outside India is a transferor-company.

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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) The benefit of amortisation of preliminary expenses under section 35D has been extended to —
    - (a) Manufacturing companies
    - (b) Post-commencement preliminary expenses of service sector units
    - (c) Non-resident companies
    - (d) Non-resident individuals.
  - (ii) No disallowance under section 40(a)(ia) shall be made in the case of a deductor in respect of expenditure incurred in the month of March, if the TDS on such expenditure has been paid before —
    - (a) 31st December
    - (b) 30th September
    - (c) Due date for filing of the return
    - (d) 30 days from the date of tax deduction.
  - (iii) With effect from assessment year 2009-10, the rate of tax under sections 111A and 115AD, on short-term capital gains, arising from the transfer of equity shares in a company or a unit of an equity oriented funds where such transaction is chargeable to securities transaction tax (STT) is—
    - (a) 20%
    - (b) 15%
    - (c) 10%
    - (d) 25%.
  - (iv) Depreciation on new plant acquired and kept as standby in anticipation of an order of supply of goods is —
    - (a) An allowable expenditure on an asset kept as standby
    - (b) Not allowable as asset acquired but not put to use
    - (c) Partly allowable
    - (d) None of the above.

- (v) *Lease rental income derived by a foreign company, by leasing its immovable property situated at Ahmedabad, India, to another foreign company whose payment in US Dollars has been made outside India as per the agreement which is also executed outside India is —*
- (a) *An exempted income in India*
- (b) *Chargeable to income-tax in India as it relates to property situated in India, and deemed to accrue or arise in India*
- (c) *Subject to DTAA agreement entered into by Indian government with another country wherein foreign company is located*
- (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) *Expenditure incurred by a company after its incorporation and after its business had been set-up, on development of website for conducting its business partly through website could be considered as \_\_\_\_\_ expenditure.*
- (ii) *Interest on borrowed funds utilised for acquisition of an asset as part of extension of business, could be capitalised till the asset \_\_\_\_\_.*
- (iii) *Subsidy received by a company operating a sugar mill, which could be utilised only for re-payment of term loans taken by it for setting-up of new units and extension of existing business would be treated as \_\_\_\_\_.*
- (iv) *Where there is a failure to deduct tax at source or to deposit the tax deducted at source by a company, the company and the Principal Officer shall be deemed to be an \_\_\_\_\_ under section 201.*
- (v) *Deduction in respect of contribution given by any person other than company under section 80GGC of the Income-tax Act, 1961, to a political party is \_\_\_\_\_.* (1 mark each)
- (c) *“All companies are not liable to wealth-tax, even those which are liable have scope for minimising it.” Comment.* (5 marks)

**Answer 1(a)**

- (i) (b) Post-commencement preliminary expenses of service sector units
- (ii) (c) Due date for filing of the return
- (iii) (b) 15%
- (iv) (a) An allowable expenditure on an asset kept as standby
- (v) (b) chargeable to income tax in India as it relates to property situated in India, and deemed to accrue or arise in India

**Answer 1(b)**

- (i) Expenditure incurred by a company after its incorporation and after its business had been set-up, on development of website for conducting its business partly through website could be considered as **revenue** expenditure.
- (ii) Interest on borrowed funds utilised for acquisition of an asset as part of extension of business, could be capitalised till the asset **put to use** .
- (iii) Subsidy received by a company operating a sugar mill, which could be utilised only for re-payment of term loans taken by it for setting-up of new units and extension of existing business would be treated as **Capital receipt** .
- (iv) Where there is a failure to deduct tax at source or to deposit the tax deducted at source by a company, the company and the Principal Officer shall be deemed to be an **assessee in default** under section 201.
- (v) Deduction in respect of contribution given by any person other than company under section 80GGC of the Income-tax Act, 1961, to a political party is **allowable**.

**Answer 1(c)**

Only those companies whose net wealth on the corresponding valuation date exceeds Rs. 15,00,000 will be chargeable to Wealth-tax. Non-profit making companies registered under Section 25 of the Companies Act are exempt from levy of wealth tax. Where the company is not resident in India, its assets and debts located outside India shall be excluded from the computation of net wealth.

Companies can minimize their Wealth-tax liability:

- (i) By avoiding investment in taxable assets like jewellery, motor cars, other unproductive assets;
- (ii) In unavoidable cases, investment in the said assets could be made out of loans or debts may be incurred in relation thereto by way of furnishing a security for the loan, so that such debts could be claimed as deduction in computing net wealth,
- (iii) Likewise, purchase house property ,likely to be used by the Directors /Managers/ Secretary, as their residential accommodation or by any other employee having substantial interest in the company could be funded out of loan/raising debts thereon.

**Question 2**

- (a) *State, with reasons in brief, whether the following statements are correct or incorrect:*
  - (i) *The cascading effect of dividend distribution tax is minimised in the case of holding and subsidiary companies.*
  - (ii) *The provisions of tax deduction at source do not apply to interest on corporate securities under certain circumstances.*

- (iii) *An assessee can be asked to pay interest under section 234A for default in filing of return in time or for non-filing of return and also under section 234B for non-payment or short payment of advance tax even though there is overlapping of some period under the two provisions. (2 marks each)*
- (b) *A new weighted deduction has been introduced recently to encourage outsourcing of scientific research. Explain briefly its scope, applicability and advantages from the tax planning point of view. (5 marks)*
- (c) *A company had taken some unsecured loans by way of inter-corporate deposits (ICDs) from three other companies for use in its business and paid interest on those ICDs, which were offered for taxation by the recipient companies.*
- The income-tax officer contends that the unsecured loans are taxable as deemed dividends under section 2(22)(e). Can he do so ? Explain. (4 marks)*

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

- (i) *True* : Section 115-O(1A) provides that while determining the tax on dividends distributed payable by a domestic company, the amount of dividends received from its subsidiary company will be reduced if the subsidiary company has paid tax under this section on such dividend and the domestic company itself is not a subsidiary of another company.
- (ii) *True* : With effect from 1st June, 2008, section 193 has removed the requirements of deducting tax at source from interest payable to a resident on any security issued by a company where such security is in dematerialized form and is listed on a recognized stock exchange in India.
- (iii) *True* : Defaults under section 234A and 234B are independent of each other. Therefore, interest is payable under both the provisions, despite there being some overlapping of same period under the two provisions [*Roshanlal Jain (AOP) v. Dy CIT*]

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

As a result of the new Clause (iia) inserted in Section 35, w.e.f. 1.4.2009, an amount equal to one and one-fourth times (125%) of any sum paid to a company by any assessee, to be used by the donee company for scientific research, will be allowed as deduction. The donee company must be a company registered in India with the main object of scientific research and development and it should be approved by the prescribed authority for this purpose.

This deduction could be claimed by any person—whether company or not making payment to the company approved for this purpose. There is no requirement that the scientific research carried out by the approved donee company should be related to the business of the donor. This would give scope for tax planning especially by small and medium sized assesseees who are otherwise handicapped for making heavy investment for building in house scientific facilities. Further, they can continue to claim deduction to the extent of 100% of the sum spent by them as revenue expenditure. On scientific research, if any, incurred by them under Section 35(1)(i).



**Answer 2(c)**

No, The Assessing Officer cannot invoke the provisions of Section 2(22)(e) to treat the Inter-corporate Deposits as 'Deemed Dividends' under Section 2(22)(e).

The requisite condition for invoking Section 2(22)(e) is that the payments must be made by way of loan or advance. There is a clear distinction between inter-corporate deposits vis-à-vis loans and advances. The deeming fiction in the provision should not be given a wider meaning than what it purports to be and the provisions would have to be accorded strict interpretation and the ambit should not be pressed beyond its true limits. *Bombay Oil Industries Ltd. v. Dy. CIT.*

**Question 3**

- (a) *When will the 'book profits' of a company deemed to be the total income of the company for the purposes of levy of minimum alternate tax (MAT) under section 115JB ?* (3 marks)
- (b) *Indicate briefly the points to be taken into account while preparing annual accounts for the purpose of MAT.* (3 marks)
- (c) *The MAT does not apply to foreign companies operating in India. Do you agree? Give reasons.* (3 marks)
- (d) *What is 'reverse mortgage' ? Whether loan received under the scheme of reverse mortgage amounts to income in the hands of borrower ? Whether mortgage of the property under reverse mortgage is treated as transfer so as to attract capital gains under section 45 ? Whether alienation of the mortgaged property by the mortgagee for the purpose of recovering the loan would amount to transfer so as to attract capital gains under section 45 ?* (6 marks)

**Answer 3(a)**

Section 115-JB provides that in the case of a company,

- if the tax payable on the total income,
- as computed under the act in respect of any previous year
- is less than ten per cent of its 'book profits',

such book profits shall be deemed to be the total income of the assessee and the tax payable for the relevant previous year shall be ten percent of such book profits.

**Answer 3(b)**

Sub-section (2) of section 115JB requires the company to prepare its profit and loss account for the relevant previous year in accordance with provisions of Parts II and III of Schedule VI of the Companies Act, 1956. However, while preparing the annual accounts including profit and loss account:

- (a) The accounting policies;
- (b) The accounting standards followed for preparing such accounts including profit and loss accounts; and
- (c) The method and rates adopted for calculating the depreciation.

shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account as laid before the company at its annual general meeting in accordance with the provisions of Section 210 of the Companies Act, 1956. But where the company has adopted or adopts the financial year which is different from the previous year under the Income Tax Act, (a), (b) and (c) aforesaid shall correspond to the accounting policies, accounting standards and the method and rates for calculating the depreciation which have been adopted for preparing such accounts including profit and loss account for such financial year or part of such financial year falling within the relevant previous year.

### **Answer 3(c)**

**Incorrect** : MAT applies to any company domestic as well as foreign. However, where a non-resident company's income is assessed on a presumptive basis under Section 44B or 44BB or at a flat rate under Section 115A on royalty and technical fees, the book profit becomes immaterial for regular assessment and the presumptive income tax will prevail.

### **Answer 3(d)**

An individual being the owner of a house property but does not have regular source of income, can mortgage his property with the Bank and the Bank in consideration of mortgage, assures to the borrower periodic amount during his lifetime is called Reverse Mortgage.

Vide Notification No.93/2008 dated 30.9.2008, The Central Government has notified the "Reverse Mortgage Scheme, 2008". As per the same, an individual aged 60 years or above and in the case of a married couple, where either the husband or wife is 60 or above, will be treated as an eligible reverse mortgagor to avail the above benefits. Any eligible person may enter a reverse mortgage transaction by applying in writing to the approved lending institution if the capital asset is a residential house property located in India, which is mortgaged, is owned by him and is free from any encumbrances.

An approved lending institution being any scheduled bank or housing finance company may disburse the loan to the reverse mortgager by any one or more of the following modes namely:

- (i) Periodic payments to be decided mutually between the institution and the reverse mortgagor.
- (ii) Lump sum payment in one or more tranches, to the extent that the aggregate of amount disbursed as lump sum payment does not exceed 50% of the total loan amount sanctioned.
- (iii) The loan under reverse mortgage shall not be granted for a period exceeding twenty years from the date of signing the agreement by the reverse mortgagor and the approved lending institution.

No, new Section 10(43) has been inserted to provide that such loan amount is exempt from Income-tax.

No, a new Clause (xvi) has been inserted in Section 47 to provide that any transfer of a capital asset in a transaction to a reverse mortgage is not treated as transfer, therefore, not liable to capital gain tax under Section 45.

Yes, the reserve mortgagor or his legal heirs or estate, shall be liable for repayment of the principal amount of loan along with interest to the approved lending institution at the time of foreclosure of loan agreement. Therefore, the alienation of the mortgaged property by the mortgagee for the purpose of recovering the loan will be treated as transfer and the borrower (i.e., mortgagor) will be liable to tax on capital gains if any, arising out of such alienation.

### **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) *The exemption notification issued under section 5A of the Central Excise Act, 1944 is not applicable in respect of DTA clearance, unless specifically provided in the notification by —*
    - (a) *SSI unit*
    - (b) *EOU unit*
    - (c) *Both (a) and (b)*
    - (d) *None of the above.*
  - (ii) *Under the central excise law, any article, material or substance, capable of being bought and sold for a consideration shall be deemed to be —*
    - (a) *Goods*
    - (b) *Manufactured*
    - (c) *Marketable and hence excisable*
    - (d) *Produced.*
  - (iii) *Questions arising out of orders made by CESTAT are appealable to High Court except those relating to —*
    - (a) *Classification and valuation*
    - (b) *Duty drawback*
    - (c) *Refund of excise duty*
    - (d) *Advance ruling.*
  - (iv) *Value of export goods under the Customs Act, 1962 is not determined by—*
    - (a) *Transaction value*
    - (b) *Residual method*
    - (c) *Computed value*
    - (d) *Market value.*
  - (v) *The term 'authorised representative' under section 35Q of the Central Excise Act, 1944 includes, among others —*
    - (a) *All Company Secretaries*
    - (b) *Company Secretaries with 10 years post qualification experience*

- (c) *Company Secretaries with certificate of practice*  
 (d) *Physics graduates.*
- (vi) *Under the Customs Act, 1962, an appeal before tribunal against the order of Commissioner shall be filed within —*  
 (a) *30 Days*  
 (b) *3 Months*  
 (c) *45 Days*  
 (d) *None of the above.*
- (vii) *Smuggled goods are liable to confiscation —*  
 (a) *Only when they are in the same form*  
 (b) *Even when the form has changed or mixed with other goods*  
 (c) *Both (a) and (b)*  
 (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) *In case of fraud, collusion, willful mis-statement and suppression of facts, or contravention of any provision of the Central Excise Act, 1944 or Rules with intent to evade payment of duty, demand for duty can be raised \_\_\_\_\_.*
- (ii) *Rules made by the Central Government and regulation made by the Central Board of Excise and Customs (CBE&C) can provide for penalty upto Rs. \_\_\_\_\_ on any person who violates any provision of rules or regulations.*
- (iii) *Persons claiming refund of excise duty under section 11B have to make an application within \_\_\_\_\_ from the 'relevant date'.*
- (iv) *Under the Customs Act, 1962, duty, interest, penalty or fine to be rounded off to \_\_\_\_\_.*
- (v) *The person from whom documents are seized is entitled to take \_\_\_\_\_ therefrom in presence of customs officer.*
- (vi) *Under section 46, an importer has to file a \_\_\_\_\_ for home consumption or warehousing.*
- (vii) *Assessees paying duty of Rs. 1 crore or more per annum through personal ledger account (PLA) are required to submit annual financial information statement for each financial year by 30th November of succeeding year in prescribed form \_\_\_\_\_.*
- (viii) *\_\_\_\_\_ can be granted in the case of lost, destroyed or abandoned goods under section 23 of the Customs Act, 1962.* (1 mark each)
- (c) *Explain briefly the term 'import manifest'.* (5 marks)

OR

*A manufacturing company has imported certain second-hand machinery for its use and declared its value on the basis of the 'transaction value'. Can the*

*declared value be rejected by the authorities and, if so, when and how ? What are the details which the importer must submit in support of its claim ?*

*(5 marks)*

**Answer 4(a)**

- (i) (b) EOU unit
- (ii) (c) Marketable and hence excisable
- (iii) (a) Classification and valuation
- (iv) (d) Market value
- (v) (c) Company secretaries with certificate of practice
- (vi) (b) 3 months
- (vii) (b) Even when the form has changed or mixed with other goods.

**Answer 4(b)**

- (i) In case of fraud, collusion, willful mis-statement and suppression of facts, or contravention of any provision of the Central Excise Act, 1944 or Rules with intent to evade payment of duty, demand for duty can be raised **within 5 years**.
- (ii) Rules made by the Central Government and regulation made by the Central Board of Excise and Customs (CBE&C) can provide for penalty upto **Rs.50,000** on any person who violates any provision of rules or regulations.
- (iii) Persons claiming refund of excise duty under section 11B have to make an application within **one year** from the 'relevant date'.
- (iv) Under the Customs Act, 1962, duty, interest, penalty or fine to be rounded off to **Rupee one**.
- (v) The person from whom documents are seized is entitled to take **extract** therefrom in presence of customs officer.
- (vi) Under section 46, an importer has to file a **Bill of Entry** for home consumption or warehousing.
- (vii) Assesseees paying duty of Rs.1 crore or more per annum through personal ledger account (PLA) are required to submit annual financial information statement for each financial year by 30th November of succeeding year in prescribed form **ER-4**.
- (viii) **Remission of duty** can be granted in the case of lost, destroyed or abandoned goods under section 23 of the Customs Act, 1962.

**Answer 4(c)**

'Import Manifest' is a record of the goods carried by a vessel, which is furnished by the carrier-in-charge of the vessel carrying imported goods. Under Section 30(1) of the Customs Act, the import Manifest is required to be filed before the arrival of the vessel or aircraft. In the case of a vehicle it is within 12 hours after arrival. The forms of the Import Manifest are prescribed in the Import Manifest (Vessels) Regulations, 1971 and

Import Manifest (Aircraft) Regulations, 1976, which have been made under Section 157 of the Customs Act, 1962. Section 30(1) proviso also enables the presentation of Import Manifest even before the arrival of the steamer/vessel. The Import Manifest is required to be delivered in duplicate in the Import Department with full particulars in respect of the following:

- (a) General Declaration re-information about the Vessel, its master, crew, passengers, etc.
- (b) Cargo declaration.
- (c) List of private property in the possession of master, officers' crew.

As regards air consignments, the Import Cargo Manifest is presented in Triplicate/Quadruplicate by the persons concerned immediately on landing of the Aircraft.

#### **Alternate Answer 4(c)**

As per the provisions of Section 14, as amended by the Finance Act, 2007, the value of imports and exports shall be based on the Transaction Value. The Customs Valuation (Determination of value of Imported Goods) Rules, 2007 also deals with the Transaction Value and conditions for its applicability. It also deals with transaction value of identical goods, similar goods and the situations where the above methods cannot be applied. It also provides for deductive value methods.

