GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

(New Syllabus)

JUNE 2019

MODULE 3

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
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(Under the jurisdiction of Ministry of Corporate Affairs)
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In answers to the questions based on case study, the students may write any other alternative answer with valid reasoning.

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

C O N T E N T S

PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2019

CORPORATE FUNDING & LISTINGS IN STOCK EXCHANGES

Time allowed : 3 hours *Maximum marks : 100*

NOTE : *Answer ALL Questions.*

PART A

Question 1

(a) *Explain with a suitable example, day count convention for Debt Securities issued under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008.*

(5 marks)

(b) *Y Ltd. an Indian Company opened irrevocable letter of credit for 6 Million Swedish Kroner in favour of Z Ltd. for import of two pulsed rectifiers.*

Z Ltd. the Swedish Company shipped only one pulsed rectifier but invoiced for two pulsed rectifiers. Bill of Lading also stated that the packing contains two pulsed rectifiers.

Based on the documents the Indian Bank remitted the amount to the Banker of Z Ltd. and debited the account of Y Ltd.

Y Ltd. wants to hold the Indian Banker responsible for wrong payment against the short shipment.

Will Y Ltd. succeed ?

Give your assessment with reasons. *(5 marks)*

(c) *You are required to compute Maximum Permissible Bank Borrowings (MPBB) under three methods of Tandon Committee Norms pertaining to M L Ltd. from the following data and how you will present it to the Board :*

Existing Current Assets	*Amount in ₹*	
Raw materials	*8,00,000*	
Work in progress	*80,000*	
Finished goods	*3,60,000*	
Receivables	*2,00,000*	
Other current assets	*40,000*	*4,80,000*
Existing Current Liabilities		
Creditors for purchases	*4,00,000*	
Other current liabilities	*2,00,000*	
Bank borrowings	*8,00,000*	*14,00,000*

Core current assets are ₹3,80,000.

(5 marks)

Answer 1(a)

SEBI has provided certain clarifications on aspects related to day count convention for debt securities issued under the SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

(i) If the interest payment date falls on a holiday, the payment may be made on the following working day however the dates of the future coupon payments would be as per the schedule originally stipulated at the time of issuing the security.

EXAMPLE:-

Date of Issue of Corporate bonds: July 01 2016

Date of Maturity: June 30, 2018

Date of coupon payments: January 01 and July 01

Coupon payable: semi-annually

In this case, January 01, 2017 is a Sunday, thus the coupon would be payable on January 02, 2017 i.e. the next working day. However the calculation for payment of interest will be only till December 31, 2016, which would have been the case if January 01, 2017 were not a holiday. Also, the next dates of payment would remain July 01, 2017 and January 01, 2018 despite the fact that one of the interest payment was made on January 02, 2017.

(ii) In order to ensure consistency for interest calculation, a uniform methodology shall be followed for calculation of interest payments in the case of leap year, which shall be as follows:

In case of a leap year, if February 29 falls during the tenor of a security, then the number of days shall be reckoned as 366 days (Actual/Actual day count convention) for a whole one year period, irrespective of whether the interest is payable annually, half yearly, quarterly or monthly etc.

EXAMPLE:-

Date of issue of corporate bonds: January 01, 2016

Coupon payable : Semi-annually

Date of coupon payments : July 01 and January 01

In the above example, in case of the leap year (i.e, 2016), 366 days would be reckoned as the denominator (Actual/Actual), for payment of interest, in both the half year periods i.e. Jan 01, 2016 to Jul 01, 2016 and Jul 01, 2016 to Jan 01, 2017.

Answer 1(b)

Indian Company will not succeed, since the foreign LC is subject to Uniform Customs and Practices for Documentary Credit (UCPDC 600) as per the guidelines of International Chamber of Commerce (ICC). According to which LC is not payment against goods but only payment against documents. As far as the Bank is concerned, the

documents as called for in the LC have been presented by the seller and there is no internecine discrepancy among the documents. Because of this he will not be held liable for short shipment of the goods, physically.

Answer 1(c)

Maximum Bank Borrowings: (Tandon Committee norms)

Method – I	*Method – II*	*Method – III*
= 0.75 (CA-CL)	= 0.75 (CA) -CL	= 0.75 (CA –CAA)- CL
= 0.75(14,80,000-6,00,000)	= 0.75(14,80,000) - 6,00,000	= 0.75(14,80,000-3,80,000)-6,00,000
= 0.75(8,80,000)		
= 6,60,000	= 5,10,000	= 0.75 (11,00,000)-6,00,000
		= 2,25,000

Review:

	Method – I	*Method – II*	*Method – III*
Maximum Bank Borrowings	6,60,000	5,10,000	2,25,000
Actual Bank Borrowings	8,00,000	8,00,000	8,00,000
Excess Bank Borrowings	1,40,000	2,90,000	5,75,000

Under all the 3 methods, the excess bank borrowings can be converted in to long term debt.

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

Question 2

(a) What do you mean by ECB ? Under what circumstances conversion of ECB's into equity is possible ? (5 marks)

(b) In the recent past, a listed housing finance company issued MASALA BONDS for a sum of ₹3,000 crore.

Explain the term MASALA BOND. Is there any advantage of MASALA BONDS over NORMAL BONDS ? (5 marks)

(c) What do you mean by Securitisation ? Explain the Securitisation Structure. (5 marks)

OR (Alternate question to Q. No. 2)

Question 2A

Distinguish between the following :

(i) Bill Discounting and Factoring

(ii) Letter of Guarantee and Bank Guarantee

(iii) Asian Development Bank and International Monetary Fund. (5 marks each)

Answer 2(a)

ECBs are commercial loans raised by eligible resident entities from recognised non-resident entities and should confirm to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalone basis.

Conversion of ECBs into equity is permitted (including those which are matured but unpaid) subject to the following conditions:

(1) The activity of the borrowing company is covered under the automatic route for FDI or approval route from the Foreign Investment Promotion Board (FIPB), wherever applicable, for foreign equity participation has been obtained as per the extant FDI policy.

(2) The conversion, which should be with the lender's consent and without any additional cost, will not result in breach of applicable sector cap on the foreign equity holding.

(3) Reporting requirements should be fulfilled;

(4) Applicable pricing guidelines for shares are complied with.

(5) Consent of other lenders, if any.

(6) If the borrower concerned has availed of other credit facilities from the Indian banking system the applicable prudential guidelines issued by RBI are complied with.

Answer 2(b)

Masala Bonds are rupee denominated borrowings by Indian companies in the overseas markets. This is different from the other overseas borrowings in the sense that the in the other borrowings, the currency is normally dollar, euro, yen etc.

The masala bonds were reckoned under both corporate debt and external commercial borrowings for Foreign Portfolio investment.

The Reserve Bank of India recently amended the Regulations and currently treats Masala Bonds under the ECB category only, where a borrower just needs to seek the RBI's approval to sell those securities. The main advantage of issuing masala bonds is that the company does not have to worry about the depreciation in the rupee in comparison to the other currencies. This is normally a big worry for corporates while raising money in the overseas markets. If the rupee weakens at the time of the redemption of the bonds, the company will have to pay more rupees to repay the dollars. This is a big advantage, as many companies which had raised via the Foreign Currency Convertible Bonds in 2007 found themselves in a great difficulty as the rupee had depreciated very sharply during the global financial crisis. In order to compensate the risk of currency depreciation, the buyer of the Masala Bond will get a higher coupon rate and therefore earns a higher yield. Many public and private companies are in the fray to issue masala bonds as the companies can have access to more funds at a marginally higher cost of financing.

Answer 2(c)

Securitization is the transformation of financial assets into securities. Securitization

is used by financial entities to raise funds other than what is available via the traditional methods of on-balance-sheet funding.

There are four steps in a securitization:

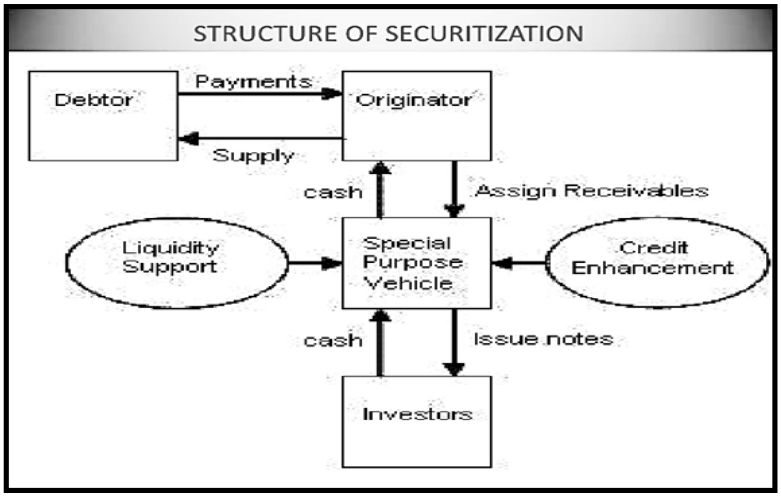
(i) Special Purpose Distinct Entity (SPDE) is created to hold title to assets underlying securities;

(ii) The originator or holder of assets sells the assets (existing or future) to the SPDE;

(iii) The SPDE with the help of an investment banker, issues securities which are distributed to investors; and

(iv) The SPDE pays the originator for the assets with the proceeds from the sale of securities

A Securitization structure typically is as under :



Answer 2A(i)

Bill Discounting : Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit. Such bills being bills of exchange can be kept upto the maturity date and encashed by the seller or may be endorsed to a third party in payment of dues owing to the latter. The most common practice is that the seller who gets the accepted bills of exchange discounts it with the Bank or financial institution or a bill discounting house and collects the money (less the interest charged for the discounting).

Factoring : Factoring is a financial transaction wherein an entity sells its receivables to a third party called a 'factor', at discounted prices. Factoring is a financial option for the management of receivables. In simple definition it is the conversion of credit sales into cash. In factoring, a financial institution (factor) buys the accounts receivable of a company (Client) and pays up to 80% (rarely up to 90%) of the amount immediately on formation of agreement.

Answer 2A(ii)

Letter of Credit : A letter of credit, sometimes referred to as a documentary credit, acts as a promissory note from a bank. It represents an obligation taken on by a bank to make a payment once certain criteria are met. Once these terms are completed and confirmed, the bank will transfer the funds. The letter of credit ensures the payment will be made as long as the services are performed.

Bank Guarantee : Bank guarantees are part of non-fund based credit facilities provided by the bank to the customers. Bank issue bank guarantee on behalf of his client as a commitment to third party assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfill his commitment to the beneficiary.

While letters of credit are used mostly in international trade agreements, bank guarantees are often used in real estate contracts and infrastructure projects.

Both bank guarantees and letters of credit work to reduce financial risk.

(Note : Student may read as Letter of Credit instead of Letter of Guarantee in Question No. 2A(ii)).

Answer 2A(iii)

Asian Development Bank : Asian Development Bank (ADB) assists its member and partners, by providing loans, technical assistance, growth and other equity investments to promote social and economic development ADB is composed of 67 members 48 of which are from the Asia and the Pacific region.

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

International Monetary Fund (IMF) : The IMF's primary purpose is to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The Funds mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability.

Question 3

(a) What is the difference between a Fixed Deposit and Inter-Corporate Deposit ? In case of default by a company, explain the role of Regulator.

(b) Explain the provisions of the Companies Act, 2013 for Issue of Sweat Equity Shares. To what extent the Sweat Equity Shares can be issued to an Independent Director ?

(c) Write a detailed note on Islamic Banking. *(5 marks each)*

Answer 3(a)

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

The role of regulator in case of default by a company:

1. If company fails to repay, the depositor may apply to Tribunal and tribunal may direct that:

   (a) the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees; and

   (b) every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both:

   Provided that if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447 of Companies Act, 2013.

2. Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 of the Companies Act, 2013 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in subsection (3) of that section and liability under section 447 of the Companies Act, 2013, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

3. Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

Answer 3(b)

According to Section 54 of the Companies Act, 2013 a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:

(a) The issue is authorized by a special resolution passed by the company in the general meeting.

(b) The resolution specifies the number of shares, current market price, consideration if any.

(c) Not listed shares, the sweat equity shares are to be issued in accordance with Rule 8 of Companies (Share Capital and Debenture) Rules, 2014.

Independent directors are not entitled for sweat equity shares.

Answer 3(c)

Islamic Banking or Sharia - Compliant Finance is banking or financing activity that complies with sharia (Islamic law) and its practical application through the development of Islamic economics. Some of the modes of Islamic banking/finance include Mudarabah (Profit sharing and loss bearing), Wadiah (safekeeping), Musharaka (joint venture), Murabahah (cost plus), and Ijara (leasing).

Sharia prohibits riba, or usury, defined as interest paid on all loans (although some Muslims dispute whether there is a consensus that interest is equivalent to riba). Investment in businesses that provide goods or services considered contrary to Islamic principles (e.g. pork or alcohol) is also haraam (sinful).

Islamic Banks work on the principles of an interest free banking. Riba or interest under Islamic Law basically means anything in "excess" – the investor should not make an "undue" profit from the hard work of the other. Islamic banks make available accounts which provide profit or loss instead of interest rates. The banks use this money collected by them and invest in something that is shari at compliant, that is not haraam and does not involve high risks.

Question 4

(a) Discuss the different modes of Euro Issue in detail.

(b) Can an entity, pursue listing of its specified securities without making a public issue ? Give the exemptions, if any.

(c) Commercial Paper is sold at a discount from its face value and redeemed at its face value. Calculate the pre-tax cost on annualised basis of commercial paper, if face value is ₹5,00,000, maturity period is 180 days and net amount realized is ₹4,80,000. (Assume 360 days in a year.)

(d) What are the merits and demerits of customer advance ? Explain.

(e) Discuss the various conditions required to be fulfilled for listing of Non-Convertible Redeemable Preference Shares. (3 marks each)

Answer 4(a)

Euro issue means modes of raising funds by an Indian company outside India in foreign currency. There are different modes of Euro issue which is as follows:

1. Depository Receipts
    a. American Depository Receipts
        i. Existing shares

ii. Fresh shares

b. Global Depository Receipts

i. From Euro market

ii. From US market

2. Foreign currency convertible bonds / foreign Currency exchangeable bonds.

Answer 4(b)

Yes. Regulation 282(1) of the SEBI (ICDR) Regulations, 2018 provides that the provisions of Chapter X of SEBI (LODR) Regulations shall apply to issuers seeking listing of their specified securities pursuant to an initial public offer or for only trading on a stock exchange of their specified securities without making a public offer. Regulation 284 (3) of the SEBI (ICDR) Regulations, 2018 lays down that the regulations relating to the following as stated under the Chapter of Initial Public Offer on Main Board shall not be applicable:

(a) allotment;

(b) issue opening or closing;

(c) advertisements;

(d) underwriting;

(e) sub-regulation (2) of regulation 5;

(f) pricing;

(g) dispatch of issue material; and

(h) other such provisions related to offer of specified securities to the public.

Answer 4(c)

$$\text{Cost of commercial paper} = \frac{\text{Face Value - Amount Realised (Net)}}{\text{Net Amount Realised}} * 360/\text{ Maturity Period}$$

$$= \frac{(5,00,000 - 4,80,000) * 360/180}{4,80,000} = 8.33\%$$

Answer 4(d)

Merits of Customer Advance

i. *Interest free* : Amount offered as advance is interest free. Hence funds are available without involving financial burden.

ii. *No tangible security* : The seller is not required to deposit any tangible security while seeking advance from the customer. Thus assets remain free of charge.

iii. *No repayment obligation* : Money received as advance is not to be refunded. Hence there are no repayment obligations.