Where the proper officer has reason to doubt the truth or accuracy of the value declared in relation to the goods, he may ask the importer to furnish further information including documents or other evidence and on a consideration of the information received should proceed to consider the value declared and even after such consideration decides to reject the declared value, shall proceed to determine the value by proceeding sequentially in accordance with Rules 4 to 9.

If the value of identical or similar goods imported at or about the same time in comparable quantities is significantly higher, or where the sale involves abnormal discount or reduction from the ordinary competitive price, special discount, misdeclaration of goods in parameters such as description, quality, quantity, country of origin, year of manufacture/production, etc. the authorities can raise doubts about the declared value. Where the declared value is reflected and assessable value is re-determined the Assessing Officer shall issue detailed speaking order.

Importers may submit, *inter alia*, a Chartered Engineer's Certificate or any equivalent in the country of supply, indicating the price, current CIF value of the new machinery, if purchased now, year of manufacture, sale price of supplier, present condition of machinery, nature of conditioning or repairs carried out, if any, the cost thereof and expected life span. In the absence of proper load port certificate of local Chartered Engineer's certificate may be submitted.

[Circular No.4/2008 dated 12.2.2008 deals with valuation practice of second hand machinery to be adopted by all customs houses/customs commissionerates.]

#### **Question 5**

- (a) Under section 37B of the Central Excise Act, 1944 and section 151A of the Customs Act, 1962, the Central Board of Excise and Customs (CBE&C) issues

*various orders, instructions and directions to its officers from time to time. What is their binding effect? Are they binding on all departmental authorities including quasi-judicial authorities like Commissioner (Appeals)? Are there any restrictions on such powers? Can they have retrospective effect?*

(5 marks)

- (b) *Hetal manufactures hair dye. It is packed in pouches, each pouch containing 3 grams, 3 pouches (sachets) are sold in one packet. The net weight of each pouch, as also the net weight of the commodity in 3 pouches and the maximum rate is printed on the pouches. Examine whether the provisions of section 4A of the Central Excise Act, 1944 will apply for the valuation purpose. (5 marks)*
- (c) *Commissioner of Central Excise can review the order but cannot issue fresh notice extending period of limitation. Comment. (5 marks)*

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

Under Section 37B of the Central Excise Act and Section 151A of the Customs Act 1962;

The Board may, if it considers it necessary or expedient so to do for the purpose of uniformity in the classification of goods or with respect to the levy of duty thereon, issue such orders, instructions and directions to officers of customs as it may deem fit and such officers of customs and all other persons employed in the execution of this Act shall observe and follow such orders, instructions and directions of the Board.

Provided that no such orders, instructions or directions shall be issued:

- (a) So as to require any such officer of customs to make a particular assessment or to dispose of a particular case in a particular manner; or
- (b) So as to interfere with the discretion of the [Commissioner of Customs (Appeals) in the exercise of his appellate functions].

Such circulars/instructions etc are binding in law on the authorities under the respective statutes but they are not binding on quasi-judicial authorities like Commissioner (Appeals) or judicial authorities like Tribunal, High Court or Supreme Court. Recently the constitution Bench of the Supreme Court also reaffirmed in *CCE v. Ratan Melting & Wire Industries* (2008) 17 STT 103 that they are not binding upon the court. "It is for the court to declare what a particular provision of statute says and it is not for the executive. A circular which is contrary to the statutory provision has really no existence in law"

The circulars are effective from the date on which they are issued. No circular can be made effective retrospectively.

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

It is beyond any doubt or dispute that the commodity in question is being sold in 'multi piece package'. Identical quantity of commodity is packed in each sachet. Yet again admittedly 3 sachet are packed in one packet. The weight of 3 sachet is 9 GMS i.e., less than the prescribed weight of 10 grams.

The packet describes the commodity in question. It not only discloses the weight contained in each sachet but also discloses the weight contained in the packet of 3

sachet. Therefore, the intention of the manufacture to sell the commodity by weight is explicit.

Rule 17 provides for additional declarations to be made on multi piece packages. It envisages declaration of the quantity and the sales price thereof on each of the packages when the quantity is sold in the multiples packages. Section 4A of the Act would apply only when it is statutorily required to apply the provisions of the Rules.

Rule 34 contains an exemption clause. The exemption clause would apply if the commodity is sold by weight or measure subject of course to the condition that net weight of the commodity is 10 grams, or less. This legal requirement in this case also stands complied with. Once it is held that Rules have no application in respect of the commodity as marketed and sold by the respondent. Section 4A of the Act will have no application [*Commissioner of Central Excise v. Craftech Product Inc.* JT (2008)(4) SC 335].

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

**Correct** : It is based on the judgement given by CESTAT in case of *Maa Communications v. CST* (2007) 6 ST 53.

The Commissioner of Central Excise can revise the orders passed by adjudicating authority subordinate to him. The revision order can be passed at any time within two years of the original order but not afterwards. No revision can be made if appeal against such order is pending with Commissioner (Appeals) Section 84.

Appeal against the order of Commissioner (after Revision) lies with CESTAT under Section 86.

#### **Question 6**

- (a) *What are the options available, in the context of CENVAT credit rules, to a manufacturer manufacturing both exempt and dutiable goods or service-provider providing taxable as well as exempt services, in respect of inputs/input services used partly for manufacture of dutiable goods/taxable services and partly for exempted goods/services ?* (5 marks)
- (b) *Under certain circumstances, the central excise law allows an assessee to approach the Central Government with a request to revise appellate orders passed by the departmental authorities. Indicate the circumstances where such a possibility exists and the powers of the Central Government in this regard.* (5 marks)
- (c) *Write a note on excise concession on export of excisable goods.* (5 marks)

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

Such manufacturer/service provider has the following options:

- (i) Maintain separate inventory and accounts of receipt and use of inputs and input services for exempted goods/exempted output services (Rule 6(2) of CENVAT Credit Rules).
- (ii) Pay an amount equal to 10% of the value of exempted goods (if he is a



manufacturer) and/or 8% of the value of exempted services (if he is a service provider) and does not maintain separate inventory and records [Rule 6(3)(i)].

- (iii) Pay an 'amount' equal to proportionate CENVAT Credit attributable to exempted final product/exempted output services.

The assessee cannot utilize CENVAT Credit in respect of inputs/input services utilized exclusively for manufacture of exempted final products/exempted taxable services.

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

Under Section 35EE of the Central Excise Act, if the Appealable order are passed by the Commissioner (Appeals) in cases of:

- (i) Loss of goods;
- (ii) Rebate of duty of excise on goods exported;
- (iii) Export under bond without payment of duty.

a revision application can be filed before the Central Government. The Central Government has the discretion to refuse such application where the amount of duty, fine penalty does not exceed Rs.5,000, under section 35EE(1A) or where the Commissioner of C.E. is of the opinion that an order passed by Commissioner (Appeals) under Section 35A is not legal or proper, he may direct the proper officer to make an application on his behalf to Central Government for revision of such an order.

On receipt of such an application, it will be examined in the Ministry of Finance, after obtaining the relevant records and giving opportunity for personal hearing. Decision will be taken at the level of Joint Secretary to the Government of India.

The Central Government has powers to increase the penalty or demand duty or increase confiscation. In all such cases, the concerned party will be given opportunity for hearing as well as defence.

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

Exporter of Excisable Goods is entitled to several benefits. Under the schemes available in Excise Law, the Exporter of Excisable Goods can avail following facilities:

- (a) To export excisable goods on payment of excise duty and to claim refund of such duties subsequent to the export.
- (b) To export the goods without paying excise duty but on the basis of a bond being executed to fulfill the obligation to export.
- (c) To claim rebate of duty paid on excisable goods used as input in the manufacture of goods which are exported.
- (d) To process excisable goods required as inputs for manufacture of goods to be exported, without paying duty on such inputs.

Besides, the CENVAT Scheme also contains in built provisions to Act as a major incentive for export, which the exporter can make use of.

**Question 7**

(a) *Pranav and Parul, the petitioners, were engaged in the business of import in trading of textiles and some other consumable goods. During search, the statements of both the petitioners were recorded and the petitioners were arrested for the offence under sections 132 and 135 of the Customs Act, 1962 on account of alleged false declaration, false documents and evasion of customs duty. Simultaneously, adjudication proceedings were also initiated under the Act. The accused persons were exonerated by the competent authority/tribunal in the adjudication proceedings. Criminal proceedings were carried on simultaneously and petitioners were alleged to have committed offences punishable under sections 132 and 135(1)(b). Whether the criminal prosecution can be permitted to continue against both when the adjudication proceedings are in favour of them ? Discuss. (5 marks)*

(b) *Eva Offshore Ltd. is engaged in drilling operations for exploration of offshore oil, gas and other related activities under contracts. The drilling operations are carried out at oil rigs/vessels which are situated outside the territorial waters of India.*

*Until around November, 1993, the company was permitted to transship stores to the oil rigs without levy of any customs duty regardless of the fact whether oil rigs were operating within a designated area or non-designated area.*

*Whether oil rigs engaged in operations in the exclusive economic zone/continental shelf of India, falling outside the territorial waters of India, are 'foreign going vessels' as defined by section 2(21) of the Customs Act, 1962, and are entitled to consume imported stores thereon without payment of customs duty in terms of section 87 of the Customs Act 1962 ? (5 marks)*

(c) *Arpit Alloys Ltd. imported a consignment of metal bars during July, 2008 by sea, weighing 5,300 tons from U.K. A bill of entry for home consumption was filed and an order for clearance was passed by the Assistant Commissioner. The company paid the applicable duty. Thereafter, delivery was taken and on examination by the company's representatives; it was found that only 5,000 tons of metal bars were available at the dock though duty was paid for the entire lot of 5,300 tons. Since there was no short landing of the cargo, the short delivery of 300 tons was also supported by the weightment certificate issued to the company by the port trust authorities. The company made a representation to the customs department for appropriate relief under the Customs Act, 1962. Examine. (5 marks)*

**Answer 7(a)**

The petitioners were engaged in the business of import in trading of textiles and some other consumable goods. During search, the statements of both the petitioners were recorded and the petitioners were arrested for the offences under Sections 132 and 135 of the Customs Act, 1962 on account of alleged false declaration, false documents and evasion of customs duty. Simultaneously, adjudication proceedings were also initiated under the act. The accused persons were exonerated by the competent authority/tribunal in the adjudication proceedings. Criminal proceedings were carried on

simultaneously and petitioner were alleged to have committed offences punishable under the Sections 132 and 135(1)(b).

The High Court observed that the charges cannot be framed and criminal prosecution cannot be permitted to continue against the petitioner once adjudication proceedings on merits have been found in favour of the petitioners.

The High Court observed that the Department had failed in adjudicatory process against petitioner and yet continued to contend that criminal proceedings must go on. The High Court observed that the legal system by which we are governed is adversarial in nature. But there is a special responsibility on Government and public authorities to act reasonably and in fair manner. The High Court opined that the already over-burdened legal system could not be further burdened by unnecessary cases.

The above contention is as per judgement in case of *Anil Mahajan and Another v. UOI and another* (Del) 5 February, 2008.

#### **Answer 7(b)**

The appellants are engaged in drilling operations for exploration of offshore oil, gas and other related activities under contract. The drilling operations are carried on at Oil Rigs/Vessels, which are situated outside the territorial waters of India. Until around November, 1993 the appellant and all other similarly situated companies which were engaged in oil and gas exploration and exploitation were permitted to transship stores to the oil rigs without levy of any customs duty regardless of the fact whether oil rigs were operating within a designated area or non-designated area.

The Supreme Court observed that the principle underlying under section 86 and 87 is that the stores are consumed on board by a foreign going vessel. If the so called foreign going vessel is located within territory over which the coastal state have complete control and has sovereign right to extend its fiscal laws to such an area with or without modifications and the stores were consumed in area to which the Customs Act has been extended. Reference or reliance to the vessel being a foreign going vessel shall be of no consequences and the customs duty would be leviable as the goods are consumed within the territory to which the Customs Act has been extended as per the Maritime Zones Act, 1976 and the International Conventions 'UNCLOS, 1982.

The Court further observed that the stores are unloaded and consumed within the maritime boundary or within the limit of Customs Act, Section 12 will be attracted as it would be construed that there would have been an import within the territory of India to which Customs Act applies.

The above contentions are as per judgement in the case of *Aban Loyd Chiles Offshore Ltd. v. UOI* (SC) 11 April, 2008.

#### **Answer 7(c)**

As per Section 23, where the imported goods have been lost without pilferage or destroyed at any time before clearance for home consumption, duty on such goods would be remitted. Here 'loss' means that the loss is forever and there is no possibility of tracing it or recovering it.

In the given case 300 metric tons of metal bars have been lost in the custody of port trust after the order for clearance was passed and duty payment was made. The weightment certificate issued by Port Trust Authorities also substantiates the same. The company is therefore entitled to remission of the duty on the lost goods i.e., 300 tons, under Section 23 of the Customs Act.

### PART C

#### Question 8

Attempt **any four** of the following :

- (i) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
- (a) *Countries that employ explicit policies designed to attract international trade oriented activities by minimisation of taxes and reduction or elimination of other restrictions on business operations are described as \_\_\_\_\_.*
  - (b) *The authority for advance ruling will not allow consideration of any question involving determination of \_\_\_\_\_ of any property.*
  - (c) *The ruling given by the authority for advance rulings will be binding on \_\_\_\_\_.*
  - (d) *Indian income-tax law does not provide any exemption in case of amalgamation of an Indian company with a foreign company wherein the resultant amalgamated company is a \_\_\_\_\_.*
  - (e) *\_\_\_\_\_ means any area outside India which may be notified as such by the Central Government for the purpose under section 90A of the Income-tax Act, 1961. (1 mark each)*
- (ii) *If a tax payer has legitimately reduced his tax burden by taking advantage of treaty, the benefit cannot be denied to him on the ground of loss of revenue. Explain in the context of decided case law. (5 marks)*
- (iii) *A resident of India has paid tax in a foreign country in respect of his income which accrued in that country. India has no double taxation avoidance agreement with that country. Such income is also taxable in India. Is there any relief available to him in respect of the tax paid by him ? Explain. (5 marks)*
- (iv) *Distinguish between 'international transactions' and 'cross border transactions'. (5 marks)*
- (v) *Can a public sector undertaking which has undertaken a transaction with a non-resident, seek an advance ruling in respect of tax liability of the non-resident and also its own liability ? Indicate the scope of applicability of such advance rulings. (5 marks)*
- (vi) *"Under the special provisions of the Income-tax Act, 1961, any income arising from an international transaction shall be computed having regard to the arm's length price." In this context, briefly indicate when the provisions of arm's length price will apply and when it will not apply and also state its scope. (5 marks)*

**Answer 8(i)**

- (a) Countries that employ explicit policies designed to attract international trade oriented activities by minimisation of taxes and reduction or elimination of other restrictions on business operations are described as **Tax Havens** .
- (b) The authority for advance ruling will not allow consideration of any question involving determination of **fair market value** of any property.
- (c) The ruling given by the authority for advance rulings will be binding on **both parties before it**.
- (d) Indian income-tax law does not provide any exemption in case of amalgamation of an Indian company with a foreign company wherein the resultant amalgamated company is a **foreign company** .
- (e) **Permanent establishment** means any area outside India which may be notified as such by the Central Government for the purpose under section 90A of the Income-tax Act, 1961.

**Answer 8(ii)**

The need for agreement of Double Tax Avoidance (DTAA) arises because of Rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries. In such a case, the possibilities are as under:

The two countries have an agreement for Double Tax Avoidance in which case possibilities are:

- (i) The income is taxed only in one country.
- (ii) The income is exempt in both countries.
- (iii) The income is taxed in both countries, but credit for tax paid in one country is given against tax payable in the other country.

If the two countries do not have an agreement for Double Tax Avoidance between them. In such a case the domestic law of the country will apply. In the case of India, the provisions of Section 91 of the Income Tax Act will apply. The Central Board of Direct Taxes has clarified vide circular No.333 dated 2nd April, 1982 that in case of conflict in the provisions of the agreement for tax avoidance of double taxation and the Income Tax Act, the provisions contained in the agreement for Double Tax Avoidance will prevail.

The Government of India has entered into numerous tax treaties as well as trade agreements with various foreign countries to provide stability and certainty to the tax laws and commercial relationship between parties in India and abroad. The large number of judicial pronouncements including Advance Rulings in the recent years under the Tax Laws, both Direct and Indirect, have added to the confidence of non-residents being inspired with Indian Fiscal and Judicial Systems. The wealth of judicial decisions from Supreme Court as well as High Court and the Tribunal in deciding numerous tax disputes help to remove the uncertainties and ambiguities in the tax system and administration. The tax treaties have helped both the collaborators from abroad and the Indian enterprises

in the private and public sectors to know precisely the nature extent and scope of tax liability as also the country in which tax is payable.

In the case of *Union of India v. Azadi Bachao Andolan* (2003 132 Taxmann 373 SC). Supreme Court clearly laid down that the benefit of DTAA can not be denied even if it leads to loss of revenue.

**Answer 8(iii)**

Yes, he can claim the unilateral relief provided under Section 91 of the Income Tax Act, 1961.

If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Hence, he will be entitled to a deduction from the Indian Income Tax payable by him of a sum calculated on such doubly taxed income so included in his total income, at the Indian rate of tax or the rate of tax of the said country, whichever is lower or at the Indian rate of tax, if both rates are equal.

**Answer 8(iv)**

A transaction will be considered as international Transaction if it satisfies the following two conditions cumulatively:

- (a) It must be a transaction between two associated enterprises; and
- (b) At least one of the two enterprises must be a non-resident.

A transaction is considered to be a cross-border transaction if it originates in one country and gets concluded in another country.

A cross-border transaction may or may not be an international transaction within the meaning of Chapter X. Similarly a transaction which is not a cross border transaction may still be an international transaction for the purposes of Chapter X if it falls within the ambit of the definition of international transaction.

**Answer 8(v)**

A public sector undertaking, being a resident, has been notified by central government vide notification No. 725(E) dated 03-08-2000 in exercise of power conferred by sub-clause (iii) of clause (b) of section 245N as applicant for the purpose of advance ruling and if it has undertaken a transaction with a Non-resident and it can seek an Advance Ruling in respect of tax liability of non-resident as per Section 245N(i)(ii).

The fact that such resident is a public sector undertaking (PSU) notified under Section 245N(b)(iii) should not make any difference. It cannot, however, seek any ruling in respect of its own tax liability. (In re Airport Authority of India (2008) 168 Taxmann 158 AAR, New Delhi).

The ruling pronounced by the authority is binding on both parties before it. It will be binding:

- (i) On the applicant who had sought it;
- (ii) In respect of the transactions in relation to which the ruling had been sought; and
- (iii) On the Commissioner and the income Tax Authorities subordinate to him, in respect of the applicant and the said transaction.

**Answer 8(vi)**

Under the provisions of Section 92(1) of the Income Tax Act, 1962 any income arising from an International Transaction shall be computed having regard to the 'arms length price'. When the international transaction comprises of only an outgoing, the allowance for any expense or interest arising from the international transaction shall also be determined having regard to the arm's length price.

Thus the provisions of 'arms length price' shall apply not only to income generating transactions (e.g. sale of goods, royalty, fees for technical services, know-how, etc. for providing services) but also to transactions resulting into expenditure (purchases, interest on loan, etc.)

The provisions will not apply if their application results in decrease in the overall incidence of tax in India in respect of the parties involved in the international transactions. Where the computation of income or determination of the allowance for any expenses or interest or any cost or expense allocated or apportioned, as the case may be, computed under section 92(2) has the effect of reducing the income chargeable to tax or increasing the loss computed on the basis of entries made in the books of account in respect of previous year in which the international transaction was entered into, the provisions will not apply [Section 92(3)].

'Arms length price' means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in controlled conditions. It is the price that would have existed between enterprises not associated or related with each other [Section 92F(ii)].

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**PROFESSIONAL PROGRAMME EXAMINATION**  
JUNE 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) Attempt **any two** of the following :

- (i) Describe salient features of strategy in the light of launch of Nano car by Tata Motors Ltd.
- (ii) "The more important the decision, the less quantifiable it is and the more we will have to rely on the options of others and our own best judgment." Explain.
- (iii) "SWOT analysis is a strategic planning tool." Discuss.
- (iv) In the process of strategic change, managers face the problem of resistance to change. Discuss the factors responsible for individual resistance.

*(5 marks each)*

(b) Enumerate the steps involved in logical sequence in respect of **any two** of the following :

- (i) BCG Matrix
- (ii) Strategic programming
- (iii) Benchmarking process.

*(5 marks each)*

**Answer 1(a)(i)**

Strategy is the pattern of organizational responses to its environment. Henry Mintzberg defines strategy as: "a pattern in a stream of decisions and actions". Based on the various views, the term strategy, is considered as a long term course of action through which an organization relates itself to the environment so as to achieve its objectives. Strategy is a unified, comprehensive and integrated plan designed to assure that the basic objectives of the enterprise are achieved. It means that the plan joins all the parts of an enterprise together, covers all the major aspects of the enterprise, and that all parts of the plan are compatible with each other.

Tata Motors Ltd. has recently launched its new model, small car 'Nano'. It is intended to be used as a fuel efficient, safer alternative to the motorcycles/two wheelers used by millions of Indians. It is launched as a part of its strategy to tap the vast low and medium income customers and to provide a safer and convenient mode of transport. It is a car of many people who are dreaming about cheapest possible higher technology vehicles. Tata Motors is expecting a revolution in Indian car market and giving stiff threat to its competitors. As the cheapest car, every ordinary person can become a proud owner of a car, sooner than later.



The following are the salient features of strategy:

- (i) Strategy is a relative combination of actions aimed to meet a particular condition to solve certain problems, or to achieve a desirable end.
- (ii) Strategy is a major course of action through which an organization tries to relate itself with environment to develop certain advantages which help in achieving its objectives.
- (iii) Strategy may involve contradictory action. As the strategic action depends on environmental variables, an organization may take contradictory actions either simultaneously or with a gap of time.
- (iv) Strategy is forward looking and it has orientation towards future as it is required to face a new situation.

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

Strategic management is basically the art and science of formulating, implementing and evaluating cross-functional decisions that enables an organization to achieve its objectives. It is the process of specifying the organization's objectives, developing policies and plans to achieve these objectives, and allocating resources to implement the policies and plans to achieve the organization's objectives. Strategic management is thus a set of decisions and actions resulting in formulation and implementation of strategies designed to achieve the objectives of an institution.

Strategic management is an ongoing process that assesses the business environment and the industries in which the company is involved; assesses its competitors and sets goals and strategies to meet all existing and potential competitors. It later reassesses each strategy annually or quarterly i.e. regularly to determine how it has been implemented and whether it has succeeded or needs replacement by a new strategy to meet changed circumstances, new technology, new competitors, a new economic environment, or a new social, financial, or political environment.

Therefore, it is correctly stated in the context of strategic management that the more important the decision, the less quantifiable it is and the more we will have to rely on the options of others and our own best judgment. Strategic management is essentially a decision-making activity. It is the result of a series of managerial decisions. Although these decisions are supported by quantifiable data, but in situations where decisions cannot be quantified, managers must rely on 'informed judgment'. For example, the most important organizational decisions, such as entering a market, introducing a new product or service, or acquiring a company, although based on information and analysis, are essentially informed judgments.

**Answer 1(a)(iii)**

SWOT analysis is a strategic planning tool used to evaluate the Strengths (S), Weaknesses (W), Opportunities (O), and Threats (T) involved in a project or in a business venture. While opportunities and threats are external to the organization, strengths and weaknesses are internal to it. The approach of matching internal capabilities with the environmental opportunities and threats is known as SWOT. Thus, it involves specifying the objective of the business venture or project and identifying the internal and external factors that are favorable and unfavorable for achieving that objective.

SWOT analysis can be best understood as under:

- *Strengths* : Attributes of the organization which are helpful in achieving the objective.
- *Weaknesses* : Attributes of the organization which are harmful in achieving the objective.
- *Opportunities* : External conditions which are helpful in achieving the objective.
- *Threats* : External conditions which are harmful in achieving the objective.

Thus, the basic objective of SWOT analysis is to provide a framework to reflect on the firm's ability to overcome threats and to avail of the opportunities emerging in the environment. Indeed the dimensions of internal capabilities have relevance in so far as they relate to the environmental conditions. Hence the analysis of comparative strengths and weaknesses requires linking internal competencies with the characteristics of external environment.

Identification of SWOT is essential as subsequent steps in the process of planning for achievement of the selected objective may be derived from the SWOT. The decision makers have to determine whether the objective is attainable, given by the SWOT. If the objective is not attainable a different objective must be selected and the process is repeated.

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

Strategic change management is the process of delivering the strategy of an organisation in a controlled, efficient and effective manner. It is not about the delivery of a single project or monitoring business as usual activities. It is basically the process of governing a portfolio of programmes, projects and initiatives within the context of a wider strategy for the organisation. The purpose of the whole exercise is to deliver value to the organization.

In the process of strategic change, managers face the problem of resistance to change. It is a human tendency to resist any change. People resist change because it requires new habits, new skills, knowledge and some sacrifices to do things by new methods. The reasons underlying resistance to change may be individual or group resistance.

There are many factors operating at the individual level which are responsible for resistance. Degree of resistance depends on how people feel about the change. Their feelings may be either real or emotional. The following are the factors responsible for individual resistance:

- (i) *Economic Factors* : People feel attached to the organization for satisfying their needs. The economic needs i.e. physiological, job security, etc., precede over other needs. People may perceive that they will be adversely affected by the change in terms of their need satisfaction due to: (a) obsolescence of skill; (b) fear of economic loss; and (c) reduced opportunity for incentives.
- (ii) *Psychological Factors* : It covers those factors which are based on people's emotions, sentiments and attitudes towards change. These are qualitative rather

than quantitative. Major psychological factors responsible for resistance may include: ego defensiveness; status quo; low tolerance of change; lack of trust on change agent and fear of unknown.

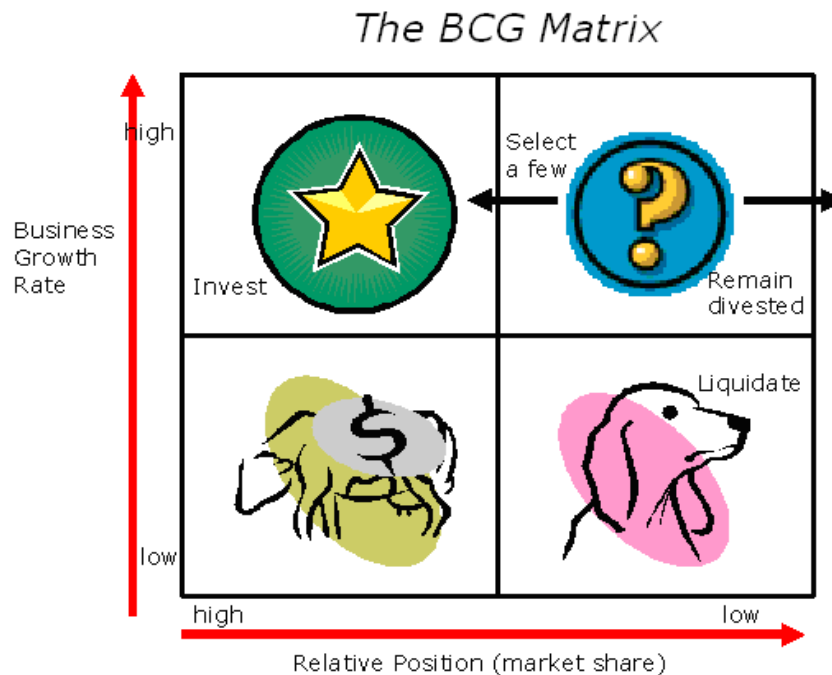
- (iii) *Social Factors*: People derive need satisfaction, particularly social needs through their mutual compatible interaction and form their own social groups at the workplace for the satisfaction of their social needs. The satisfaction of these needs is affected by a change which people resist. The major social factors causing resistance to change are: (a) desire to maintain existing social interaction; and (b) feeling of outside interference.

### Answer 1(b)(i)

#### BCG Matrix

The Boston Consulting Group developed the growth-share matrix to analyze the problem of resource deployment among the business units or products of multi-business firms i.e. a model for managing a portfolio of different business units (or product lines). It is based on product life cycle theory. The basic idea behind this model is that if a product has a bigger market share or if the products' market grows faster, it is better for the organization. The original BCG model was based on a lifecycle view of the product of a company. It is also known as a portfolio management tool.

BCG matrix may be graphically shown as under:



BCG matrix provides four categories in the portfolio of an organization which are as follows:

- (i) *Dogs (Low Growth and Low Market Share)* : Each of businesses or products in quadrant I with low expected growth rates and low relative market standing are labeled as "dogs" or "cash traps." The strategy in this category should consist of cost cutting by divestments, retrenchment, or even liquidation. These units or products are likely to be characterized by high costs, low quality, less effective marketing procedures, and so on, which would collectively contribute to weak competitive position and low potential for profits.
- (ii) *Question Marks (High Growth and Low Market Share)* : Those in quadrant II, with high projected growth rates and low market standing, are labeled as 'question marks'. The reason is that although they are operating in markets with expected growth potential, they are otherwise experiencing competitive disadvantage. This quadrant has worst cash characteristics, because they have high cash demands and generate low returns because of their low market shares.
- (iii) *Stars (High Growth and High Market Share)* : Products or business units in quadrant III, have both high market standing and high industry growth potential and are labeled as 'stars'. They should receive heavy cash investment in order to maintain their market share. Successful resource deployment beyond cash requirements could lead to a superior market share when industry growth potential falls off. Resources should be allocated to these units to grow faster than the competitions in sales and profits. Stars are leaders in the business and generate large amounts of cash.
- (iv) *Cash Cows (Low Growth and High Market Share)* : A product or business would become a cash generator in quadrant IV. Cash cows have a strong market position in industries that have matured. These products or businesses can thus be "milked" by investing just enough cash to maintain market standing and applying excess cash inflows to the firm's other activities which are growth industries or products.

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

#### **Strategic programming**

A programme is a statement of the activities or steps needed to accomplish a single use plan. Program is a list of planned activities or the plan for future action. The programs make the strategy action oriented. Strategic programming concerns with planning as to how the deliberate strategy can best match the intended strategy to the realized strategy for effective implementation of strategy. A strategic programming is aimed at producing a particular kind of realized strategy.

Following are the major steps involved in strategic programming:

- (i) Identification mission.
- (ii) Setting objectives.
- (iii) Developing alternative strategies.
- (iv) Evaluation of strategies.

- (v) Selection of optimal alternatives.
- (vi) Preparation of master plans.
- (vii) Preparation of medium term plan.
- (viii) Preparation of short-term plan.
- (ix) Evaluation of results.

**Answer 1(b)(iii)****Benchmarking process**

Benchmarking is the continuous process of measuring products, services and practices against the competitors and those companies recognized as industry leaders. It is another method of comparative analysis of organizational strengths and weaknesses. It is a process of identifying, understanding and adapting outstanding practices from within the same organization or from other businesses to help improve performance. It involves open learning how others do something better than one's own company so that one not only can intimate, but perhaps even improve on their current technique. The benchmarking process normally includes the following steps:

- (i) Identify the area or process to be examined.
- (ii) Find behavioural and output measures of the area or process and obtain measurements.
- (iii) Select an accessible set of competitors and best-in-class companies against which to benchmark.
- (iv) Calculate the differences among the company's performance measurements and those of the best-in-class and determine why the differences exist.
- (v) Develop tactical programs for closing performance gaps.
- (vi) Implement the programs and then compare the resulting new measurements with those of the best-in-class companies.

**Question 2**

- (a) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *Leadership is not confined just to the CEO or the top level of the organisation.*
  - (ii) *Environmental analysis consists of external analysis.*
  - (iii) *Strategies for global business do not differ from domestic business.*
  - (iv) *Mission is a statement which distinguishes the organisation from others.*
  - (v) *Defensive types of strategies do not include retrenchment.*
  - (vi) *Vision is not a mental perception of the environment an organisation wants to create.*

(2 marks each)

(b) Calculate 'economic value added' (EVA) from the following data :

Particulars	Rs. in Crores
Turnover	1,000
Cost of production	600
Average cost of capital :	
Debt (Long+Medium+Short Term)	200
Equity	100
Income-tax is @ 30%. Net operating profit after tax is 20%.	

(8 marks)

**Answer 2(a)**

- (i) **Correct** : Leadership is not confined just to the CEO or the top level of the organization as leadership is a performing art, a collection of practices and behaviors and not a position. For strategic management to be successful, everyone should be encouraged to think strategically and thus encouraged to be a leader.
- (ii) **Correct** : Environmental analysis consists of external analysis. However, it includes internal analysis too. It is the process by which organizations comprehends various environmental factors and determines the opportunities and threats that are provided by these factors.
- (iii) **Incorrect** : Strategies for global business differ from those of domestic business because of difference in the nature of competitive forces. A firm's decision to adopt strategies for global business depends on two factors: (a) extent of cost pressures to denote the demand on a firm to minimize its per unit costs; and (b) extent of pressures for local responsiveness to denote to make a firm to tailor its strategies to respond to national-level differences in terms of variables like customer preferences and tastes, government policies, and business practices.
- (iv) **Correct** : An organization's mission is a fundamental statement of the purpose and direction which defines the place of the organization within its environment. Thus, mission statements of every organization differs from others of its type, thereby separating it from competitors as well as non-competitors.
- (v) **Incorrect** : Generally not all strategies have expansion orientation. Very often the strategist is forced to control the firm's operations. There are three basic types of defensive strategies i.e., retrenchment, divestment and liquidation. Thus, defensive types of strategies include retrenchment.
- (vi) **Incorrect** : Vision of a company is the mental perception of the kind of environment that an organization aspires to create with a broad time frame. A vision relates to an organization's broadest and most desirable goal. A company forms its vision in the light of the information and insight gained from studying its internal and external environments.

**Answer 2(b)**

$$\begin{aligned}
 \text{Economic Value Added (EVA)} &= \text{Net operating profit after taxes} - \text{Cost of capital employed} \\
 &= \text{NOPAT} - \text{Cost of capital employed}
 \end{aligned}$$

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$$\begin{aligned}\text{Now, Cost of capital employed} &= \text{Cost of debt} + \text{Cost of equity} \\ &= \text{Rs. 200 crores} + 100 \text{ crores} \\ &= \text{Rs. 300 crores}\end{aligned}$$

NOPAT, as given in the question = 20%

$$\begin{aligned}\text{i.e. NOPAT} &= 20\% \text{ of Rs. 1000 crores} \\ &= (20/100) \times 1000 \text{ crores} \\ &= \text{Rs. 200 crores}\end{aligned}$$

$$\begin{aligned}\text{So, Economic value added (EVA)} &= \text{NOPAT} - \text{Cost of capital employed} \\ &= \text{Rs. 200 crores} - 300 \text{ crores} \\ &= \text{Rs. (-100 crores)}\end{aligned}$$

**Ans: EVA = Rs. (-100 crores)**

### Question 3

- (a) *Risk management has become prime concern and acquired added significance after the global financial crisis and corporate frauds. The operations of your company are global and attract various types of risks and uncertainties. Prepare a note on risk management process for submission to the Managing Director of your company. (12 marks)*
- (b) *Write short notes on **any two** of the following :*
- (i) *Strategic decision-making*
  - (ii) *Steps involved in business process re-engineering (BPR)*
  - (iii) *Integration strategies. (4 marks each)*

### Answer 3(a)

To  
Managing Director  
XYZ Ltd.