Demerits of Customer Advance

i. *Limited amount* : The amount advanced by the customer is subject to the value of the order. Borrowers' need may be more than the amount of advance.

ii. *Limited period* : The period of customers' advance is only upto the delivery goods. It cannot be reviewed or renewed.

iii. *Penalty in case of non-delivery of goods* : Generally advances are subject to the condition that in case goods are not delivered on time, the order would be cancelled and the advance would have to be refunded along with interest.

Answer 4(e)

As per regulation 17 of the SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013, an issuer may list its non-convertible redeemable preference shares issued on private placement basis on a recognized stock exchange subject to the following conditions:

i. The issuer has issued such non-convertible redeemable preference shares in compliance with the provisions of the Companies Act,2013 rules prescribed thereunder and other applicable laws.

ii. Credit rating has been obtained in respect of such non-convertible redeemable preference shares from at least one credit rating agency registered with SEBI.

iii. It must be in dematerialized form.

iv. The minimum application size for each investor is not less than ten lakh rupees.

v. The issuer shall create a capital redemption reserve in accordance with the provisions of the Companies Act, 2013.

vi. The disclosure as provided in regulation 18 of the SEBI NCRPS regulations have been made.

vii. The minimum application size for each investor is not less than ten lakh rupees; and

viii. The issue is in compliance with sub-regulation (3) and (4) of regulation 4.

ix. Where the application is made to more than one recognised stock exchange, the issuer shall choose one of them as the designated stock exchange.

PART B

Question 5

(a) Explain the Regulation 39 of Issuance of Certificates or Receipts for securities and dealing with unclaimed securities under SEBI Listing Regulations, 2015.

(b) List out the Half Yearly Compliance Calendar for listed entity for SME (Small and Medium Enterprise) as per SEBI Listing Regulations, 2015.

(c) Write down the criteria to get listed on Singapore Exchange Ltd. (SGX).

(d) "Information dissemination through website assumes significance particularly in respect of listed companies".

Discuss and explain the statutory disclosures on company's website.

(5 marks each)

Answer 5(a)

Regulation 39 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides that:

(1) The listed entity shall comply with Rule 19(3) of Securities Contract (Regulations) Rules, 1957 in respect of Letter/Advices of Allotment, Acceptance or Rights, transfers, subdivision, consolidation, renewal, exchanges, issuance of duplicates thereof or any other purpose.

(2) The listed entity shall issue certificates or receipts or advices, as applicable, of subdivision, split, consolidation, renewal, exchanges, endorsements, issuance of duplicates thereof or issuance of new certificates or receipts or advices, as applicable, in cases of loss or old decrepit or worn out certificates or receipts or advices, as applicable within a period of thirty days from the date of such lodgement.

(3) The listed entity shall submit information regarding loss of share certificates and issue of the duplicate certificates, to the stock exchange within two days of its getting information.

(4) The listed entity shall comply with the procedural requirements specified in Schedule VI to these regulations while dealing with securities issued pursuant to the public issue or any other issue, physical or otherwise, which remain unclaimed and/or are lying in the escrow account, as applicable.

Answer 5(b)

Half Yearly Compliance Calendar for listed entity for SME (Small and Medium Enterprise) as per SEBI Listing Regulations, 2015

Sr. No.	*Regulation Reference*	*Frequency*	*Period Covered*	*Date by which to be filed*
1.	31(1) – Shareholding Pattern	Half Yearly	April September October	21st October and 21st April
2.	32(8) – Statement of deviation or variation	Half Yearly	April September October	-
3.	33(5) – Financial Results	Half Yearly	April September October	14th November and 30th May
4.	7(3) – Compliance Certificate to the exchange	Half Yearly	April September October	31st October and 30th April
5.	40(10) – Compliance Certificate w.r.t Transfer or transmission or transposition of securities within 30 days	Half Yearly	April September October March	31st October and 30th April

Answer 5(c)

Process to get listed on SGX Mainboard

1.	Meet With Accredited Issue Managers	Meet with accredited Issue Managers to share your company's plans and learn how to get listed.
2.	Appoint An Accredited Issue Manager	The Issue Manager will manage the listing application for your company, including recommendations on the appointment of other professionals required.
3.	Assessment Period	You will work closely with your mandated Issue Manager to decide on a suitable structure and method of offering of your company's securities. The Issue Manager will guide you in preparing the listing application for your company.
4.	Stage 1: Submission of Section (A) Of The Listing Admissions Pack	Preparation for the listing application begins. As you will be collaborating with the Issue Manager, you may want to familiarise yourself with the Mainboard Rules available online.
5.	Stage 2 : Submission of Section (B) Of The Listing Admissions Pack	After SGX has informed the Issue Manager that it may proceed with Stage 2 of the application, the Issue Manager can submit Section (B) of the Listing Admissions Pack, together with the full listing application (including the relevant undertakings and confirmations required under the Mainboard Listing Manual and the prospectus/shareholders' circular). SGX is committed to provide an iterative response within four weeks from the commencement of Stage 2.
6.	Approval	Once the submission is approved, SGX will issue an ETL letter, which is valid for three months.
7.	Lodgement Of Documents & Public Exposure	The company can now lodge the preliminary prospectus on MAS' website, the Offers and Prospectuses Electronic Repository and Access (OPERA), for public feedback for at least a week.
8.	Registration Of Documents & Launch Of Offer (IPO)	The company can now register the final prospectus on OPERA, pending public feedback or changes and approval from MAS.
9.	Confirmation of Allotment & Trading Commences	Once the offer period closes, allocation of the subscriptions will commence and your company's securities will be allotted and credited to successful investors. A welcome ceremony will be held at SGX to commemorate the listing of your company's securities, culminating in a countdown to the first trades of your company's securities.

Answer 5(d)

As per regulation 46 of the SEBI Listing Regulations 2015, every website of a listed

Company must contain statutory disclosures in terms of the SEBI Listing Regulations under a separate section on its website which are enumerated as follows:

(a) details of its business;

(b) terms and conditions of appointment of independent directors;

(c) composition of various committees of board of directors;

(d) code of conduct of board of directors and senior management personnel;

(e) details of establishment of vigil mechanism/ Whistle Blower policy;

(f) criteria of making payments to non-executive directors , if the same has not been disclosed in annual report;

(g) policy on dealing with related party transactions;

(h) policy for determining 'material' subsidiaries;

(i) details of familiarization programmes imparted to independent directors including the following details:-

  (i) number of programmes attended by independent directors (during the year and on a cumulative basis till date),

  (ii) number of hours spent by independent directors in such programmes (during the year and on cumulative basis till date), and

  (iii) other relevant details

(j) the email address for grievance redressal and other relevant details;

(k) contact information of the designated officials of the listed entity who are responsible for assisting and handling investor grievances;

(l) financial information including:

  (i) notice of meeting of the board of directors where financial results shall be discussed;

  (ii) financial results, on conclusion of the meeting of the board of directors where the financial results were approved;

  (iii) complete copy of the annual report including balance sheet, profit and loss account, directors report, corporate governance report etc.;

(m) shareholding pattern;

(n) details of agreements entered into with the media companies and/or their associates, etc.;

(o) schedule of analyst or institutional investor meet and presentations made by the listed entity to analysts or institutional investors simultaneously with submission to stock exchange;

(p) new name and the old name of the listed entity for a continuous period of one year, from the date of the last name change;

(q) items in sub-regulation (1) of regulation 47;

(r) with effect from October 1, 2018, all credit ratings obtained by the entity for all its outstanding instruments, updated immediately as and when there is any revision in any of the ratings.

(s) separate audited financial statements of each subsidiary of the listed entity in respect of a relevant financial year, uploaded at least 21 days prior to the date of the annual general meeting which has been called to inter alia consider accounts of that financial year.

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

Question 6

(a) The provisions of SEBI Listing Regulations, 2015, shall not be applicable to "perpetual debt instrument" and "perpetual non-cumulative preference shares" listed by Banks. Comment.

(b) IPO being "once a life time event, mis-calculation of any nature can create a hurdle for company's future growth".