10th June, 2009

*Sub. : Risk Management Process*

Risk management has become a prime concern for every business in the present global competitive and knowledge based environment. Every business entity in the world exists for providing value to its stakeholders. All entities face uncertainty or risk and the challenge for management is to determine how much uncertainty or risk to accept. Uncertainty presents both risk and opportunity with potential to erode or enhance value. Risk management enables management to effectively deal with uncertainty and associated risk and opportunity enhancing to build the value.

Risk management refers to identification of opportunities and avoiding or mitigating losses. It is a logical and systematic process of establishing the context, identifying, analyzing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process, in a way which enables an organisation to minimise losses and maximise opportunities.

Risk management helps management to achieve the entity's performance and profitability targets and prevent loss of resources. It ensures effective reporting and compliance with laws and regulations and helps to avoid damage to the entity's reputation and associated consequences. It also helps an entity to accomplish its target where it wants to go and avoid pitfalls and surprises along the way.

As the operations of our company are global we may attract the following types of risks:

- (1) *Systematic Risk* : It refers to risk which affects the entire market. This type of risk is not diversifiable and can not be eliminated. A significant political event, for example, could affect several of the assets in our portfolio. Interest rates, recession, political disturbances, change in government policy etc., all represent sources of systematic risk because they affect the entire market and cannot be avoided through diversification.
- (2) *Market Risk* : The market risk is also called the undiversifying risk, because this risk can not be avoided no matter how many different stocks might be present in the portfolio.
- (3) *Business Risk* : It basically refers to the situation of uncertainty associated with operating cash flows of a business. It may be external and internal risk. External business risk is the result of operating conditions which are imposed upon the organisation by circumstances beyond its control. Internal business risk is associated with the efficiency with which a firm conducts its operations within the broader operating internal environment imposed upon it.
- (4) *Purchasing Power Risk* : It refers to the impact of inflation or deflation in the economy on an investment.
- (5) *Interest-Rate Risk* : It is the risk where an investment's value will change as a result of a change in interest rates.

In the present era of economic recession and corporate financial fraud it has become inevitable for an organization to have a sound risk management framework, which will mitigate the impact of any arising risk and enhance the value of business. But by following a comprehensive risk management process our company can overcome the risky prepositions and manage risk.

In this direction, we may consider a comprehensive risk management process containing the following:

- Evaluate the methodology for identifying the risks surrounding the business activities
- Assessment of the likelihood of an event occurring for each asset
- Explanation of the course of action say, how to respond to these events
- Putting systems in place to deal with the consequences
- Monitoring the effectiveness of our risk management approaches and controls
- Prioritize risk reduction measures based on the strategy of the organization.

Submitted for your kind information and advice please.

Sd/-

Company Secretary



**Answer 3(b)(i)****Strategic decision making**

Strategic decision making is the core of strategic management. It enhances manager's abilities to obtain insight and exercise judgment by deepening their decision making skills and helping them to design more effective decision processes. Strategic decision is a major choice of an action concerning committing of resources with a view to achieve organizational objectives. Unlike many other decisions, strategic decisions deal with the long run future of the entire organization. It has the following features:

- (i) Strategic decision is a major choice of action which affects the entire organization or major parts of it.
- (ii) It affects the long-term prosperity of the organization because the commitment is for long-term.
- (iii) It involves commitment of large amount of resources i.e., human, financial and physical in implementing the chosen strategic option.
- (iv) Because of high-level of futurity, a strategic decision is made after analyzing various factors both within the organization and its environment.
- (v) Since a strategic decision has major impact on the organization on long-term basis, it is made by top management which has much wider perspective of the organization and its environment.

Strategic decision making involves the usual decision-making process-specific objectives derived from organization's strategic intent, search for alternatives to achieve those objectives, evaluation of these alternatives and choice of the most appropriate alternative. Thereafter, this choice is put into action. Strategic choice cannot be taken without careful thought as to their implementation. It must be feasible as well as appropriate to the requirement of the situation.

After comparing possible strategies, the manager must decide what will be the future strategies of the organization. Many different decision models have been proposed to explain how these decisions can be made. The decision-making contexts constitute different frames of reference a decision maker might take. It is important to note which frame of reference or context surrounds a particular decision model and then to compare it only with other decision models within that context. The manager may actually select more than one model or strategy. In contingency planning systems, an action plan could be selected for the environmental scenario that is most likely to occur and/or the set of goals appropriate to that scenario. Another strategy would be selected for an optimistic scenario - a reasonable but very favorable set of environmental circumstances with a somewhat low probability of occurrence. Then a third strategy would be chosen for the pessimistic scenario, which also has a low probability of occurrence but carries unfavorable implications.

**Answer 3(b)(ii)****Steps involved in business process re-engineering**

Business process re-engineering (BPR) is a management approach aimed at improvements by means of elevating efficiency and effectiveness of the processes

which exist within and across organizations. Business process re-engineering can be defined as the analysis and design of workflows and processes within and between organizations. It is basically the critical analysis and radical redesign of existing business processes to achieve breakthrough improvements in performance measures. Business process re-engineering is also known as business process redesign, business transformation or business process change methodology.

Following steps are involved in business process re-engineering:

- (i) *Developing business vision and process objective* : Under this process it is desirable that a vision of organization is defined clearly so that one can put business process function in tune with the vision. BPR is driven by a business vision which implies specific business objectives such as cost reduction, time reduction, output and quality improvement, etc. Accordingly, organization should make projections about where it should go and what are the major challenges ahead.
- (ii) *Identifying the process to be redesigned* : Once business vision and process objectives are clearly defined, the organization should focus and identify those processes which needs redesigning.
- (iii) *Measuring the performances of existing processes* : Under this step, the organisation should focus on various methods used to measure the performance of a process to determine whether an opportunity exists to improve its efficiency, effectiveness and adaptability.
- (iv) *Identification of the opportunity for application of information technology* : Under this step, the emphasis is placed on application of information technology knowledge to support a process and redesign the process accordingly.
- (v) *Building prototype of new processes* : Under this step, the organization should design a new process on an experimental basis in the light of series of revision and improvement until the redesign process is put in actual operation. The prototype must be tested to measure this performance and incorporate needed changes.

The purpose of business process reengineering is improvement in business performance by redesigning the various processes involved. This is because business performance is the result of outcome of the inter-related work processes that constitute the business system.

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

#### **Integration strategies**

Integration strategies seek to acquire a service or product by merging with or acquiring the prior provider. Therefore, the process of integration should be implemented within a framework of goals that spells out the limits of such evaluative criteria as return on sales and investment, pivotal expense items, time, and cash flow. Integration strategies can be achieved in the following ways:

- (i) *Backward Integration*

Backward integration involves gaining increased control over the firm's supply (or input) activities. It can be implemented through merger with or acquisition of

the organization that produces the company's inputs or by growing one's own supply systems. However, it is often easier to finance an acquisition than internal expansion. The main reasons to support the backward integration are: (a) getting regular and adequate supply of inputs; (b) enjoying the benefits of enhanced quality control; (c) getting higher return on investments by better use of facilities; (d) improving negotiation power with suppliers; and (e) saving indirect taxes payable on purchase of inputs.

(ii) *Forward Integration*

Forward integration consists of obtaining control over the external portions of the organizations marketing systems. This is down stream expansion which refers to moving higher up in the production and or distribution process towards the end user or consumer. In most cases this means either acquiring a distribution system or establishing one internally. For example, a textile unit producing cloth, opens its own retail outlet is an example of forward integration.

(iii) *Horizontal Integration*

Horizontal integration refers to a situation when two or more firms engaged in similar activities think of joining hands for their betterment. Integration is the order of the day particularly with sweeping phase of globalization. It builds up synergy and can provide companies with opportunities to have fast access to new products, services, geographical regions and customers.

(iv) *Vertical Integration*

Vertical integration is a case when a firm accepts either earlier activities or the latter activities than what it is engaged in the series of activities that start converting raw materials till the handling over of the end products to the class of consumers. In a sense, vertical integration permits the organization to enlarge its scope of operations within the same overall industry. It is characterized by the firm's expansion into other parts of industry value chain directly related to the design, production, distribution and marketing using existing set-off products or services. For example, a dyeing unit takes over the spinning, weaving, bleaching and printing, finishing and marketing is a case of vertical integration.

## PART B

(Answer ANY ONE question from this part.)

### Question 4

- (a) Briefly explain the concept of 'strategic alliance', its forms and principles for its success. (8 marks)
- (b) The Board of directors of your company has forwarded you the proposed foreign technical collaboration agreement for scrutiny and comments. There are clauses in the agreement putting restrictions on use of technical know-how after the expiry of the agreement; further research and development of technical know-how after the expiry of the agreement; sharing of technical know-how with any other Indian company; sale of goods outside assigned territory and price-fixation. Examine the agreement and pinpoint restrictive clauses and their effect on interests of your company in particular and Indian industry in general. (8 marks)

(c) Explain briefly 'equity joint venture' and 'contractual joint venture'.

(4 marks)

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

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 not a partnership, and neither company has legal power to control or obligate the other. Instead, it is a commitment by the two companies to provide capabilities or cross servicing in certain identified areas.

By properly utilizing a strategic alliance, companies can expand their product and service offerings substantially, without the usual corresponding investment in staff, equipment, and facilities. Strategic alliances are motivated by considerations such as cost reduction, technology sharing, product development, market access etc.

Strategic alliances have objectives similar to those of conventional acquisitions but such alliances can prove to be less expensive than acquisition, if they are structured properly. This is because if two or more companies pool their resources they can secure their joint objectives more easily and economically.

Such alliance may be in the form of:

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

Principles for successful strategic alliances includes Articulating Goals, Selection of Appropriate Partners, Working at Strategic and Operational Levels, Organizational Alignment, Dealing with Conflicts and Cultural issues, Maintaining Strong Executive Sponsorship, Experimenting and Committing to Learning.

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

##### **Restrictions after Expiration of Arrangements**

The use of such clauses in technology transfer agreements generally oblige the company acquiring technology to pay royalties during the entire duration of manufacture of product or the application of the process involved, without specifying any time limit. Sometimes these clauses also contain restrictions to be continued even after the expiration of the agreement, for example, restrictions on competition, restriction on Research and development activities and specially, the acquiring company's obligation to keep secret and not to make use of the confidential information even after the expiration of the life of the arrangement.

### **Restrictions on Research and Development**

Such restrictions in the technology transfer agreement generally involve limitations on the research and development policies and activities of the company acquiring technology.

The use of such clauses affects directly or indirectly the possibilities for the technological development capabilities of the recipient company. Such provisions also restrict the freedom of recipient party to undertake its own Research and development programmes. These restrictions also cover such provisions which are in direct competition with Research and Development activities of the company supplying technology.

The restrictions on Research and Development activities of recipient company have also been declared as restrictive practices under the UNCTAD Code. The provisions recognised such clauses as restricting the acquiring party from undertaking R&D activities directly to absorb and adapt the transferred technology to suit local conditions or restriction on initiation of R&D programmes in connection with new products, processes or equipment.

### **Price Fixation**

Price fixing clauses in a technology transfer arrangement involve the practices where the supplier company reserve the right to fix the sale or resale price of the product manufactured by the imported technology. In certain cases the imposition of resale conditions might be justified, e.g. where the supplier company practices a legal selective distribution system, the supplier may impose the conditions on his distributor only to sell to qualified dealers. Therefore, the price-fixing clauses may cover the price determined by the supplier on goods produced with the help of transferred technology. Price-fixing may also involve horizontal price cartels between several technology suppliers or several technology recipients.

The developing countries have enacted regulations on transfer of technology which deal with restrictive business practices on the basis of a conceptual approach which, though not necessarily incompatible with anti-trust or competition laws, but substantially differs from it.

The main object of such an approach is to protect certain wider interests which are closely related to the economic and technological development of the recipient country. The approach adopted by the developing countries seeks to prohibit any practice that establishes a relationship of dependence or control over the productive, technological or marketing activities of the recipient country or any other practices which adversely affect the economy and development policies of the recipient country.

### **Answer 4(c)**

#### **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.

### **Contractual Joint Venture**

The contractual joint venture might be used where the establishment of a separate legal entity is not needed or the creation of such a separate legal entity is not feasible in view of one or the other reasons. The contractual joint venture agreement can be entered into in situations where the project involves a narrow task or a limited activity or is for a limited term or where the laws of the host country do not permit the ownership of property by foreign citizens. For the purposes of contractual joint venture, the relationship between parties is set forth in the contract or agreement concluded between them.

### **Question 5**

- (a) *Your company is negotiating an international joint venture with a company registered in Italy for the manufacture of fuel efficient engine for a small car. As a Company Secretary, prepare a note for the consideration of the Managing Director —*
- (i) *giving the best method of resolution of disputes in international joint ventures; and* (8 marks)
  - (ii) *drafting of arbitration clause nominating the London Court of International Arbitration for resolution of disputes between the parties.* (8 marks)
- (b) *State the steps involved in the process of integrating alliances into corporate strategy.* (4 marks)

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

To

The Managing Director

Internationally, it is accepted that commercial disputes should be resolved through arbitration and not through normal judicial system. The object of arbitration is settlement of dispute in an expeditious, convenient, inexpensive and private manner so that they do not become the subject of future litigation between the parties.

International commercial arbitrations are those which satisfy two basic criteria, i.e., different nationality of parties and international character of the transaction. UNCITRAL Model Law on International Commercial Arbitration under Article 1(3) enumerates the basic ingredients of international commercial arbitration.

The Model Law clarifies that the term “commercial” in relation to international commercial arbitration covers matters arising from all relationships of a commercial nature, whether contractual or not.

Parties to an international commercial arbitration are generally free to choose the place for conduct of arbitral proceedings. The place of arbitration chosen by or on behalf of the parties may expressly be provided in the arbitration agreement or the terms of reference or in some other way. However, the place of arbitration as designated by the parties does not imply that the arbitral tribunal must hold meetings or hearings at the

designated place of arbitration. In international commercial arbitration, it is well established that the arbitral tribunal may meet or hear the parties at different places, if considered necessary, but the place or seat of arbitration remains the same as agreed upon between the parties.

Sd/-

Company Secretary

**Answer 5(a)(ii)**

To

The Managing Director

*Arbitration Clause Recommended by London Court of International Arbitration (LCIA)*

Parties to an international contract who wish to have any disputes referred to arbitration under the LCIA Rules are recommended to insert in the contract an arbitration clause in the following form:

“Any dispute arising out of or in connection with his contract, 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, which Rules are deemed to be incorporated by reference into this clause”.

Parties are also reminded that difficulties and expenses may be avoided if they expressly specify the law governing their contract. The parties may if they wish also specify the number of arbitrators, and the place and language of the arbitration. The following provisions may be suitable:

“The governing law of this contract shall be the substantive law of.....”

“The tribunal shall consist of .....(a sole or three) arbitrator(s).”

In the case of a three-member tribunal, the following words may be added

“...two of them be nominated by the respective parties”

“The place of the arbitration shall be .....(city)”

“The language of the arbitration shall be .....

Sd/-

Company Secretary

**Answer 5(b)**

Strategy for Alliances must be integrated into the overall corporate strategy and articulated in the strategic plan with a process for implementation. The entire process of developing and managing an alliance could be as follows;

- (a) Development of the strategic domestic or global plan

- (b) Development of the alliance plan
- (c) Alliance partner — search and selection
- (d) Development of the implementation plan
- (e) Execution of the implementation plan

### PART C

*(Answer ANY TWO questions from this part.)*

#### Question 6

*Read the following passage and answer the questions given at the end :*

*India has imposed anti-dumping duties on imports of compact discs recordables (CDRs) from China, Hong Kong, Singapore and Chinese Taipei. The move is expected to give some relief to domestic producers of CDRs. The Central Board of Excise and Customs (CBEC) had notified the imposition of anti-dumping duty in the range of \$0.050 to \$0.099 per piece.*

*Imposition of duty is expected to level the field for domestic players. The domestic industry had petitioned the government against such imports as these were eroding their margins.*

*The designated authority – Director General of Anti-Dumping (DGAD) had made a recommendation to the CBEC in this regard. The authority, in its final findings, had concluded that the CDRs had entered Indian market from the identified countries at price less than their normal value in the domestic market.*

*“The domestic industry had suffered material injury and the injury has been caused to the domestic industry both by volume and price effect of dumped imports of subjected goods originating in or exported from the subject countries”, it had said.*

*The authority maintained that dumping margins of the CDRs imported from these countries were substantial and above the de minimis and recommended imposition of definitive anti-dumping duties.*

*Answer the following questions —*

- (i) What is dumping ? Illustrate.*
- (ii) How did DGAD come to the conclusion of dumping of CDRs ?*
- (iii) Under what conditions DGAD would have suspended the investigations ?*
- (iv) With whom the appeal against the order of DGAD may be filed and in how many days ? (5 marks each)*

#### Answer 6(i)

Dumping occurs when the export price of goods imported into India is less than the Normal Value of 'like articles' sold in the domestic market of the exporter. Imports at cheap or low prices do not per se indicate dumping. The price at which like articles are sold in the domestic market of the exporter is referred to as the "Normal Value" of those articles.

The normal value is the comparable price at which the goods under complaint are sold, in the ordinary course of trade, in the domestic market of the exporting country or



territory. If the normal value cannot be determined by means of domestic sales, the Act provides for the following two alternative methods:

- (i) Comparable representative export price to an appropriate third country.
- (ii) Cost of production in the country of origin with reasonable addition for administrative, selling and general costs and for profits.

The export price of goods imported into India is the price paid or payable for the goods by the first independent buyer.

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

In determining the dumping of CDRs first of all the DGAD must have constructed Export Price. If there is no export price or the export price is not reliable because of association or a compensatory arrangement between the exporter and the importer or a third party, the export price may be constructed on the basis of the price at which the imported articles are first resold to an independent buyer. If the articles are not resold as above or not resold in the same condition as imported, their export price may be determined on a reasonable basis.