Keeping this in mind list out the important aspects that key Managerial Personnel shall consider while preparing for an IPO.

(c) What are the documents required to be prepared by the company secretary for listing approval for Bonus Shares issued by the company for documentation purpose ?

(d) For listing and trading of SME — Initial Public Offer (IPO), what are the documents to be submitted by the Company Secretary on T+2 days ? (5 marks each)

OR (Alternate question to Q. No. 6)

Question 6A

(i) Discuss the post issue formalities to be completed by the company secretary for Rights Issue of equity shares for listing purpose.

(ii) Briefly explain the concept of market segmentation.

(iii) Enumerate the principles governing disclosures for the listed companies.

(iv) PQR successfully completed its Initial Public Offer (IPO). List out the documents to be submitted on T+2 days for listing. (5 marks each)

Answer 6(a)

The statement is wrong. Chapter V of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides for obligations of listed entity which has listed its non-convertible debt securities or non-convertible redeemable preference shares or both. The provisions of this chapter shall also be applicable to "perpetual debt instrument" and "Perpetual non-cumulative preference share" listed by banks.

Further, Chapter V of these regulations deals with the provisions which are applicable to perpetual debt instrument" and "perpetual non-cumulative preference share" listed by banks relating to the following:

- Intimation to stock exchange(s),
- Disclosure of information having bearing on performance/operation of listed entity and/or price sensitive information
- Financial Results
- Annual Report
- Asset Cover
- Documents and Intimation to Debenture Trustees
- Other submissions to stock exchange(s)
- Documents and information to holders of non-convertible debt securities and nonconvertible preference shares
- Structure of non-convertible debt securities and non-convertible redeemable preference shares
- Record Date
- Terms of non-convertible debt securities and non-convertible redeemable preference shares
- Website etc.

Answer 6(b)

Company Secretary being Key Managerial Person under the Companies Act 2013 is an important personnel as far as compliance of various legislation is concerned. Company Secretary assumes a significant importance when he/she is required to be a part of the Company which proposes to attain 'listed' status. Besides complying with provisions of the Companies Act, a Company Secretary of an IPO bound Company is required to be aware and well versed with atleast fundamental requirements as far as preparation for IPO as well as continuation of being listed is concerned. The Key Managerial Personnel/ Management shall consider the following measures while preparing for an IPO issue :

- Due Diligence
- Setting up of Relevant Teams
- Management Structure
- Data Room
- Financial Information & Reporting Process
- Other Regulatory Compliances
- Industry data
- Management Discussion & Analysis
- Publicity & Advertising
- Road shows
- Material Contracts & Documents

Answer 6(c)

The following documents are required to be prepared by the Company Secretary for listing approval for Bonus equity shares issued by the Company:

1. Letter of Application (i.e. by Listed companies applying for listing of further issue) duly completed.
2. Certified true copy of the Board resolution in which the equity shares were allotted.
3. Brief particular of the new securities issued.
4. Shareholding Pattern as per the format prescribed under Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 giving details pre and post allotment of bonus shares.
5. Certificate from Statutory Auditors / Practicing Chartered Accountant / Practicing Company Secretary to the effect that the SEBI (ICDR) Regulations, 2018 for bonus issue has been complied with.
6. Confirmation by the Managing Director/ Company Secretary.
7. Details of further listing /processing fee remitted.

Answer 6(d)

Listing and Trading of SME- Initial Public Offer (IPO)

Documents to be submitted by the Company Secretary on T+2 days (i.e. within 2 working days from the closure of the issue):

- All due diligence certificates filed with SEBI by Merchant bankers.
- List of authorized signatories along with their specimen signatures.
- Confirmation from Lead Managers that devolvement notices have been sent to underwriters (applicable if the issue has devolved).
- The company should inform that the dividend entitlement for the current year for all the existing shares including the shares issued in the public issue shall rank pari-passu.
- Confirmation from the company regarding the email ID for Investor Grievances as per Regulation 46 of SEBI (LODR), Regulations, 2015.
- Copies of all advertisements published in connection with the issue upto T+2 stage.
- Confirmation from the company stating that they have obtained authentication for SCORES from SEBI as per SEBI Circular dated April 13, 2012.

Answer 6A(i)

The following are the post issue formalities to be completed by the Company Secretary for Rights Issue of equity shares for listing purpose.

The Company has to finalise the basis of allotment, and submit the documents as under, within 10 days from closure of the issue:

1. Bid data of Exchanges other than the designated stock exchange.
2. All rejections application along with Summary statement (1 set photocopy to be submitted).
3. Certified copies of all Bank final certificates (ASBA & NON ASBA).
4. Minutes of Basis of allotment duly signed by all the Lead Manager, Registrar and the Company.
5. Basis of allotment sheet for each category.
6. Round summary in case of over subscription, in hard as well as soft format.
7. Copy of post issue initial monitoring report filed with SEBI (3 day monitoring report).
8. Undertaking from Lead Manager, Company and the Registrar.
9. Pre Allotment shareholding and Post proposed Allotment Shareholding pattern as per Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015.
10. The calculation of ex right price by the Statutory Auditor/ Practicing company secretary/ Practicing Chartered Accountant, if not available in the offer document.

Answer 6A(ii)

Market segmentation is the practice of dividing a large market into segments with similar needs. International listing enables firms to divide foreign investor markets into segments which are easy to access. Companies seek to list internationally because they anticipate to gain from a lower cost of capital. This is due to greater availability of their stocks to foreign investors. Their access to these stocks may otherwise be restricted due to international investment barrier.

Answer 6A(iii)

As per Regulation 4 (1) of SEBI Listing Regulation, 2015, the listed entity shall abide by the following principles, while making disclosures to the stock exchanges or its website or through any other medium:

1. Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.
2. The listed entity shall implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and shall also ensure that the annual audit is conducted by an independent, competent and qualified auditor.
3. The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange and investors is not misleading.

4. The listed entity shall provide adequate and timely information to recognised stock exchange and investors.
5. The listed entity shall ensure that disseminations made under provisions of these regulations and circulars made thereunder, are adequate, accurate, explicit, timely and presented in a simple language.
6. Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by investors.
7. The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by the SEBI and the recognised stock exchange(s) in this regard and as may be applicable.
8. The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.
9. Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information.
10. Periodic filings, reports, statements, documents and information reports shall contain information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.

Answer 6A(iv)

Documents to be submitted on T+2 days for listing are as follows:-

— All due diligence certificates filed with SEBI by Merchant banker(s).

— Observation Letter issued by SEBI pursuant to filing of draft offer document.

— List of authorized signatories along with their specimen signatures.

— Confirmation from Lead Managers that devolvement notices have been sent to underwriters (applicable if the issue has devolved).

— Certificate from the BRLM(s) that the issue has received minimum subscription as specified under Regulation 45 (1) of SEBI (ICDR) Regulations, 2018.

— Confirmation from the company regarding the email ID for Investor Grievances as per Regulation 46 of SEBI (LODR), Regulations, 2015.

— Copies of all advertisements published in connection with the issue upto T+1 stage.

— Confirmation from the company stating that they have obtained authentication for SCORES from SEBI as per Regulation 13 of LODR, Regulations, 2015.

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MULTIDISCIPLINARY CASE STUDIES

Time allowed : 3 hours *Maximum marks : 100*

NOTE : *Answer ALL Questions.*

Question 1

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

Historically, the pharmaceutical industry has been a profitable one. Between 2002 and 2006, the average rate of return on invested capital (ROIC) for firms in the industry was 16.45%. Put differently, for every dollar of capital invested in the industry, the average pharmaceutical firm generated 16.45 cents of profit. This compares with an average return on invested capital of 12.76% for firms in the computer hardware industry, 8.54% for grocers, and 3.88% for firms in the electronics industry. However, the average level of profitability in the pharmaceutical industry has been declining of late. In 2002, the average ROIC in the industry was 21.6%; by 2006, it had fallen to 14.5%.