Thereafter, DGAD must have decided about margin of dumping. Margin of dumping refers to the difference between the Normal Value of the like article and the Export Price of the product under consideration.

The export price and the normal value of the goods must be compared at the same level of trade, normally at the ex-factory level, for sales made as near as possible in time. Due allowance is made for differences that affect price comparability of a domestic sale and an export sale. These factors, inter alia, include physical characteristics, levels of trade, quantities, taxation and conditions and terms of sale.

Anti-dumping action can be taken only when there is an Indian industry which produces “like articles” when compared to the allegedly dumped imported goods. The article produced in India must either be identical to the dumped goods in all respects or in the absence of such an article, another article that has characteristics closely resembling those goods.

The Indian industry must be able to show that dumped imports are causing or are threatening to cause material injury to the Indian ‘domestic industry’. Material retardation to the establishment of an industry is also regarded as injury.

A ‘causal link’ must exist between the material injury being suffered by the Indian industry and the dumped imports. In addition, other injury causes have to be investigated so that they are not attributed to dumping.

#### **Answer 6(iii)**

The DGAD may suspend or terminate the investigation in the following cases:

- (i) if there is a request in writing from the domestic industry at whose instance the investigation was initiated.
- (ii) when there is no sufficient evidence of dumping or injury.
- (iii) if the margin of dumping is less than 2% of the export price.

- (iv) the volume of dumped imports from a country is less than 3% of the total imports of the like article into India or the volume of dumped imports collectively from all such countries is less than 7% of the total imports.
- (v) injury is negligible.

**Answer 6(iv)**

Appeal against the order of the DGAD may be filed with the Customs, Excise and Gold (Control) Appellate Tribunal within 90 days of the date of the order.

**Question 7**

- (a) Describe the time-frame for different stages of dispute settlement under the WTO. (8 marks)
- (b) Write short notes on any three of the following :
  - (i) Objectives of ASEAN
  - (ii) Rules of origin criteria
  - (iii) Distortion of trade
  - (iv) Non-tariff barriers. (4 marks each)

**Answer 7(a)**

The approximate period for each stage of a dispute settlement procedure are target figures - the agreement is flexible. In addition, the countries can settle their dispute themselves at any stage. Totals are also approximate.

60 days	Consultations, mediation, etc.
45 days	Panel set up and panelists Appointment.
6 months	Final panel report to parties.
3 weeks	Final panel report to WTO members.
60 days	Dispute Settlement Body adopts appeals report.

**(if no appeal)**

**Total = 1 year**

**If Appeal**

60-90 days	Appeal report
30 days	Dispute Settlement Body adopts appeals report.

**Total = 1 year 3 months**

**Answer 7(b)(i)**

Objectives of ASEAN are as under: to accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South East Asian nations, and to promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to the principles of the United Nations Charter.

**Answer 7(b)(ii)**

“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 (charged to counter export subsidies), and more.

Rules of origin are also used to compile trade statistics, and for “made in” labels that are attached to products.

This first-ever agreement on the subject requires WTO members to ensure that their rules of origin are transparent; that they do not have restricting, distorting or disruptive effects on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard. In other words, they should state what does confer origin rather than what does not.

**Answer 7(b)(iii)****Distortion of Trade**

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. 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. Governments usually give following reasons for supporting and protecting their farmers, even if this distorts agricultural trade:

- to make sure that enough food is produced to meet the country’s needs,
- to shield farmers from the effects of the weather and swings in world prices to preserve rural society.

**Answer 7(b)(iv)**

Non-Tariff Barriers are

- technical regulations and standards
- import licensing, import quota restriction
- rules for the valuation of goods at customs
- preshipment inspection: further checks on imports

- investment measures
- export subsidies and domestic support
- service barriers
- lack of adequate protection to intellectual property rights.

### Question 8

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

- (i) The World Trade Organisation (WTO) is a simple extension of GATT.
- (ii) SAPTA is a free trade agreement between South Asian Countries.
- (iii) Most favoured nation (MFN) concept means some kind of special treatment for one particular country.
- (iv) The word 'plurilateral' in the context of the WTO means plurality of agreements.
- (v) 'Champagne' a term associated with wine produced in a certain region of France can be made in India and exported as 'Champagne'.

(2 marks each)

(b) "Subsidies and countervailing measures (SCM) agreement creates three basic categories of subsidies." Explain. (6 marks)

(c) What are the objectives of South Asian Association for Regional Co-operation (SAARC) ? (4 marks)

### Answer 8(a)(i)

#### Incorrect

*Reason:* The World Trade Organization is not a simple extension of GATT; rather it completely replaces its predecessor and has a very different character. The principal differences are GATT was a set of rules, a multilateral agreement, with no institutional foundation, only a small associated secretariat which had its origins in the attempt to establish an International Trade Organization in the 1940s. The WTO is a permanent institution with its own secretariat.

The GATT rules applied to trade in merchandise goods. In addition to goods, the WTO covers trade in services; Trade-related aspects of intellectual property and Trade related investment measures.

### Answer 8(a)(ii)

#### Incorrect

*Reason:* SAPTA is the acronym of SAARC Preferential Trading Arrangement. In this Agreement, the Contracting States establish the SAARC Preferential Trading Arrangement (SAPTA) to promote and sustain mutual trade and the economic cooperation among the Contracting States, through exchanging concessions in accordance with this Agreement. SAPTA will be governed by the provisions of this Agreement and also by the rules, regulations, decisions, understandings and protocols to be agreed upon within its framework by the Contracting States.

**Answer 8(a)(iii)****Incorrect**

*Reason* : Most-favoured-nation (MFN) under WTO is actually non-discrimination — treating virtually everyone equally. What happens under the WTO is this; each member treats all the other members equally as “most-favoured” trading partners. If a country improves the benefits that it gives to one trading partner, it has to give the same “best” treatment to all the other WTO members so that they all remain “most-favoured”.

**Answer 8(a)(iv)****Incorrect**

*Reason* : Plurilateral agreements are those agreements which are negotiated amongst a narrower group of signatories and is binding only between/among those signatories. Some of the examples plurilateral agreements are: Trade in Civil Aircraft, Government Procurement.

**Answer 8(a)(v)****Incorrect**

*Reason* : Place names are sometimes used to identify a product. Well-known examples include “Champagne”, “Scotch”, “Tequila”, and “Roquefort” cheese. Wine and spirits makers are particularly concerned about the use of place names to identify products. A company situated outside that area, or a product not using the raw material used that particular place, can not use the name of that area.

Such products are governed by the law of Geographical indications and Appellation of Origin.

The TRIPs agreement of WTO contains special provisions for such products. In India the Geographical Indications of Goods (Registration and Protection) Act, 1999 provides protection to such products.

Therefore, Champagne can not be made in India and exported as Champagne.

**Answer 8(b)**

The SCM Agreement creates three basic categories of subsidies, namely prohibited, actionable (i.e., subject to challenge in the WTO or to countervailing measures), and non-actionable. All specific subsidies fall into one of these three categories.

Prohibited subsidies are those subsidies that require recipients to meet certain export targets, or to use domestic goods instead of imported goods, are prohibited because they are specifically designed to distort international trade, and are therefore likely to hurt other countries’ trade. They can be challenged under the WTO dispute settlement procedure where they are handled under an accelerated timetable. If the dispute settlement procedure confirms that the subsidy is prohibited, it must be withdrawn immediately. Otherwise, the complaining country can take counter measures. If domestic producers are hurt by imports of subsidized products, countervailing duty can be imposed.

*Actionable subsidies* : The complaining country has to show that the subsidy has an adverse effect on its interests. Otherwise the subsidy is permitted. The agreement

defines three types of damage they can cause. One country's subsidies can hurt a domestic industry in an importing country. They can hurt rival exporters from another country when the two compete in third markets. And domestic subsidies in one country can hurt exporters trying to compete in the subsidizing country's domestic market.

*Non-actionable subsidies* : These can either be non-specific subsidies, or specific subsidies for industrial research and pre-competitive development activity, assistance to disadvantaged regions, or certain types of assistance for adapting existing facilities to new environmental laws or regulations. Non-actionable subsidies cannot be challenged in the WTO's dispute settlement procedure, and countervailing duty cannot be imposed on subsidized imports.

**Answer 8(c)**

The objectives of SAARC are as under:

- To promote the welfare of the peoples of South Asia and to improve their quality of life;
  - To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realise their full potentials;
  - To promote and strengthen collective self-reliance among the countries of South Asia;
  - To contribute to mutual trust, understanding and appreciation of one another's problems;
  - To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;
  - To strengthen cooperation with other developing countries;
  - To strengthen cooperation among themselves in international forums on matters of common interests; and
  - To cooperate with international and regional organizations with similar aims and purposes.
-

**PROFESSIONAL PROGRAMME EXAMINATION**

JUNE 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) *The issuer and merchant banker need not ensure that the security created to secure the debt securities is adequate to ensure 100% asset cover for the debt securities.*
- (ii) *A private placement is an issue of shares or convertible securities by a company to a select group of persons under section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue.*
- (iii) *A 'takeover bid' is an offer addressed to each shareholder of a company, whose shares are not closely held, to buy his shares in the company at the offered price within the stipulated period of time.*
- (iv) *As per clause 49 of the listing agreement in respect of good corporate governance, a director shall not be member in more than 20 committees or act as chairman of more than 10 committees across all companies in which he is a director.*
- (v) *A company can deliver the share certificate at any time after receiving the application for registration of transfer as per the Companies Act, 1956.*  
(2 marks each)

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

- (i) *All preferential issues by the listed companies should be approved by the shareholders' resolution in the meeting of shareholders.*
- (ii) *A depository participant is the agent of the investor in the depository system providing the link between the company and investor through the depository.*  
(5 marks each)

**Answer 1(a)(i)**

**The statement is incorrect.**

As per SEBI (Issue and Listing of Debt Securities) Regulations, 2008, it is the duty of the issuer & merchant banker to ensure that the security created to secure the debt securities is adequate for ensuring 100% asset cover for the debt securities.

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

**The statement is correct.**

A Private Placement of Securities is not like that of Public Offerings of Securities.

Instead offering the securities to the public, these are being offered to select group persons under the Section 81 of the Companies Act, 1956. Private placement is a faster way for a company to raise capital. It is generally known by the name preferential allotment, which has to comply with Chapter XIII of SEBI (DIP) Guidelines, 2000, in case, the issuer is a listed company.

**Answer 1(a)(iii)**

**The statement is correct.**

A “takeover bid” is an offer addressed to each shareholder of a company, whose shares are not closely held, to buy his shares in the company at the offered price within the stipulated period of time. It is addressed to the shareholders with a view to acquire sufficient number of shares that gives the offerer company, the voting control of the target company.

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

**The statement is incorrect.**

As per Clause 49 of the listing agreement, a director shall not be member in more than 10 committees or act as Chairman of more than 5 committees across all companies in which he is a director.

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

**The statement is incorrect.**

Under Section 113 of the Companies Act 1956, a Company is required to deliver the share certificate within 3 months after the allotment of any securities and within 2 months after the application for registration of transfer of any such securities.

**Answer 1(b)(i)**

Preferential issues are governed under Section 81(1A) of the Companies Act, 1956 and Chapter XIII of the SEBI(DIP) Guidelines, 2000. While Section 81(1A) requires the company to obtain shareholders approval through special resolution, Chapter XIII of SEBI(DIP)Guidelines, 2000 stipulates that allotment pursuant to any resolution passed at a meeting of shareholders of a company granting consent for preferential issues of any financial instrument, shall be completed within a period of 15(fifteen days) from the date of passing of the resolution. If, the allotment on preferential basis is pending on account of pendency of any approval of such allotment by any regulatory authority or the Central Government, the allotment shall be completed within 15 days from the date of such approval. If SEBI has granted relaxation to the issuer in terms of regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential allotment of shares, fully convertible debentures and partly convertible debentures, shall be made by it within such time as may be specified by the Board in its order granting relaxation.

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

Just as brokers act as an agent of the investor at the stock exchange a depository participant (DP) is the representative (agent) of the investor in the depository system



providing the link between the companies and investor through the depository. The depository participant maintains securities account balance and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, financial institutions like banks, custodians, stockbroker etc. can become participants with the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the depository can be compared to a bank, DP is like a branch of that bank with which an account can be opened. The maintain characteristic of a depository participant are as under:

- Acts as an agent of depository
- Customer interface of depository
- Demat Account opening
- Facilitates dematerialization
- Instant transfer on pay-out
- Credits to investor in IPO, rights, bonus etc.
- Settles trades in electronic segment etc.

## Question 2

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

(i) Public issue is not governed by the —

- (a) Companies Act, 1956
- (b) Foreign Exchange Management Act, 1999
- (c) Payment of Bonus Act, 1965
- (d) Securities Contracts (Regulation) Act, 1956.

(ii) In case of underwriting of rights issue, if minimum subscription is not received, the entire subscription should be refunded within —

- (a) 45 days
- (b) 60 days
- (c) 42 days
- (d) 30 days.

(iii) A down stream merger occurs when —

- (a) There is a merger of parent company into its subsidiary company
- (b) There is a merger of subsidiary company into its parent company
- (c) There is a merger of a healthy company with a financially weak company
- (d) There is a merger of a subsidiary company into its parent company where the parent company owns substantially all of the shares of the subsidiary company.

- (iv) 'Overseas Custodian Bank' means a banking company which is established in a country —
- Inside India
  - Outside India
  - Inside as well as outside India
  - Either inside or outside India.
- (v) If a company or any other person contravenes any provision of the rules for which no punishment is provided under the Companies (Issue of Indian Depository Receipts) Rules, 2004, the company and every officer in default shall be punishable with fine which may extend to —
- Equal the amount of IDR issue
  - Twice the amount of IDR issue
  - Thrice the amount of IDR issue
  - Four times the amount of IDR issue.
- (vi) Payment of foreign technology collaboration by Indian companies under the FEMA regulations are allowed under automatic route subject to the limitation of the lump sum payments not exceeding —
- US \$5 million
  - US \$10 million
  - US \$2 million
  - US \$3 million. (1 mark each)
- (b) Write a note on 'intellectual property due diligence'. (4 marks)
- (c) Distinguish between the following :
- 'Due diligence' and 'audit'.
  - 'American depository receipts (ADRs)' and 'global depository receipts (GDRs)'. (3 marks each)

**Answer 2(a)(i)**

- (c) Payment of Bonus Act, 1965

**Answer 2(a)(ii)**

- (c) 42 days.

It may be noted that, this period has been reduced to 15 days vide SEBI Circular dated August 28, 2008.

**Answer 2(a)(iii)**

- (a) There is a merger of parent company into its subsidiary company

**Answer 2(a)(iv)**

- (b) Outside India

**Answer 2(a)(v)**

(b) Twice the amount of IDR issue

**Answer 2(a)(vi)**

(c) US \$2 million

**Answer 2(b)****Intellectual Property due diligence**

The recent concept of valuation of intangible assets related to Intellectual Property like Patents, Copyrights, Design, Trademarks, Brands etc., also getting greater importance as these Intellectual Properties of the business are now often sold and purchased in the market by itself, like any other tangible asset. The main objective of intellectual property due diligence is to ascertain the nature and scope of target company's right over the intellectual property, to evaluate the validity of the same and to ensure whether there are no infringement claims.

**Answer 2(c)(i)**

<i>Particulars</i>	<i>Audit</i>	<i>Due diligence</i>
Scope	Limited to financial analysis	Includes not only analysis of financial statements, but also business plan, sustainability of business, future aspects, corporate and management structure, legal issues etc.
Data	Based on historical data	Covers future growth prospects in addition to historical data.
Mandatory	Mandatory	Mandatory based on the transaction.
Assurance	Positive assurance i.e. true and fairness of the financial statements	Negative assurance. i.e. identification of risks if any.
Type	Post mortem analysis	It is required for future decision.
Nature	Always uniform	Varies according to the nature of transaction
Repetitiveness	Recurring event	Occasional event

**Answer 2(c)(ii)****American Depository Receipts (ADR)**

An American Depository Receipt (ADR) is a dollar denominated form of equity ownership in the form of depository receipts in a non-US Company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares.

**Global Depository Receipts (GDR)**

Global Depository Receipts means any instrument in the form of a Depository receipts or certificate created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.

**Question 3**

- (a) *As a Practising Company Secretary, you have been asked to carry out the due diligence of XYZ Ltd. for a possible acquisition of the controlling interest from the owners of the said company. Explain briefly the possible hurdles that may occur while carrying out the due diligence and the steps needed to overcome such hurdles.* (6 marks)
- (b) *Anshul Power Generation Ltd. is contemplating setting-up an audit committee as part of good corporate governance. As a Company Secretary of the company, advise the company on the constitution, composition, quorum and the role of audit committee.* (6 marks)
- (c) *Explain the following terms used in due diligence report —*
- (i) *Deal breakers*
  - (ii) *Deal diluters.* (2 marks each)

**Answer 3(a)****Possible Hurdles in Carrying out a Due Diligence and Remedial Actions**

1. *Non availability of information*  
In many occasions, when a person carries out due diligence, the required information may not be available or sufficient to drive a complete picture.
2. *Unwillingness of Target Company's personal in providing the complete information*  
Non- co-operation of Target Company's personal may also prove to be a major hurdle during due diligence process. Sometimes, the available information would be pretended as not available.
3. *Providing of incorrect information*  
Providing of incorrect information by the target personal also acts as a major hurdle in the due diligence process.
4. *Complex tax policies and hidden liabilities*  
Complex tax policies & structure may create a number of hidden tax liabilities, which may not be easy to track.
5. *Multiple Regulations and its applicability*  
Owing to the new and emerging legislations, it is difficult to interpret whether a specific legislation is applicable for business and getting legal opinion on the same, may prove to be very costly.
6. *Process in providing data*  
Multiple Layers of review and scrutiny, before data is provided for due diligence also hinders and delays the due diligence process.