The profitability of the pharmaceutical industry can be best understood by looking at several aspects of its underlying economic structure. First, demand for pharmaceuticals has been strong and has grown for decades. Between 1990 and 2003, there was a 12.5% annual increase in spending on prescription drugs in the United States. This growth was driven by favourable demographics. As people grow older, they tend to need and consume more prescription medicines, and the population in most advanced nations has been growing older as the post-World War II baby boom generation ages. Looking forward, projections suggest that spending on prescription drugs will increase between 10 and 11% annually.

Second, successful new prescription drugs can be extraordinarily profitable. For example, Lipitor, the cholesterol lowering drug sold by Pfizer, was introduced in 1997, and by 2006 this drug had generated a staggering $12.5 billion in annual sales for Pfizer. The costs of manufacturing, packing, and distributing Lipitor amounted to only about 10% of revenues. Pfizer spent close to $500 million on promoting Lipitor and perhaps as much again on maintaining a sales force to sell the product. This still left Pfizer with a gross profit of approximately $10 billion. Since the drug is protected from direct competition by a twenty-year patent, Pfizer had a tempoerary monopoly and could charge a high price. Once the patent expired, in 2010, other firms were able to produce "generic" versions of Lipitor and the price fell substantially within a year.

Competing firms can produce drugs that are similar (but not identical) to a patent-protected drug. Drug firms patent a specific molecule, and competing firms can patent similar, but not identical, molecules that have a similar pharmacological effect. Thus, Lipitor does have competitors in the market for cholesterol lowering drugs, such as Zocor, sold by Merck, and Crestor, sold by AstraZeneca. But these competing drugs are patent protected. Moreover, the high costs and risks associated with developing a new drug and bringing it to market limit new competition. Out of every 5,000 compounds tested in the laboratory by a drug company, only five entered

clinical trials, and only one of these will ultimately make it to the market. On an average, estimates suggest that it costs some $800 million and takes anywhere from ten to fifteen years to bring a new drug to market. Once in the market, only three out of ten drugs ever recoup their R&D and marketing costs and turn a profit. Thus the profitability of the pharmaceutical industry rests on a handful of blockbuster drugs. At Pfizer, the world's largest pharmaceutical company, 55% of revenues were generated from just eight drugs.

To produce a blockbuster, a drug company must spend large amounts of money on research, most of which fail to produce a product. Only very large companies can shoulder the costs and risks of doing this making it difficult for new companies to enter the industry. Pfizer, for example, spent some $7.44 billion on R&D in 2005 alone, equivalent to 14.5% of its total revenues. It is a established fact that it is difficult to get into the pharma industry. Although a large number of companies were ranked among the top twenty in the industry in terms of sales in 2005, most failed to bring standard products to the market.

In addition to spending on R&D, the incumbent firms in the pharmaceutical industry spend large amounts of money on advertising and sales promotion. While the $500 million a year that Pfizer spends promoting Lipitor is small relative to the drug's revenues, it is a large amount for a new competitor to match, making market entry difficult unless the competitor has a significantly better product.

There are also some big opportunities on the horizon for firms in the industry. New scientific breakthroughs in genomics are holding out the promise that within the next decade, pharmaceutical firms might be able to bring to market new drugs that treat some of the most intractable medical conditions, including Alzheimer's, Parkinson's disease, cancer, heart disease, stroke, depression, anxiety, stress and AIDS.

However, there are some threats to the long-term dominance and profitability of industry giants like Pfizer. First, as spending on health care rises, politicians look for ways to limit health care costs, and there is likelihood of some forms of price control on prescription drugs. Price controls are already in effect in most developed nations, and although they have not yet been introduced in the United States, they could be.

Second, twelve of the thirty-five top-selling drugs in the industry lost their patent protection between 2004 and 2009. By one estimate, some 28% of the global industry's sales of $307 billion was exposed to generic challenge in the United States alone, due to drugs going off patent between 2006 and 2012. It is not clear to many industry observers whether the established drug companies have enough new drug prospects in their pipelines to replace revenues from drugs going off patent. Moreover generic drug companies have been aggressive in challenging the patents of proprietary drug companies and in pricing their generic offerings.

As a result, their share of industry sales has been growing. In 2005, they accounted for more than half by volume of all drugs prescribed in the United States, up from one-third in 1990.

Third, the industry has come under renewed scrutiny following studies showing that some FDA approved prescription drugs, known as COX-2 inhibitors, were associated

with a greater risk of heart attracks. Two of these drugs, Vioxx and Bextra, were pulled from the market in 2004.

Questions :

(a) Drawing on the Five Forces Model of Michael E. Porter, explain why the pharmaceutical industry has historically been a very profitable industry.

(b) There are apprehensions in the pharma industry that its profitability, measured by rate of return on invested capital (ROIC) may decline in the near future. Why do you think it may occur ?

(c) What are the prospects and opportunities for the pharma industry going forward? What are the threats that are discernible ?

(d) What must pharma industry do to exploit the opportunities ? What strategies should the industry adopt to counter the threats ? (10 marks each)

Answer 1(a)

Michael Porter Five Force Model

a. *Threat of new Entrants (low)*

The Intensity of this force is low as opening a new pharmaceutical company requires a huge capital investment. It is not possible for everybody to open a pharmaceutical company. Some of the factors that restrict to enter in pharmaceutical industry are as under:

— Product specialty or blockbuster drugs required

— High advertisement and sales promotion cost

— High research and marketing cost

— High manpower cost

— Risk associated with new product development i.e. less success rate in clinical trials, less probability of profitable product etc. As per study, out of every 5000 compounds tested in the laboratory by a drug company, only five entered clinical trials and one of these ultimately make it to the market. Also, three out of ten drugs ever recoup their R & D and marketing costs and turn a profit.

— In view of large amount of funds, few mega firms only enter into this industry.

b. *Bargaining power of suppliers (low)*

Generally, good manufacturing companies have their own research and development facilities, so for raw materials they are almost self-dependent. The companies who are depending on the outside suppliers, purchases the goods in quantity from the suppliers which reduces the bargaining power of suppliers.

c. *Bargaining power of Buyers (low)*

— Drugs are protected from direct competition by a twenty year patent. Being some of the giants had monopoly power in this industry; there is no option with the buyer to purchase the patented drugs, if prescribed by the medical practitioner.

— Consumption of more prescribed medicines.

— Branded, highly researched and quality products push up the buyers to purchase and redu the bargaining power of buyers.

d. *Threat of Substitutes (low to medium)*

— Generic version of medicine.

— The Intensity of this force is low to medium. Generic drugs companies have been aggressively challenging the patents of proprietary drugs companies and in pricing their generic offerings. As a result, their share of industry sales has been growing. In 2005, they accounted for more than half by volume of all drugs prescribed in United States up from one third in 1990. However, for patented drugs, no substitute is available as competing firm can patent similar molecule but not the identical.

e. *Competitive Rivalry (low)*

- In generic drugs, rivalry is high as compared to patented drugs. Because other companies can't manufacture those drugs as a specific molecule is patented.
- Competing Firms can produce drugs that are similar (but not identical) to a patent-protected drug.
- Drug firms patent a specific molecule, and competing firms can patent similar, but not identical molecules that have a similar pharmacological effect. Thus, Lipitor dose have competitors in the market for cholesterol lowering drugs, such as Zocor, sold by Merck, and Crestor, sold by AstraZeneca.
- On other side, once the patent of a particular drug is expired, other companies with patent of identical product or with generic product may enter into the market.

Answer 1(b)

The profitability of pharmaceutical industry can be best understood by looking at several aspects of its underlying economic structure. There are valid apprehensions in the pharma industry that its profitability, measured by rate of return on invested capital (ROIC) may decline in the near future as it come down from 21.6% in 2002 to 14.5% in 2006.. It may occur due to following reasons:

— Major concern of the politicians is to limit healthcare cost and to price control on prescription drugs.

— Many drugs going off the patent make revenues suffer. Company may lose the revenue due to drugs going of the patents. As per the estimate, twelve out of thirty-five top selling drugs lost their patent protection between 2004 to 2009.