### 7. *Absence of proper MIS*

Due diligence process would become difficult if there is no proper MIS in the company.

#### **Actions to break hurdles in due diligence**

- Follow up questions/actions
- Ask several people the same questions
- Polite persistence
- Independent check with regulatory authorities
- Developing an MIS.

Considering this hurdles, it is advisable to insert the necessary disclaimer clause in the due diligence report.

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

#### **Constitution/Composition of Audit Committee**

1. All listed companies shall have qualified and independent audit committee.
2. The audit committee shall have minimum three directors as members.
3. Two-thirds of the members of audit committee shall be independent directors.
4. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
5. The Chairman of the Audit Committee shall be an independent director;
6. The Company Secretary shall act as the secretary to the committee.

#### **Quorum of the meeting of Audit Committee**

The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings and the quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

#### **Role of Audit Committee**

The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the Quarterly/annual financial statements before submission to the board for approval.

5. Reviewing, with the management, the statement of uses / application of funds raised through an issue, the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.
6. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower Mechanism, in case the same is existing.
13. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

**Answer 3(c)(i)**

After completion of Due Diligence, the professionals submit a report which is in general called 'Due Diligence Report'. The findings mentioned in the reports are very significant and the outcome of the report may be deal-makers, Deal-Breakers, Deal-Diluters, Deal-cautioners.

*Deal Breakers* - In this report the findings can be very glaring and may expose various non-compliance that may arise any criminal proceedings or known liabilities.

**Answer 3(c)(ii)**

*Deal Diluters* – The findings arising out of a diligence may contain violations which may have an impact in the form of quantifiable penalties and in turn may result in diminishing the value of company.

**Question 4**

- (a) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
  - (i) *Shares issued under an Employee Stock Purchase Scheme (ESPS) are subject to lock-in for a minimum period of \_\_\_\_\_ year from the date of allotment.*

- (ii) *The credit rating is required to be obtained from atleast \_\_\_\_\_ registered credit rating agencies under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.*
  - (iii) *A public limited company is required to appoint the Company Secretary to act as compliance officer under clause \_\_\_\_\_ of the listing agreement.*
  - (iv) *As per clause 49 of listing agreement, at least \_\_\_\_\_ of the Board should include independent directors where chairman of the Board is a non-executive director.*
  - (v) *An American Depository Receipt (ADR) is a \_\_\_\_\_ denominated form of equity ownership in the form of depository receipts in a non-US company.*
  - (vi) *Pre-issue paid-up capital and free reserves of the issuing company should be at least \_\_\_\_\_ under the Companies (Issue of Indian Depository Receipts) Rules, 2004 for the issue of IDRs. (1 mark each)*
- (b) *As a Practising Company Secretary, you have been appointed as secretarial auditor of Lilly Ltd. Explain briefly how you would undertake the process of secretarial audit. (10 marks)*

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

- (i) Shares issued under an Employee Stock Purchase Scheme (ESPS) are subject to lock-in for a minimum period of **One** year from the date of allotment.
- (ii) The credit rating is required to be obtained from atleast **Two** registered credit rating agencies under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.
- (iii) A public limited company is required to appoint the Company Secretary to act as compliance officer under clause **47(a)** of the listing agreement.
- (iv) As per clause 49 of listing agreement, at least **1/3** of the Board should include independent directors where chairman of the Board is a non-executive director.
- (v) An American Depository Receipt (ADR) is a **Dollar** denominated form of equity ownership in the form of depository receipts in a non-US company.
- (vi) Pre-issue paid-up capital and free reserves of the issuing company should be at least **US\$ 50 millions** under the Companies (Issue of Indian Depository Receipts) Rules, 2004 for the issue of IDRs.

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

A Practising Company Secretary should follow the following process for conducting Secretarial Audit :

1. Before embarking on a assignment one should familiarize himself thoroughly with relevant Acts, Rules, Regulations, Orders, Notifications, Guidelines, Circulars by the Government from time to time.

2. Where the position of law is not clear, he should request the company to obtain legal opinion in order to be doubly sure about the compliances.
3. Where certain facts cannot be personally checked, he should obtain a certificate from the Company in order assure himself that proper compliance have been made.
4. He should also keep himself abreast of latest judicial pronouncements on all import issues.
5. Private Companies, Government Companies and Section 25 Companies are exempt from some provisions of Companies Act. These should be kept in view by the Secretarial Auditor.
6. The Secretarial Auditor should preserve the working sheets and other papers, the details of the documents instead prepared etc. for future references and queries if any.
7. While undertaking Secretarial Audit/Consultancy, as required, the following should be examined carefully:
  - Memorandum and Articles of Association (Extent of applicability of Table A).
  - Certificate of Incorporation.
  - Certificate of Commencement of Business.
  - Annual Reports.
  - Minutes Books of Board/Committee/General Meeting.
  - Register of Members/Debentureholders.
  - Register of Directors.
  - Register of Loans, Guarantee, Security and Investments.
  - Register of Charges.
  - Foreign Register of Members and Debentureholders, if any.
  - Copies of Annual Returns.
  - Register of Contracts.
  - Register of Directors' Shareholdings.
  - Share Transfer Books.
  - Correspondence with the Ministry of Corporate Affairs, Registrar of Companies, MRTP Commission, Ministry of Industry, Ministry of Inance, Stock Exchanges etc.
  - Listing Agreement with the Stock Exchange.
  - Register of investments of the company not held in its name.



- Register of Buy-back of Securities under Section 77A(9).
  - Copies of various e-forms filed under Section 610B of the Companies Act, 1956.
  - Various advertisements/press release issued by the company during the year.
  - Other registers as may be notified from time to time under various rules.
8. As soon as the assignment is over the Secretarial Auditor should submit his report to the Board of Directors. He may also submit interim report also from time to time if necessary. The report should set out in detail the scope of the work, his observations on irregularities noticed, weakness in the policies and procedures etc.

#### Question 5

- (a) *Sanjay is a Practising Company Secretary and has been engaged as internal auditor of the operations of depository participants. Do you feel it is mandatory on the part of the depository participants to appoint an internal auditor ? What should be the contents of the internal audit report ?* (8 marks)
- (b) *As a Practising Company Secretary, you have been assigned to work out preliminary considerations for setting-up a joint venture. State the preliminary considerations to be taken care of in this regard.* (4 marks)
- (c) *A depository participant is required to enter into two important agreements in the course of trading in dematerialised securities. Explain.* (4 marks)

#### Answer 5(a)

Yes it is mandatory on the part of the Depository Participant to appoint an internal auditor.

As per Circular issued by the two Depository Service providers in India i.e. NSDL & CSDL every depository participant shall ensure that an internal audit in respect of the operations Depository is to be conducted either by a qualified Company Secretary or a Chartered Accountant holding a Certificate of Practice and a copy of the internal audit report shall be submitted to the Depository.

The 'Internal Audit' report should contain the following aspects:-

1. Comments on the maintenance of records.
2. Observations about discrepancies or weakness in the internal control system.
3. Comments on the used authorization and data security systems.
4. Instances of non-adherence to the operational procedures prescribed relating to functions of participant.
5. Instances of non-compliance with the relevant legislations governing the depository operations.
6. General observations & recommendations.

7. Competence with the provisions of SEBI Act, Regulations, Bye Laws, Business Rules, Agreements.

### Answer 5(b)

#### Preliminary considerations

- *Selection* : Selection of an appropriate co-venturer can have long lasting implications for the operation and success of the venture as the ability of the co-managing parties to co-exist and make unanimous decisions is essential to the success of a joint venture.
- *Setting out the objectives and expectations* : Setting out the objectives and expectations of the venture is pre-requisite. It is essential that the nature, scope and duration of the joint venture be identified.
- *Employ competent professionals* : Competent professional like CS, Legal experts experienced in drafting joint venture and strategic alliance agreements should be retained as consultants, to structure the deal with proper legal advice.
- *Negotiation* : It is appropriate that negotiations be conducted at the level of more senior management.
- *Attitude* : Negotiations for alliances should not be entered into with an adverse approach to the opposing party.
- *MOU* : The next step is to prepare memorandum of understanding, setting out the objectives of the joint venture prior to finalising the joint venture agreement. The MOU may set out the key features of the proposed joint venture arrangements and can represent a broad outline of the definitive agreement.
- *Due Diligence* : After the parties have agreed on the basic terms of the joint venture arrangement a fixed period of time is often set in which to conduct a detailed and comprehensive review of all information pertinent to the proposed business venture prior to the execution of the joint venture agreement. This process is referred to as “due diligence”.

### Answer 5(c)

The two important agreements to be entered into by Depository Participants (DP) are :

1. *Standard Agreement with the Depository (NSDL)/(CDSL)*

Important clauses needing compliance on part of the DP are :-

- (a) Adherence to the SEBI Act 1992, the SEBI (Depositories and Participants) Regulations 1996, Byelaws and the Business Rules of the Depository.
- (b) Payment of requisite fees and charges as prescribed.
- (c) Compliance with valid instructions of the investor.
- (d) DP to reconcile its own records with the Depository on a daily basis, to maintain systems to comply with insurance mechanism to contribute to

Investors Protection Fund, to comply with accounting requirements, to resolve grievances etc.

2. Standard agreement with the Investor

Important clauses needing compliance by DP are as under:

- (a) The DP shall strictly adhere to the instructions of the client with regard to transfer to and from the Accounts of the Client.
- (b) The DP shall provide a statement of Accounts to the client at regular intervals unless otherwise agreed.
- (c) The DP shall resolve all legitimate grievances of the client within a stipulated period of time.

**Question 6**

- (a) *Anmol Milk Products Ltd. is planning to expand its operation by financing Rs.75 crore through a term loan from the IDBI Bank Ltd. The company has applied for a term loan and the assets of the company will be mortgaged to the lending bank as security.*

*The bank has approached you, being a Practising Company Secretary, to furnish a certificate in respect of necessary powers of the company and its directors to enter into an agreement. State the general points to be kept in mind for furnishing such a certificate. (6 marks)*

- (b) *Enumerate the points to be checked by a Secretarial Auditor in respect of the Air (Prevention and Control of Pollution) Act, 1981. (6 marks)*
- (c) *Describe the role of a Company Secretary in Practice in securities management and compliances under the SEBI Act, 1992 and its regulations. (4 marks)*

**Answer 6(a)**

**Requirement of Industrial Development Bank of India**

The following points would be kept in mind by the company Secretary in Practice while furnishing of such certificate –

The Memorandum and Articles of Association of the Company has to be examined for this purpose. Particularly the objects clause of the Memorandum of Association has a specified recital pertaining to borrowing powers of the company. The standard clause pertaining to borrowing powers included in the incidental or ancillary objects read as follows-

“To borrow or raise money or to receive money on deposit for the purposes of the company, in such manner and upon such terms as may seem expedient, and to secure the repayment thereof and of moneys owing or obligations incurred by the company and to create, issue and allot redeemable or irredeemable bonds, mortgages or other instruments, mortgage debentures (such bonds or debentures being made payable to bearer or otherwise and issuable or payable either at par, premium, discount or as fully paid), and for any such purposes to charge all or any part of the property and profits of the company both present and future including its uncalled capital.”

Compliance of the provisions of Section 149 of the Companies Act, 1956, in respect of public limited companies has to be ensured. Exercise of borrowing powers in contravention of Section 149 attracts levy of fine.

Resolutions passed at the meeting of the board/ general meeting for exercising the power of borrowing have to be checked;

Section 292 of the Companies Act requires inter alia, that the power to borrow moneys can be exercised by the Board of Directors only by means of resolution passed at meetings of the Board. This power of borrowings may also be delegated to any committee of directors, managing director, manager or any other principal officer. The delegation should be only by means of resolution passed at board meeting and not by circulation. Every resolution delegating this power should specify the total amount up to which moneys may be borrowed by the delegate.

The certificate will have to refer to the relevant clause(s) of the Memorandum of Association of the company, which gives specific powers to the company, and secure the repayment of the same by mortgage, charge, lien etc. The opinion will also have to refer to the relevant articles of the Association and the general body resolution, if any, under which the Board of Directors are authorized to borrow or raise moneys, secure the repayment thereof and execute on behalf of the company, bonds deeds, documents etc. The opinion should also spell out the limitations and restrictions, if any, on the powers of the Board of directors to borrow or raise money.

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

#### **Checklist : Air (Prevention and control of Pollution) Act, 1981**

The Secretarial auditor has to check the following points in respect of Air (Prevention and Control of Pollution) Act, 1981:-

1. *Prohibition on use of certain appliances in declared areas (Section 19)*
  - (i) Whether any notification has been issued under Section 19 declaring the area in which the premises of the factory of the company is situated, as air pollution control area.
  - (ii) If so, whether directions, if any, of the state Government concerned regarding use of approved appliances have been complied with
2. *Previous consent of the State Board for operating industrial plants (Section 21)*
  - (i) Whether previous consent of the State Board has been obtained for establishing or operating any new industrial plant set up by the Company.
  - (ii) Whether the conditions of consent have been complied with.
  - (iii) Whether consent given has been cancelled. If yes, what action has been taken by the company in the matter.
3. *Whether the air pollutants conform to the standards (section 22) prescribed by the State Government*
4. *Restraints on causing air pollution (section 22A)—*
  - (i) Whether any court has been made orders restraining the company in regard to emission of any air pollutant

- (ii) Whether the state board has been authorized to implement the court's direction in a specified manner.
5. *Information to be furnished to the State Board etc. (Section 23, 24, 25 & 26)*
    - (i) Whether information, if any, has been given to the State Board regarding emission or apprehended emission of any air pollutant in excess of the standard laid down.
    - (ii) Whether any inspection has been carried/information called or samples have been taken by the state board or any officer empowered by it.
  6. *Whether any appeal has been preferred by an aggrieved person against the orders of State Board. (Section 31)*
  7. *Compliance with directions issued by the Central/State Board (s)–(Section 31-A)*

Whether any directions have been issued by the central/state board(s) particularly in regard to—

    - Closure, prohibition or regulation of any industry operation of process; or
    - The stoppage or regulation of supply of electricity, water or any other service.
    - (ii) If so, whether such directions have been complied with.
  8. *Prosecution of company and its directors (Chapter VI)*
    - (i) Whether prosecution proceedings have been initiated against the company and its directors for violation of any provisions of the Act.
    - (ii) If yes, what is the State/result of such proceedings?

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

#### **Role of Company Secretary in Practice**

The Securities and Exchange Board of India Act, 1992/rules/regulations/ guidelines/ circulars

1. SEBI has authorized the practicing company secretary to appear before the Securities Appellate Tribunal as an authorized representative of an appellant
2. Practicing Company Secretary can, certify non-promoter holdings as per clause 35 of Listing Agreement in demat mode in case of the companies which have established connectivity with both the depositories.
3. PCS is authorized to issue certificate of compliance of conditions of corporate governance for companies who have listed their equity shares, debt instruments and Indian Depositories in stock exchanges. .
4. PCS can issue certificate regarding maintenance of adequate security cover in respect of listed debentures every quarter.
5. PCS can conduct Internal Audit of Portfolio Managers.

6. PCS can issue a certificate to listed companies to the effect that all refund orders/certificates to allottees of the previous issues were dispatched within prescribed time and manner and securities were listed on the stock exchanges specified in the offer document.
7. PCS is authorized to issue a certificate to the effect that provisions of SEBI Guidelines, 2000 relating to Bonus Shares have been complied with.
8. PCS is authorised to conduct Internal Audit of sub-brokers.

### Question 7

- (a) Write short notes on any two of the following :
- (i) Takeover defences
  - (ii) Appraisal of register of members/debentureholders
  - (iii) Risks on trading in debt securities. (4 marks each)
- (b) Distinguish between **any two** of the following:
- (i) 'Dematerialisation' and 'rematerialisation'.
  - (ii) 'Financial collaboration' and 'technical collaboration',
  - (iii) 'Depository' and 'depository participant'. (4 marks each)

### Answer 7(a)(i)

#### Take Over Defenses

Hostile takeovers directly made to the shareholders of target company has resulted in a multiple defensive strategies by corporate from being taken over by the company.

Few of the defensive strategies are as follows.

1. *Packman Defense*  
Under this strategy target company attempts to purchase the shares of acquirer company provided it has substantial cash flow or liquidable asset.
2. *Shark Repellants*  
An increasingly used defense mechanism being used is anti-takeover amendments to the company's Articles of Association which is called shark repellants
3. *Poison pills*  
Creation of securities (which is also called poison pills) which provide their holders with special rights exercisable only after a period of time following the occurrences of triggering event.
4. Refusal by the Board to register a transfer is also being adopted as a defensive strategy.

### Answer 7(a)(ii)

While conducting share transfer Audit, the following issues are to be considered with respect to appraisal of Register of members/ debentures.

Check whether a company has properly maintained its register of members and register of debenture holders with respect of following aspects:

- (a) Whether the registers are maintained in the form prescribed under the companies (Issue of Share Certificates) Rules, 1960 or as near there to as circumstances admit.
- (b) Whether the details of the transfers have been posted in the proper folios in the register of members. In case of transferee being a new member whether new folio has been allotted to him. In case after recording the transfer the holding of a member becomes nil whether the folio has been properly closed.
- (c) Whether entries in the register are authenticated by the Secretary or any other person authorized by the Board.
- (d) Whether in case of Company having more than 50 members, an index of members is maintained.
- (e) Whether every change in the register of members has been recorded in the index within stipulated time.

**Answer 7(a)(iii)**

The risk on Trading Debt Securities may be :

1. *Default Risk* is the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security.
2. *Interest Rate Risk* is the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments.
3. *Reinvestment Rate Risk* is the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market.
4. *Counter Party Risk* refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale-value at the time of settlement.
5. *Price Risk* refers to the possibility of not being able to receive the expected price on any order due to a adverse movement in this price.