— A long gestation period is required in bringing a new drug to the market. The estimates suggest that it takes 10 to 15 years to bring a new drug to the market.

— Threat of risk associated with the prescribed drugs with some disease as per the study conducted like GDA approved prescription drugs, known as COX-2 inhibitors, were associated with a greater risk of Heart attacks.

— High cost of research and development. A large number of pharma companies have failed to bring a standard product to the market. Only three out of ten drugs ever recoup their R & D and marketing costs and turn a profit.

— High costs and risks associated with developing a new drug and bringing it to market limits the competition. Out of 5000 compounds in the laboratory by a drug company, only five enter clinical trials, and only one of those actually reach the market.

— Promotion of generic drugs in Government hospitals

Answer 1(c)

Though the average level of profitability in the pharmaceutical industry has been declining over time (In 2002, the average ROIC in the industry was 21.6; by 2006, it had fallen to 14.5%), but still the pharmaceutical industry is generating high profits compare to other industry i.e. computer hardware 12.76%; Grocers 8.54%; Electronics 3.88%.

The prospect for the industry for going forward is very positive. Because the demand for pharmaceuticals has been strong and has grown for decades. Between 1990 and 2003, there was a 12.5% annual increase in spending on prescription drugs in the United States. This growth was driven by favorable demographics, i.e., longevity of life has increased in many developed as well as developing countries like India. Projections state that spending on prescription drugs will increase between 10% to 11% annually. As people grow older, they tend to need and consume more prescription medicines. Many new drugs need to be produced for ailments and diseases like Alzheimer's, Parkinson's, Cancer, heart disease, stroke, AIDS. Then there are health issues related to growing pollution – air, water, and noise pollution. Pollution is contributing a large number of deaths. Anxiety, stress, and other psycho-related prescription drugs can be extraordinarily profitable. High costs and risks associated with developing a new drug and bringing it to the market limit new competition.

There are, of course, threats to the pharma industry as well.

I. The government looks for ways to limit health care costs through some form of price control on prescription drugs. Price controls are already in effect in many countries – developed and developing ones, including India.

II. Renewed scrutiny : some approved drugs have been found to be associated with greater risk of heart attacks. Prescription drugs are always under scrutiny and can become redundant or undesirable, as research evolves.

III. To produce a blockbuster drug, a pharmaceutical company must invest large amount of money, most of which may fail to produce a product.

IV. There is the likelihood of sub-standard products being marketed by unscrupulous drug manufacturers.

V. Unethical practices by drug manufacturers to market their products is a big threat to the industry itself.

VI. Whistleblower policy offers generous incentives to employees of Pharam Company for revealing malpractices in their company. This also pose a great threat.

Answer 1(d)

— The Pharma industry must adopt multipronged steps to exploit opportunities. It has to adopt market segmentation strategy. It is especially required for small and specialized firms in the drug industry.

— The firms have to intelligently do product positioning.

— Unique molecule should be developed having similar pharmaceutical effect alike of competitor product.

— The firm have to work upon the new drugs prospects which helps to replace the revenue from drugs going up patents, especially in the new drugs which helps to cure the ailments like Alzheimer's, Parkinson's etc.

— On the R&D front, firms usually need to evaluate whether to perform R&D within the firm or to outsource.

The firm may adopt the following strategies:

Cost Leadership Strategy : The Industry needs to control the price of prescription drugs as the price controls are already in effect in most of developed nations but it is yet to be introduced in the United States. Cost leadership is only possible till the expiration of Patent. Simultaneously, the firms need to do the extensive research on the new drugs prospects to replace the revenues from drugs going off patent.

Product Differentiation Strategy : Industry can produce the good quality and well researched drugs which helps in differentiating it with the generic products. Industry should do the intensive research on the new drugs which helps to cure the most intractable medical conditions like Alzheimer's, Parkinson's disease, Cancer, heart disease, stroke, depression, and anxiety. Stress and AIDS.

Niche/ Focus Strategy : Industry should also focus on the various studies which shows that prescribed drugs are associated with serious health diseases like FDA approved prescription drugs, known as COX-2 inhibitors, were associated with a greater risk of heart attacks. These drugs or any such drugs should be pulled from the market on immediate basis.

Question 2

(a) Discuss :

(i) Whether the Companies Act, 2013 bars filing of a joint application for compounding of offence by a defaulting company along with its officers in default ?

(ii) Whether the Companies Act, 2013 bars filing of a joint application for compounding of the same offence committed in different years ?

(iii) Whether an offence punishable under the relevant provisions of the Companies Act, 2013 with 'imprisonment or fine', if repeated within a period of three years results into a mandatory imprisonment for the defaulters and whether the same can be compounded or not ? (6 marks)

(b) The legal principle is that coercive recovery proceedings cannot be initiated against a sick company.

Manmohan and Raj Kumar were guarantors to the loan obtained by a sick company. Recovery proceedings against them were initiated before the Debt Recovery Tribunal (DRT). They contended that recovery proceedings under the

Recovery of Debts Due to Banks and Financial Institutions Act, 1993 are to be treated as a suit and if the principal borrower is declared as a sick company, proceedings cannot lie or be continued against the guarantors. Will they succeed in getting protection under section 22A of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) ? Give reasons in support of your answer.

(6 marks)

Answer 2(a)(i)

The Companies Act, 2013 does not provides for any bar on filing of joint application for compounding of offence by a defaulting company along with its officers in default.

Section 441(1) of the Companies Act, 2013 provides that any offence punishable under this Act whether committed by a company or any officer thereof not being an offence punishable with imprisonment only, or punishable with imprisonment and also with fine, may, either before or after the institution of any prosecution, be compounded by

(a) the Tribunal; or

(b) where the maximum amount of fine which may be imposed for such offence does not exceed twenty-five lakh rupees, by the Regional Director or any officer authorised by the Central Government.

Answer 2(a)(ii)

In terms of the scheme envisaged section 441 of the Companies Act, 2013, there is no bar on preferring a single application for compounding the same offence committed during different financial years by the company and its officers, nor there do any bar on a joint application being made by a company along with its officers in default. Procedures are deemed to be permitted unless expressly prohibited. (*Rajendra Prasad Gupta* vs. *Prakash Chandra Mishra and Ors.* AIR 2011 SC 1137).

In absence of any specific bar of joinder of parties or joining of separate cause of actions in preferring a compounding application, joining of parties for same offence is permitted. Facts leading to any non-compliance under the Act on part of the company and its officers in default will be same, any suggestion to the contrary will only lead to multiplication of proceedings and different findings, which is not desirable.

Answer 2(a)(iii)

Section 451 of the Companies Act, 2013 provides that if a company or an officer of a company commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence.

However, according to section 441(6) of the Companies Act, 2013 any offence which is punishable with imprisonment only or with imprisonment and also with fine are not compoundable, but any offence which is punishable with imprisonment or fine, or with imprisonment or fine or with both, are compoundable.

Answer 2(b)

Supreme Court in the matter of KSL & Industries Ltd. v. Arkhangelsk Threads Ltd. & Others (2015) held that provisions of section 22 of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) will prevail over section 34 of the Debts Due to Banks and Financial Institutions Act, 1993 and had reiterated the legal principle that coercive recovery proceedings could not be initiated against a sick company.

The problem is based on the decision of Division Bench of Delhi High Court in the case of *Om Prakash Parasrampuria & Others* v. *Union of India & Others* decided on 3.3. 2016.

The Delhi High Court had in the instant case held that the word 'suit 'cannot be understood in its broad and generic sense to include any action before a legal forum involving an adjudicatory process. If that were so, the legislature would have made the necessary provisions in section 22 of the SICA.

The term 'suit' would therefore apply to proceedings in a Civil Court and not actions for recovery proceedings filed by the banks and financial institutions before a Tribunal such as the Debt Recovery Tribunal (DRT).

The proceedings against Manmohan and Raj kumar can continue.

Question 3

(a) The elder son of Prem Kumar Biswas was a truck driver with one Bidhan Chander Roy. He met with an accident while on his way to deliver consignment of the owner in the truck from Kolkata (West Bengal) to Lucknow (Uttar Pradesh). He sustained severe injuries on the head and died on the spot.

Prem Kumar Biswas filed for compensation under the Employees State Insurance Act, 1923 and the Commissioner allowed a compensation of Rs. 15,20,268. Aggrieved by the order, the Insurance company preferred an appeal before the High Court in Kolkata. One of the contentions of the insurance company was that the deceased lost his life as a result of his own negligence and that Prem Kumar Biswas was not entitled to any compensation.

There was no document on record to prove the exact amount of wages being earned by the deceased at the time of the accident. But it was proved that the deceased was a highly skilled workman and was often required to undertake long journeys outside the State in the line of duty. The vehicle he used to ply had a registred National Route Permit.

The High Court set aside the order of the Commissioner for workmen's compensation and reduced the amount of compensation to Rs. 11,00,000. Prem Kumar Biswas intends to prefer an appeal before the Supreme Court challenging the correctness of the impugned judgement of the High Court.

Will he succeed ? Give reasons in support of your answer. (6 marks)

(b) Ramesh Kumar and Jainendra Singh (respondants) had asked following information from RBI under the Right to Information Act, 2005 :

(i) Details of the reports pertaining to investigation and audit carried out by RBI and details of past 20 years investigation with respect to cooperative banks.

(ii) Details of the report sent by RBI to the Finance Ministry with respect to FEMA violations committed by several commercial banks.

(iii) Details of the inspection reports of apex cooperative banks.

(iv) Details of the loans taken by the industrialists that have not been repaid and about the names of the top defaulters who have not repaid their loans to public sector banks.

(v) Details of the show cause notices and fines imposed by the RBI on various banks.

RBI refused to provide the requisite information on the grounds of economic interest, commercial confidence, fiduciary relationships with other banks and the public interest.

Is the refusal by the RBI tenable ? Give reasons in support of your answer.

(6 marks)

Answer 3(a)

The present problem is similar to the case of *Jaya Biswas & Ors.* V *Branch Manager, IFFCO Tokio General Insurance Company Ltd. (SC)* – (Civil Appeal No. 869 of 2016(Arising out of S.L.P.(C) No.1903 of 2015 decided on 04/02/2016). In this case Supreme Court inter-alia observed that the Employees' Compensation Act, 1923 is a welfare legislation enacted to secure compensation to the poor workmen who suffer from injuries at their place of work. The Preamble of the Act reads, "An act to provide for the payment by certain classes of employees to their amount of compensation for injury by "accident". By increasing the importance for the employer of adequate safety devices, it reduces the number of accidents to workmen in a manner that cannot be achieved by official inspection.

The Act is a social welfare legislation meant to benefit the workers and their dependents in case of death of workman due to accident caused during and is the cause of employment. It has to be proved by the employee that

i. There was an accident
ii. The accident had a casual connection with the employment
iii. The accident must have been suffered in the course of employment.

In the instant case, the deceased was on way to deliver the consignment during the course of employment when he met with the accident. The accident squarely arose out of and in the course of employment. The contention of the insurance company that the deceased died as a result of his own negligence, doesn't hold ground. Section 3 of the Act, doesn't create any exception of the kind, which permits the employer to avoid his liability if there was negligence on the part of workman. The act does not envisage a situation where the compensation payable to an injured or deceased workman can be reduced on account of contributory negligence. Mere negligence does not entitle a workman to compensation.

There was no evidence to prove that there was negligence on the part of the driver. Even if there was any negligence on his part, it would not entitle his dependents from

claiming compensation under the Act. It can be said that the avail of compensation by the Commissioner was well reasoned and elaborate. The High Court should not have reduced the amount of compensation. It appears the judgement of the High Court suffers from gross infirmity.

In view of the above Prem Kumar Biswas should prefer an appeal before Supreme Court and should succeed.

Answer 3(b)

In the given case refusal by RBI is not tenable.

The given case is similar to the case of *Reserve Bank of India* vs. *Jayantilal n. Mistry* [SC]Transferred Case (Civil) No. 91 of 2015 (Arising out of Transfer Petition (Civil) No. 707 of 2012) along with batch of petitions [Decided on 16/12/2015]. In this case Supreme Court inter-alia held that in the instant case, the RBI does not place itself in a fiduciary relationship with the Financial institutions (though, in word it puts itself to be in that position) because, the reports of the inspections, statements of the bank, information related to the business obtained by the RBI are not under the pretext of confidence or trust. In this case neither the RBI nor the Banks Act in the interest of each other. By attaching an additional fiduciary label to the statutory duty, the Regulatory authorities have intentionally or unintentionally created and in terrorem effect.

RBI is a statutory body set up by the RBI Act as India's Central Bank. It is a statutory regulatory authority to oversee the functioning of the banks and the country's banking sector. RBI has been given powers to issue any direction to the banks in public interest, in the interest of banking policy and to secure proper management of a banking company. It has several other far-reaching statutory powers.

RBI is supposed to uphold public interest and not the interest of individual banks. RBI is clearly not in any fiduciary relationship with any bank. RBI has no legal duty to maximize the benefit of any public or private sector bank, and thus there is no relationship of 'trust' between them. RBI has a statutory duty to uphold the interest of the public at large, the depositors, the country's economy and the banking sector. Thus, RBI ought to act with transparency and not hide information that might embarrass individual banks. It is duty bound to comply with the provisions of the RTI Act, and disclose the information sought by respondents herein.

In the present case, we have to weigh between the public interest and fiduciary relationship (which is shared between the RBI and the Banks). Since, RTI Act is enacted to empower the common people, the test to determine limits of S. 8 of the RTI Act is whether giving information to the general public would be detrimental to the economic interests of the country? To what extent should the public be allowed to get information?

In the context of above questions, it had long since come to our attention that the Public Information Officers (PIO) under the guise of one of the exceptions given under S. 8 of RTI Act, have evaded the general public from getting their hands on the rightful information that they are entitled to.

And in this case the RBI and the Banks have sidestepped the general public's demand to give the requisite information on the pretext of "fiduciary relationship" and "economic interest". This attitude of the RBI will only attract more suspicion and disbelief

in them. RBI is a regulatory authority should work to make the banks accountable to their actions.

The ideal of 'Government by people' makes it necessary that people have access to information on matters of public concern. The free flow of information about affairs of Government paves way for debate in public policy and fosters accountability in Government. It creates a condition for 'open governance' which is a foundation of democracy.

Question 4

(a) A multiproduct company catering to applications in diverse sectors had borrowed from various financial institutions including Kundan Bank Ltd. A corporate debt restructure plan (CDR) was framed between 19 lenders and the company in 2014 and a master restructuring agreement (MRA) was made by which funds were to be infused by the creditors and certain obligations were to be met by the debtors. The aforesaid restructuring plan was implementable over a period of 2 years.

On 07-12-2016 Kundan Bank Ltd. made an application in which it was stated that the company being a defaulter within the meaning of the Insolvency and Bankruptcy Code, 2016, the insolvency resolution process ought to be set in motion. To this application, a reply was filed by means of an interim application on behalf of the company by the erstwhile Directors. It was claimed that there was no debt legally due in as much as vide two notifications issued under the Maharashtra Relief Undertakings (Special Provision Act), 1958 (hereinafter referred to as the Maharashtra Act), all liabilities of the appellant and remedies for enforcement thereof were temporarily suspended for a period up to 18-07-2017.

The company made a second application on 16-1-2017. It pleaded that owing to non-release of funds under the MRA, it was unable to pay back its debts.

Will the company succeed in its contentions ? Give reasons in support of your answer. (6 marks)

(b) CTVN and Channel 10 telecasted Mahabharat TV serial in dubbed form in Bangla language in the State of West Bengal. The co-ordination committee comprising film and TV entities in the State banned the telecast of the dubbed version of the serial contending that it was affecting the TV and film industry of the State. CTVN and Channel 10 intend to contest the ban before the Competition Commission of India.