**Answer 7(b)(i)**

**Dematerialisation**

Dematerialisation is a process of conversion of physical certificates into electronic balances. Before the process of dematerialisation is set in motion some essential prerequisites need to be considered as under:

- (a) An investor must open an Account with a DP.
- (b) The securities must be in the name of the account holder and owned by him.
- (c) A separate demat requisition form (DRF) is required for each issuer.
- (d) The DRF form must be signed by all the joint holders.

**Rematerialisation**

Rematerialisation means the conversion of dematerialised holdings back into the physical certificates.

In a simplified form the process of Rematerialisation could be explained hereunder:

- (a) Investor to submit the Rematerialisation Request Form (RRF) to the DP.
- (b) DP to electronically intimate the Depository.
- (c) DP to submit RRF to the Registrar/Issuer Company.
- (d) Depository confirms rematerialisation request to the Registrar/Issuer Company.
- (e) Registrar/Issuer Company verifies particulars, prints certificates and intimates the Depository.
- (f) Depository updates Accounts and downloads details to DP.
- (g) Registrar/issuer dispatches certificates to the investors.

**Answer 7(b)(ii)*****Financial Collaboration v. Technical Collaboration***

Financial collaboration involves Foreign Direct Investments in the form of Equity, FCCBs, etc., and in Technical collaboration in involves 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 7(b)(iii)****Depository**

A depository is to securities as a bank is to cash. A depository holds securities of investors in electronic form. It facilitates settlement of trades in, and transfer, transmission, lending, borrowing and pledging of, securities by way of book-entry, as and when instructed by investors.

**Depository Participant**

A participant is assigned the role to act as the agent of a Depository under the Act and cannot act unless registered with SEBI. The primary function of depository participants, as the agent of the depository, is to provide securities' related services offered by the depository to the clients.

**Question 8**

*Critically examine and comment on any four of the following :*

- (i) *A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction.*
- (ii) *In case of preferential issue of shares by listed companies, valuation is to be done by an independent qualified valuer.*



- (iii) *Under the Employee Stock Option Scheme, the companies have freedom to determine the exercise price.*
- (iv) *A conglomerate merger involves coming together of two companies in different industries.*
- (v) *Securities held in a depository account can be pledged or hypothecated against a loan, credit or guarantee availed of by the beneficial owner of such securities.*  
(4 marks each)

#### **Answer 8(i)**

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction as the nature of due diligence varies from the type of transaction, its volume, the motive and objective of parties to a transaction. The nature and the extent of due diligence depends upon the risk perceived by parties to a transaction. The scope of due diligence is transaction-based and is depending on the needs of the people who is involved in the potential investments, in addressing key uncovered issues, areas of concern/threat and in identifying additional opportunities.

The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision provide a basis for determining or validating the appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction.

#### **Answer 8(ii)**

As per Chapter XIII of SEBI (DIP) Guidelines 2000, in case of preferential allotment of shares to promoters, their relatives, associated and related entities, for consideration other than cash, valuation of assets in consideration for which the shares are proposed to be issued, should be done by an independent qualified valuer. The word valuer shall mean Chartered Accountant or Merchant Banker appointed to determine the value of intellectual property rights or other addition. This is defined under SEBI (Issue of Sweat Equity) Regulations 2002.

#### **Answer 8(iii)**

The companies granting option to it is employees pursuant to the Employees Stock Option Scheme is having the freedom to determine the exercise price subject to adherence to the accounting policies, specified in Schedule I of SEBI (ESOP &ESPS) Guidelines, 1999.

#### **Accounting Policies for ESOS**

- (a) In respect of options granted during any accounting period, the accounting value of the options shall be treated as another form of employee compensation in the financial statements of the company.
- (b) The accounting value of options shall be equal to the aggregate, over all employee stock options granted during the accounting period, of the intrinsic value of the option or, if the company so chooses, the fair value of the option.
- (c) Where the accounting value is accounted for as employee compensation in

accordance with clause (b), the amount shall be amortised as specified under the schedule.

- (d) When an unvested option lapses by virtue of the employee not conforming to the vesting conditions after the accounting value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expense equal to the amortized portion of the accounting value of the lapsed options and a credit to deferred employee compensation expense equal to the unamortized portion.

When a vested option lapses on expiry of the exercise period, after the fair value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expenses.

**Answer 8(iv)**

**Conglomerate Merger**

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 commonality 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. A conglomerate merger is one which is neither horizontal nor vertical. In this the merging companies operate in unrelated markets having no functional economic relationship.

**Answer 8(v)**

Securities held in a depository account can be pledged or hypothecated against a loan, credit, guarantee etc, availed by the beneficial owner of such securities. For this, it is imperative that both the parties to the agreement, to have a beneficiary account with a depository. It is however not necessary that both of them have their depository account with the same participant or same depository. If a beneficial owner intends to create a pledge on a security, owned by him, Regulation 58 of SEBI (Depositories and Participants) Regulations, 1998 have to be borne in mind, which prescribes the procedure to be followed such as making of application to depository through Depository Participant, creation of charge, invocation of pledge etc.

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## GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

**NOTE :** Answer Question No. 1 which is compulsory and any two of the rest from this part.

### PART A

#### Question 1

- (a) On 8th February, 2009, The Hindustan Times published a news caption “Crisis of unimaginable proportions — Fraud @ Satyam. Company running out of cash to pay salaries — faces lawsuits.”

It further remarked : “The country is rocked by possibly the biggest corporate fraud. The company’s profits and cash reserves had been doctored for several years with possible connivance of auditors.” Obviously, the company had committed breach of good governance practices and legal bulwarks.

If you have to investigate into this case, which aspects of Corporate Governance would you look into ? (10 marks)

- (b) Choose the most appropriate answer from the given options in respect of the following :
- (i) Corporate governance means —
    - (a) Corporate management
    - (b) Corporate administration
    - (c) Corporate planning
    - (d) Corporate system.
  - (ii) Board of directors play a pivotal role in ensuring —
    - (a) Good meetings
    - (b) Good management
    - (c) Good administration
    - (d) Good governance.
  - (iii) Remuneration Committee of the Board should have —
    - (a) Six members
    - (b) Independent director as its chairman
    - (c) Company Secretary as advisor
    - (d) No interested director.
  - (iv) The aim of internal control system is to —
    - (a) Boost company image in market
    - (b) Rationalise the company affairs and activities
    - (c) Help company in achieving its goals
    - (d) Keep check on internal management.

- (v) *Shareholders can apply for winding-up of the company under section 397 read with section 399 of the Companies Act, 1956 in case of —*
- (a) *Oppression and mismanagement*
  - (b) *Misbehaviour of managing director with shareholders*
  - (c) *Company insolvency*
  - (d) *Failure to pay debts.* (1 mark each)
- (c) *State, with reasons in brief, whether the following statements are correct or incorrect:*
- (i) *Audit committee is more of a formality than an independent regulator.*
  - (ii) *Insider trading is permissible with the sanction of the SEBI.*
  - (iii) *Government regulations and public policy tend to bring the bare minimum involvement by the corporates towards their corporate responsibilities.*
  - (iv) *Clause 49 was incorporated in the listing agreement in February, 2000 by the SEBI.*
  - (v) *The matters required to be included in the directors' responsibility statement are to be included in the directors' report.* (1 mark each)

**Answer 1(a)**

One of the most appropriate definition of Corporate Governance (CG) has been given by ICSI, i.e. Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustained development of all stakeholders. Its principles are:-

1. Sustained development of all stakeholders
2. Effective management and distribution of wealth
3. Discharge of social responsibility
4. Application of best management practices
5. Compliance with law in letter and spirit
6. Adherence of ethical standards

Satyam failed fundamentally on counts of integrity, probity and ethics. The very intent of the promoter directors was to siphon-off the funds of the company to fuel their insatiable greed to amass wealth.

The accounts of Satyam did not reflect true and fair views of the state of affairs of the Company. The auditors, after the confession by the managing director; stated that the accounts of Satyam could not be relied upon.

One the face of it Satyam was a compliant company but the intent of the promoter directors was to defraud.

Some of the issues that should be investigated in the Satyam case include

- (i) Transaction with related parties

- (ii) Violation of SEBI (Substantial Acquisition of Shares and Takeover) Regulations;
- (iii) Violation of SEBI (Prohibition of Insider Trading) Regulations
- (iv) The nature of information placed before the Board and the Audit Committee.
- (v) The role of the internal auditors
- (vi) The role of the statutory auditors
- (vii) The role of Chief Financial Officer
- (viii) The role of the Company Secretary.

**Answer 1(b)(i)**

- (d) Corporate System

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

- (d) Good Governance

**Answer 1(b)(iii)**

- (b) Independent director as its Chairman

**Answer 1(b)(iv)**

- (c) Help company in achieving its goals

**Answer 1(b)(v)**

- (a) Oppression and mismanagement

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

*Incorrect*

An Audit Committee oversees the financial reporting process of a company.

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

*Incorrect*

Insider Trading is not permissible even with the permission of SEBI.

**Answer 1(c)(iii)**

*Correct*

The laws in India takes care of just the basic Corporate Social Responsibilities through various legislations under labour laws.

**Answer 1(c)(iv)**

*Correct*

Clause 49 was incorporated in the listing agreement in February 2000 by SEBI, as part of its endeavour to improve the standards of Corporate Governance.

**Answer 1(c)(v)**

*Correct*

Matters required to be included in the Director's Responsibility Statement are to be included in the Board's report in terms of clause (2AA) of Section 217 of the Companies Act, 1956.

**Question 2**

(a) Write notes on any two of the following :

(i) Objectives of legal compliance committee

(ii) Internal control system

(iii) Risk management process. (5 marks each)

(b) Distinguish between 'corporate blogging' and 'company's vertical communication'. (5 marks)

**Answer 2(a)(i)**

Due to complexity of compliance with the provisions of a number of applicable laws, it has become necessary that the Board of Directors constitute a non mandatory Corporate Compliance Committee & ensure due compliance with laws and procedures applicable to a legal entity. Such a Committee may also be called Legal Compliance Committee.

**Objectives of Corporate Compliance Committee**

The primary objective of the Compliance Committee is to review, oversee, and monitor:

- the Company's compliance with applicable legal and regulatory requirements,
- the Company's policies, programs, and procedures to ensure compliance with relevant laws, the Company's Code of Conduct, and other relevant standards;
- the Company's efforts to implement legal obligations arising from settlement agreements and other similar documents; and
- perform any other duties as are directed by the Board of Directors of the company.

The duties and responsibilities that can be delegated to the committee include:

1. To oversee the company's compliance efforts with respect to relevant company policies, the company's Code of Conduct, and other relevant laws and regulations and monitor the company's efforts to implement legal obligations arising from agreements and other similar documents;
2. Review the company's overall compliance program to ensure that it is well communicated, supports lawful and ethical business conduct by employees, and reduces risk to the company for non compliance with laws and regulations related to the company's business;
3. Review complaints received from internal and external sources, regarding matters

other than the financial matters which are within the purview of the Audit Committee;

4. Review the policies, programs and procedures for ensuring compliance with relevant laws, the company's Code of Conduct, value statement, other relevant standards, and legal obligations, including those imposed by settlement agreements;
5. Presentation to the Board for adoption of policies, for adoption appropriate changes to the policies, and oversee implementation of and compliance with these policies;
6. Review regularly the company's compliance risk assessment plan;
7. To discuss any significant compliance issues with the Chief Executive Officer;
8. To investigate or cause to be investigated any significant instances of non compliance, or potential compliance violations that are reported to the Committee;
9. To coordinate with other Committees regarding matters brought to the Committee's attention that relate to issues and compliance with applicable laws and regulations;
10. To regularly report to the Board on the Committee's activities, recommendations and conclusions;
11. To discuss any significant compliance issues with the Chief Executive Officer;
12. To periodically report to the Board and CEO on the adequacy and effectiveness of the company's compliance program.

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

##### **Internal Control System**

Internal control is defined as a process, effected by an organization's people and information technology (IT) systems, designed to help the organization accomplish specific goals or objectives.

It is a means by which an organisation's resources are directed, monitored and measured. It plays an important role in preventing and detecting fraud and protecting the organisation's resources, both physical (i.e. machinery and property) and intangible (i.e. reputation or intellectual property such as trademarks).

An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of the Company that, taken together.

- Facilitates its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieve the Company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed;
- Helps to ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organization;

- Helps ensure compliance with applicable laws and regulations, and also internal policies with respect to conducting business.

**Answer 2(a)(iii)****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 comprise 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.

All companies have express or implied objectives which ultimately contribute to the maximization of shareholder value. Risk management actively supports the achievement of those objectives. It is not a process for avoiding risk. Properly implemented risk management can actively allow a company to undertake activities that have a higher level of risk thereby achieving a greater benefit because risks have been identified, understood and well managed.

Organizations which do have risk management policies in place are rewarded by added premium in the market and shall be better placed to pursue objectives and opportunities with confidence.

Risk management can be seen as a tool for creating opportunities for the businesses as they develop during the risk management process. Moreover such opportunities arise also from the complementary effect of risk management with other business planning process.

In other words, risk management is not just about preventing risks, but also managing it properly. However, managing risks properly does not mean becoming risk averse, or ignoring new opportunities for being "too risky".

Risk management provides a framework to:

- ensure that all the foreseeable risks involved are actually understood and accepted before important decisions are taken.
- monitor new projects, and ongoing operations, to ensure that they continue to develop satisfactorily, and no problems or new risks emerge.

It is pertinent to note that every activity carries a potential reward as well. Risk management, essentially, is about managing risk against reward.

**Answer 2(b)**

A corporate blog is a blog published by or with the support of an organization to reach the organizations goals. The word blog is derived from the word weblog wherein regular entries of commentary description of events are published. Corporate blog is



used by an organization to reach its organizational goals. The advantage of the blogs is that posts and comments are easy to reach and follow due to centralized hosting and generally structured conversation threads. Corporate blog is very popular as economical, effective, has wide coverage, is expedient and cost effective. As a marketing and public relations tool, its value is immense.

Vertical communication on the other hand, focuses the internal targets alone like employees. It is management tool though its public relations value is equally important. Moreover, it consists mainly by instructions, orders, task points, company's image-material and internal newsletter type communication.

### Question 3

- (a) *What is 'corporate philanthropy' ? How is it different from corporate social responsibility (CSR) ?* (7 marks)
- (b) *Describe the responsibilities of the Board of directors towards company, management, stakeholders and government.* (8 marks)

### Answer 3(a)

Philanthropy means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

The Etymological origin of the word is from Late Latin *philantropia*, from Greek *philantropia*, from *philanthropos* loving people that is *phil-* + *anthropos* human being. It is the active effort to promote human welfare.

Corporate Social Responsibility on the other hand is about how a company align their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/ or planet issues. CSR initiatives of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which drives the CSR initiatives in companies.

### Answer 3(b)

#### Responsibilities of Board of Directors

Responsibilities cast upon Directors are quite onerous and multifarious. Directors are in fiduciary position and must exercise their powers for the benefit of the company. Board is responsible for direction, control and supervision of the management of the company's affairs. They have to establish effective corporate governance procedures and best practices. Ultimate control and management vests with the Board.

#### Responsibilities towards the company

The board should ensure that:

- It acts in the best interest of the company.

- The decisions it takes does not serve the personal interests of its members.
- It helps the company in increasing its profits and turnover by following principles of equity, ethics and values.
- It helps the company in building its goodwill.
- It shares with the management the decision taken by them and the reasons thereof.
- That the company has systems and means to best utilize the resources of the company and especially its intangible resources.

### **Responsibilities towards management**

The board must ensure that:

- It gives its guidance, support and direction to the management in every decision.
- It acts as leader to inspire and motivate the management to perform their duties.
- It encourages leadership development.
- It encourages compliance and disclosures.
- It trusts the management and gives it the freedom to act.
- It does not dictate terms but take objective decisions.
- It follows the company's code of conduct and the other rules and the regulations of the company.

### **Responsibilities towards stakeholders**

The board must ensure that:

- Its every decision helps in the increasing the stakeholders value.
- It does not act in a manner by which any stakeholder is prejudiced.
- One stakeholder should not be benefited at the cost of the other.
- It must discourage restrictive or monopolistic activities for the undue benefit of the company.
- That proper system is established and followed which helps in resolving the grievances of the stakeholders.
- That company has policies for different class of stakeholders which are equally applicable. Such policies should be based on the principles of equity and justice.
- That company discloses its policies to all the stakeholders.
- The stakeholders are able to establish long term relationships based on trust and confidence.

**Responsibility towards government**

The board must ensure that:

- The company complies with all the laws applicable to it whether they are the central laws or state laws.
- There are systems and checks to ensure that the above is complied.
- That all the dues towards the government in the form of taxes, rates, etc. are paid on time.
- It supports the initiatives taken by the government for the promotion of welfare and security of the nation.

**Question 4**

- (a) *“A positive synergy out of due integration of the social responsibility of business with the commercial focus is on the whole a fairy tale with catchy gains.”*  
*Elucidate.* (7 marks)
- (b) *Enumerate various committees of the Board of directors which are required to be constituted under clause 49 of the listing agreement and state their functions?*  
 (8 marks)

**Answer 4(a)**

The integration of the CSR initiatives of a company with its commercial purpose does give rise to positive synergies. The positive synergies of CSR include:

- a. CSR creates a favorable public image
- b. The positive image created out of CSR promotes goodwill and loyalty of the stakeholders including employees
- c. Society gains in the form of better neighborhood and employment opportunities.
- d. Satisfaction of changed consumer needs and expectations
- e. Social involvement reduces the need for legal and governmental interference
- f. External environment is also improved
- g. Good CSR ensures due balance of authority (financial power) and responsibility
- h. It has exemplary impact on other units too
- i. Encourages cooperative/positive attitudes
- j. Project assessments are made in terms of social cost-benefits too.
- k. CSR alone is suitable for promoting national and public interest and economic growth with welfare.

The synergy between the social involvement of business into its basic commercial-profit-gain focus arises due to the following reasons :

- Globalization – coupled with focus on cross-border trade, multinational enterprises and global supply chains — is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things.
- Advances in communications technology, such as the Internet, cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organizations now regularly draw attention through their websites to business practices they view as problematic.
- Consumers and investors are showing increasing interest in supporting responsible business practices and are demanding more information on how companies are addressing risks and opportunities related to social and environmental issues.
- Numerous serious and high-profile breaches of corporate ethics have contributed to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability and ethical standards.
- Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.
- There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that corporate social responsibility addresses.
- Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.

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

#### **Various Committees of the Board which are required to be constituted under Clause 49**

Audit Committee and Shareholders Grievance Committees are mandatory committees which have to be constituted by a listed entity to whom clause 49 of the Listing Agreement is applicable.

#### **Audit Committee**

A key element in the corporate governance process of any organization is its audit committee. The battle for financial statement integrity and reliability depends on balancing the pressures of multiple stakeholders, including management, regulators, investors and the public interest.

#### **Functions of Audit Committee**

The functions of the audit committee include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the annual financial statements before submission to the board for approval. :
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval
6. Reviewing, with the management, performance of statutory and internal auditors, and adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any areas of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower mechanism, in case the same is existing.

The Audit Committee shall mandatorily review the following information:

1. Management discussion and analysis of financial condition and results of operations;
2. Statement of significant related party transactions (as defined by the audit committee), submitted by management;
3. Management letters / letters of internal control weaknesses issued by the statutory auditors;
4. Internal audit reports relating to internal control weaknesses; and
5. The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

#### **Shareholders Grievance Committee/Investor Grievance Committee**

In terms of Clause 49-IV(G)(iii) of the Listing Agreement, a board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of

balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as 'Shareholders/Investors Grievance Committee'.

The number of meetings of the Shareholders/Investors Grievance Committee should be in accordance with the exigencies of business requirements

To expedite the process of share transfers, the Board of the company shall delegate the power of share transfer to an officer or a committee or to the Registrar and Share Transfer Agents. The delegated authority shall attend to share transfer formalities at least once in a fortnight

### **PART B**

*(Answer ANY TWO questions from this part.)*

#### **Question 5**

- (a) *Explain the concept of 'business ethics'.* (2 marks)
- (b) *State the essential features of a good business ethics programme.* (3 marks)
- (c) *You are the Company Secretary of Satyadhan Services Ltd. The company is currently facing crisis of sagging public image. The Board wants to publicise its ethical programme which takes care of the public aspirations. Draft a catchy 8-Point 'Good Ethics Programme' (GEP) for consideration of the Board of directors.* (10 marks)

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

##### **The Concept of Business Ethics**

Business ethics is a form of applied ethics. In broad sense ethics in business is simply the application moral or ethical norms to business. The term ethics has its origin from the Greek word "ethos", which means character or custom - the distinguishing character, sentiment, moral nature, or guiding beliefs of a person, group, or institution. The synonyms of ethics as per Collins Thesaurus are – conscience, moral code, morality, moral philosophy, moral values, principles, rules of conduct, standards.

Business ethics comprises the principles and standards that guide behaviour in the conduct of business. Businesses must balance their desire to maximize profits against the needs of the stakeholders. Maintaining this balance often requires tradeoffs. To address these unique aspects of businesses, rules – articulated and implicit, are developed to guide the businesses to earn profits without harming individuals or society as a whole.

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

##### **Features of Good Ethics Programme**

The following factors indicate the success of an ethics programme:

- *Leadership* : that executives and supervisors care about ethics and values as much as they do about the bottom line.
- *Consistency between words and actions* : that top management "practises what it preaches".

- *Fairness* : that it operates fairly.
- *Openness* : that people talk openly about ethics and values, and that ethics and values are integrated into business decision-making.
- *Just rewards* : that ethical behaviour is rewarded.
- *Value-driven* : that an ethics and compliance programme is values-driven.

**Answer 5(c)**

**Note for the Board**

**Placed below is a draft ethics programme of Sathyadhan Services Limited**

**Ethics Programme of Sathyadhan Services Limited**

- Codes of ethics have been developed for :
  - Board and Senior Management,
  - employees,
  - vendors & contractors;
- Constitution of a Committee of the Board to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Adequate training of the Code of ethics to all whom the code would apply.
- Inclusion of ethics-related criteria in employees' annual performance reviews and in the evaluation and compensation of management;
- Expression by senior management that all known ethics breaches have been reported, investigated, and resolved;
- Disclosure of practices and processes the company has adopted to promote ethical behavior.
- Re-iteration that the Code of ethics as communicated and illustrated to through the training is sacrosanct and would apply in every situation and any deviation would be strictly dealt with.

**Question 6**

(a) *“Ethics is the first line of defence against corruption, while law enforcement is remedial and reactive. However, both fail to achieve the desired aim in the Indian set-up.” Do you agree? Give reasons in support of your answer.*

*(7 marks)*

(b) *Explain and distinguish between ‘activity analysis’ and ‘stakeholders analysis’.*

*(8 marks)*

**Answer 6(a)**

It is absolutely correct to say that ethics is the first line of defense against corruption. What prevents corruption in the first place is ethics. The enforcement of law is a reaction to the occurrence of the corruption. While the law can only lay down the dos and don'ts

and the consequences of doing or not doing something, the compliance to law in letter & spirit can be achieved only through ethical practices being followed.

An act may be perfectly legal but totally unethical. Therefore, the statement law enforcement is remedial and reactive is also true.

However, ethics is not absolute and is open to the influence of time, place and situation. Certain unethical practices on account of the fact that it is widely prevalent is apparently justified.

The following are some of the factors that have contributed to the prevalence of corruption in India :

- (i) Cultural ethos : Putting a premium on materialism, profiteering, power-play and casual attitude for ethical values..Myopic concerns over-riding long-term considerations and values.
- (ii) Institutional failures : procedural rigmaroles, in-built obstacles, bureaucratic red-tapism etc.
- (iii) Poor enforcement of law : delays in justice.
- (iv) Erosion of values in politicians, entrepreneurs; political lobbying etc.

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

#### **Stakeholder Analysis**

Stakeholder analysis is the identification of a project's/activity's key stakeholders, an assessment of their interests, and the ways in which these interests affect project riskiness and viability. It is linked to both institutional appraisal and social analysis: drawing on the information deriving from these approaches, but also contributing to the combining of such data in a single framework. Stakeholder analysis contributes to project design/activity design through the logical framework, and by helping to identify appropriate forms of stakeholder participation.

Doing a stakeholder analysis can:

- draw out the interests of stakeholders in relation to the problems which the project is seeking to address (at the identification stage) or the purpose of the project (once it has started).
- identify conflicts of interests between stakeholders,
- help to identify relations between stakeholders which can be built upon, and may enable establish synergies
- help to assess the appropriate type of participation by different stakeholders.

The underlining factor in the stakeholder concept is that every activity of an organization should be based taking into account the interests of all the stakeholders. A holistic approach ensuring fairness to all the stakeholders is completely necessary for the sustainability of an enterprise.

A major reason for increasing adoption of a Stakeholder Concept in setting business



objectives is the recognition that businesses are affected by the "environment" in which they operate. Businesses come into regular contact with customers, suppliers, government agencies, families of employees, special interest groups. Decisions made by a business are likely to affect one or more of these "stakeholder groups".

The stakeholder concept suggests that the managers of a business should take into account their responsibilities to other groups - not just the shareholder group - when making decisions. The concept suggests that businesses can benefit significantly from cooperating with stakeholder groups, incorporating their needs in the decision-making process.

### Activity Analysis

The ethical dimension of an activity can be determined with the help of the following grid which is self-explanatory:

#### Activity Analysis

(Ethical)

<p><b>Parasite 1</b> Helping self Injuring Others</p>	<p><b>Win-win Situation 3</b> Helping self Helping Others</p>
<p><b>Martyr 2</b> Helping Others Injuring self</p>	<p><b>Total Loss 4</b> Injuring self Injuring Others</p>

The first block in the grid – help self and injuring others is obviously unethical. The second block that is helping others and injuring self may appear to be ethical, however it is not ethical. The third grid wherein one helps self and also helps others is the most ideal and ethical situation. The win-win situation. The last grid is a situation that should be avoided at all costs and is highly unethical.

### Question 7

- (a) Outline the main provisions of a 'model code of business conduct and ethics'.  
(7 marks)
- (b) Write short notes on any two of the following :
- (i) Ethics audit
  - (ii) Ethical dilemma
  - (iii) Deontological ethics.
- (4 marks each)

### Answer 7(a)

The Code should 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 taking 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)(i)**

#### **Ethics Audit**

Ethics Audit is an audit of all those functions & activities where deviation of the code of ethics of the conduct is most likely to occur. The following are the some of the suggested steps in ethics audit :

1. The first step in conducting an audit is securing the commitment of the firm's top management.

2. The second step is establishing a committee or team to oversee the audit process.
3. The third step is establishing the scope of the audit.
4. The fourth step should include a review of the firm's mission values, goals, and policies.
5. The fifth step is identifying the tools or methods that can be employed to measure the firm's progress and then collecting and analyzing the relevant information.
6. The sixth step is having the results of the data analysis verified by an independent party.
7. The final step in the audit process is reporting the audit findings to the board of directors and top executives and, if approved, to external stakeholders.

### **Answer 7(b)(ii)**

#### **Ethical Dilemma**

Dilemma is a situation that requires a choice between options that are or seem equally unfavorable or mutually exclusive.

By definition, an ethical dilemma involves the need to choose from among two or more morally acceptable courses of action, when one choice prevents selecting the other; or, the need to choose between equally unacceptable alternatives (Hamric, Spross, and Hanson, 2000).

A dilemma could be a right vs. wrong situation in which the right would be more difficult to pursue and wrong would be more convenient. A right versus wrong dilemma is easier to resolve.

An ethical dilemma is a situation that will often involve an apparent conflict between moral imperatives, in which to obey one would result in transgressing another. This is also called an ethical paradox.

An ethical dilemma involves a situation that makes a person question what is the 'right' or 'wrong' thing to do. Ethical dilemmas make individuals think about their obligations, duties or responsibilities. These dilemmas can be highly complex and difficult to resolve. Easier dilemmas involve a 'right' versus 'wrong' answer; whereas, complex ethical dilemmas involve a decision between right and right.

### **Answer 7(b)(iii)**

**Deontological ethics** is an approach to ethics that holds that acts are inherently good or evil, regardless of the consequences of the acts. A central theme among deontological theorists is that we have a duty to do those things that are inherently good ("truth-telling" for example); while the ends or consequences of our actions are important, our obligation or duty is to take the right action, even if the consequences of a given act may be bad.

It is sometimes described as "duty" or "obligation" based ethics, because deontologists believe that ethical rules "bind you to your duty."

**PART C****Question 8**

Attempt any four of the following :

- (a) Explain the concept of 'triple bottom line' (TBL). (5 marks)
- (b) What do you understand by 'corporate sustainability' ? State the key drivers which need to be garnered to ensure sustainability. (5 marks)
- (c) Explain the benefits of sustainability reporting. Describe sustainability reporting in emerging economies. (5 marks)
- (d) Write a note on — World Commission on Environment and Development (WCED). (5 marks)
- (e) Choose the most appropriate answer from the given options in respect of the following :
  - (i) The UN climate change conference was held in Bali, Indonesia in —
    - (a) January, 2005
    - (b) June, 2000
    - (c) December, 2007
    - (d) January, 2009.
  - (ii) The International Labour Organisation (ILO) was created by a treaty in —
    - (a) Rome
    - (b) Versailles
    - (c) Paris
    - (d) Geneva.
  - (iii) The Biodiversity Treaty has —
    - (a) Two goals
    - (b) Four goals
    - (c) Only one goal
    - (d) Three goals.
  - (iv) The rule in Rylands vs. Fletcher originally applies only to —
    - (a) Natural resources
    - (b) Industrial disasters
    - (c) Agrarian water logging
    - (d) Dangerous industries.
  - (v) The Corporate Manslaughter and Corporate Homicide Act, 2007 applies to industries located in —
    - (a) India
    - (b) UK

- (c) USA
- (d) France. (1 mark each)
- (f) State, with reasons in brief, whether the following statements are correct or incorrect:
- (i) Sustainable development and economic growth are co-terminous.
  - (ii) In real life, many public limited companies do not exist in perpetuity.
  - (iii) Stakeholders identification is optional as per the global reporting initiative.
  - (iv) Agenda-21 was adopted at the Earth Summit in New York in 1992 by way of a treaty.
  - (v) There is an absolute and non-delegatable duty on an enterprise which is engaged in a hazardous or inherently dangerous activity. (1 mark each)

### Answer 8(a)

#### Triple Bottom Line (TBL)

In 1999 Elkington developed the concept of the Triple Bottom Line which proposed that business goals were inseparable from the societies and environments within which they operate. Whilst short-term economic gain could be chased, a failure to account for social and environmental impacts would make those business practices unsustainable.

The Triple Bottom Line is made up of "Social, Economic and Environmental" aspect and indicated by the phrase "People, Planet, Profit".

**"People"** means Human Capital. It implies fair and beneficial business practices toward labour and the community and region in which a corporation conducts its business would create long term value. Well being of a corporate, its labour and other stakeholder interests are interdependent. For example, fair pay to workforce, health and safety at work place, tolerable working hours etc.

**The second aspect of TBL is "Planet"** - the Natural Capital. It refers to sustainable environmental practices. A company which decides to follow TBL always keep in mind that it does no harm nature or create negative environmental impact.

**The third aspect of triple bottom line is profit. The concept of profit for TBL company is somehow more wider in all perspective.** It is the reflection of economic impact the organization has on its business activities and that too after meeting all social and environmental cost. It somehow indicates real value addition a corporate made through its various activities.

World wide many corporates are now adopting Triple Bottom Line under vision and mission and practicing the same through aligning their corporate polices in that direction.

Many countries worldwide are now contemplating how to integrate this triple bottom line under their legal system.

### Answer 8(b)

Corporate sustainability indicates new philosophy as an alternative to the traditional growth and profit-maximization model under which sustainable development comprising

environmental protection, social justice and equity, and economic development are given more significant focus while recognizing simultaneous corporate growth and profitability.

It 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.

Corporate sustainability 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. Corporate sustainability leaders achieve long-term shareholder value by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks.

Concern towards social, environmental and economical issues, i.e., covering all the segments of stakeholders, are now basic and fundamental issues which permits a corporate to operate in long run sustainably. Following key drivers need to be garnered to ensure sustainability

- *Internal capacity building strength* – In order to convert various risks into competitive advantage.
- *Social impact assessment* – In order to become sensitive to various social factors, like changes in culture, living habits etc.
- *Repositioning capability* through development and innovation Crystallization of all activities to ensure consistent growth

Corporate sustainability is a business approach creating shareholder value in long run.

### **Answer 8(c)**

#### **Benefits of Sustainability Reporting**

Benefits of sustainability reporting are:

- Legitimation of corporate activities, products and services which create environmental and social impacts.
- Increase in corporate reputation and brand value.
- Gaining a competitive advantage.
- Comparison and benchmarking against competitors.
- Increasing transparency and accountability within the company.
- Establishing and supporting employee motivation as well as internal information and control processes.

#### **Sustainability Reporting in Emerging Economies**

Investors increasingly recognize the value of robust sustainability reporting and expectations for such reporting have spread to companies in emerging markets. While it may be difficult for emerging market companies to devote the resources to such reporting,

companies should begin by taking the first step of committing to the process of reporting, and demonstrating that they are managing the sustainability issues most material to their sector. Such companies would develop a competitive advantage in the marketplace and reach a greater range of investors and customers.

Increasingly global companies understand that a commitment to sustainability reporting can contribute to financial success. Such transparency allows companies to reach a broader range of investors and customers, enhance operational efficiency, improve brand positioning, and develop leadership in the marketplace.

Recently, in India, Corporate Environmental Reporting as a useful adjunct to the concept sustainable development, has been recognized in various policy documents like the Approach Paper to the Eleventh Plan and the National Environmental Policy 2006.

**Answer 8(d)**

The Brundtland Commission, formally the World Commission on Environment and Development (WCED), known by the name of its Chair Gro Harlem Brundtland, was convened by the United Nations in 1983. The Commission was created to address growing concern “about the accelerating deterioration of the human environment and natural resources and the consequences of that deterioration for economic and social development.” In establishing the Commission, the UN General Assembly recognized that environmental problems were global in nature and determined that it was in the common interest of all nations to establish policies for sustainable development.

The Report of the Brundtland Commission, *Our Common Future*, published in 1987, dealt with sustainable development and the change of policies needed for achieving that. The definition of this term in the report is quite well known and often cited:

“Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

**Answer 8(e)(i)**

- (c) December, 2007

**Answer 8(e)(ii)**

- (b) Versailles

**Answer 8(e)(iii)**

- (d) Three goals

**Answer 8(e)(iv)**

- (c) Agrarian water logging

**Answer 8(e)(v)**

- (b) UK

**Answer 8(f)(i)**

*Correct*

Sustainable development balances the need for economic growth with environmental protection and social equity.

**Answer 8(f)(ii)**

*Correct*

Many times corporates become non-functional and reach a closure situation.

**Answer 8(f)(iii)**

*Incorrect*

The reporting organization should identify its stakeholders and explain in its report how it has responded to their reasonable expectations and interests.

**Answer 8(f)(iv)**

*Incorrect*

It was adopted at Rio De Janeiro and not New York.

**Answer 8(f)(v)**

*Correct*

An enterprise owes an absolute and non-delegable duty to the community to ensure that no harm results to anyone on account of hazardous or inherently dangerous nature of the activity which it has undertaken.

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