Discuss whether :

(i) Activities in which the co-ordination committee indulged can be treated as 'agreement' for the purposes of section 3 of the Competition Act, 2002 and the Co-ordination Committee would be covered by the definition of 'person' under 2(l) of the Act ?

(ii) The act of banning of the TV serial amounts to violation of the provisionsof section 3(3)(b) of the Competition Act, 2002 ? (4+2=6 marks)

Answer 4(a)

On a bare reading of the judgement of *Innovative Industries Ltd.* Vs *ICICI Bank & another*, it seems that the case involved more adjudication on grounds related to Constitutional Law than on the Code. This case related to the first-ever application filed for initiating insolvency proceedings under the new Code. The Court was cognizant of the fact and hence wanted to settle the law so that all 'Courts and Tribunals take notice of the paradigm shift in the Law'.

The case involved contradictory provisions in the Code and a State law of State of Maharashtra, Maharashtra Relief Undertakings (Special Provisions) Act, 1958. This state law provided for overtaking of industries by the state by declaring them 'relief undertakings'. Such overtaking can be done through government notifications to that effect under the Act. This is done to protect employment of the people who are working in such an undertaking.

The Code instead provides for overtaking of an undertaking's business by an 'Insolvency Professional' through a committee of creditors. In the instant case, insolvency application was filed against Innoventive Industries Ltd. which later claimed to be a relief undertaking under the Maharashtra Act. This brought the two legislation on a collision course, for the simple reason that enforcement of one will hinder the enforcement of the other.

Supreme Court dealt with the constitutional law doctrine of repugnancy. This doctrine stems from the operation of Article 254 of the Constitution. As per this doctrine, whenever central and state laws are framed on the same subject and are contradictory to each other, it is the central law which prevails and the state law is rendered void.

A plain reading of Article 254 gives an impression that if both central and state governments frame laws on a same entry under the concurrent list, only then the Central law will prevail. In the instant case, however, the laws even though coming in conflict with each other, were framed under different entries of the concurrent list. This involved an adjudication by the Supreme Court on this point. The National Company Law Tribunal (NCLT) had ruled that Innoventive Industries Ltd. can't claim any relief under Maharashtra Act. It also decided that there is no repugnancy between the two laws, as they operate in different fields.

The appeal to the Supreme Court, hence involved two major questions. One was, whether the petitioner can seek relief under the Maharashtra Act at the cost of the Code. The second was, whether both the laws are repugnant to each other.

Invoking a lot of international cases, especially of the Commonwealth countries and previous Judgments of the Supreme Court, the bench ruled that there is indeed repugnancy between the two laws. The court held that even if the two legislations are framed on different entries of the concurrent list, the Central law will always prevail if it comes in conflict with the State law. The State law, therefore was held inoperable to the extent that it was in contradiction to the Code.

The court delved into great detail of the provisions of the Code and held it to be intended as an 'exhaustive legislation' by the Parliament, to cover the whole field of its operation. In such instances involving an exhaustive law, even though the State law may not be in strict violation of the code, it will even then be rendered inoperative to give way to implement the exhaustive law on the point.

Answer 4(b)(i)

The given case is similar to the case of *Competition Commission of India* v. *Co-ordination Committee of Artists and Technicians of W.B. Film and Television & Ors* [SC] Civil Appeal No. 6691 of 2014 [Decided on 07/03/2017].

An agreement referred to in Section 3 of the Competition Act, 2002 has to relate to an economic activity which is central to the competition law. Economic activity refers to any activity consisting of offering products in a market regardless of whether the activities are intended to earn a profit. The "agreement" or "concerned practice" is the means through which enterprise or association of enterprises or person or association of persons restrict competition. The functional approach and the corresponding focus on the activity, rather than the form of the entity may result in an entity being construed an enterprise when it engages in some activities, but when it engages in others. Non-profit making organizations or public bodies may of turn operate in their charitable or public activity but may be construed an undertaking when they engage in commercial activities. Coordination Committee, which is engaged in activities which are not charitable. It is engaged in economic activities on behalf of the film and TV artists. In action in banning the dubbed TV serial amounts to an "infringement" under the Competition Act, 2002.

The Commission Committee, which may be a "person" as per Section 2(l) of the Competition Act, 2002, is not undertaking any economic activity by itself. But the Commission Committee is an association of enterprises (constituent members) and these members are engaged in production, distributions, and exhibition of films. Thus the Commission Committee amounts to an "enterprise" or the kind of 'association of persons' as per the Section 3 of the Act.

Answer 4(b)(ii)

The act of the Commission Committee deprives the consumers of exercising their choice. Its act definitely caused harm to consumers by depriving them from watching the dubbed serial on TV channel. It also hindered competition in the market by barring dubbed TV serials from exhibition on TV channels in the State. Such acts or conduct also limit supply of serial clubbed in Bangla which amounts to violation of the provisions of Section 3(3)(b) of the Competition Act, 2002.

Question 5

(a) Ramakrishnan was employed by the Mukateshwara Silk Company Ltd. at its registered office in Mumbai in the dyeing section in the year 1988. He was later on promoted in 1992 and again in 2000 and continued to be located at the company's registered office in Mumbai. The company in its orders of transfer located Ramakrishnan at the company's establishment in Panjim (Goa) in 2005 and again transferred him at company's another establishment in Jamnagar (Gujarat) in 2006. However, Ramakrishnan's services, were terminated in 2007 due to the closure of the establishment in Jamnagar.

Aggrieved by the order of termination Ramakrishnan intends to institute a suit in the Labour Court in Mumbai under the Industrial Disputes Act, 1947. Will he succeed ? Give reasons in support your answer. (6 marks)

(b) Robert Steel Tube Co. Ltd. had applied for allotment of 2500 acres of land on

30-6-1994 and in principle approval of allotment of 2500 acres of land was given on the terms and conditions laid down in the policy decision of the State Government as revised on 25-1-1995 for the establishment of the steel plant. Robert Steel Tube Co. Ltd. deposited Rs. 1.25 crores with the Haryana Industrial Development Corporation Ltd. (Corp.) on 3-4-1995 and took possession of 1756.29 acres of land in the first phase in 1996. However, the company did not execute the lease deed with the Corporation. Ultimately, on 25-7-2003 on failure to get the lease deed executed, the land was resumed and possession letter of 1756.29 acres of land was cancelled by the Corporation. The amount of Rs. 1.25 crores deposited by the company was forfeited and adjusted towards compensation for use and occupation of the land and damages.

Out of the resumed land, the Corporation allotted 934.31 acres of land to other units. Robert Steel Tube Co. Ltd. made unsuccessful representations to the Corporation for allottment. Thereafter, the company filed a writ petition before the High Court for allotment of the balance land of 821.98 acres to it.

Will the company succeed in its petition against the Corporation ? Give reasons in support of your answer. (6 marks)

Answer 5(a)

The fact of the case is similar to the case of *Nandram* vs. *Garware Properties Ltd (SC) Civil Appel No. 1409 of 2016 (Arising out of SLP (C) No. 33917 of 2011) [Decided on 16/02/2016].*

Ramakrishnan was employed at the office in Mumbai. He was only transferred to its establishment in Jamnagar. The decision to close down the establishment at Jamnagar was taken by the company in Mumbai. The decision to terminate the services of Ramakrishnan was taken in Mumbai. Thus, part of cause of actions has arisen in Mumbai. No doubt, the Labor Court in Jamnagar has the jurisdiction to consider the case of Ramakrishnan if he prefers to institute the suit there.

But that does not mean that the Labor Court in Mumbai within whose jurisdiction the management of the company has taken the decision to close down the establishment in Jamnagar and pursuant to which services of Ramakrishnan were terminated does not have the jurisdiction.

Hence, both the Labor Courts in Mumbai and Jamnagar have the jurisdiction to deal with the matter.

Ramakrishnan can institute the suit in the Labor Court in Mumbai.

Answer 5(b)

The fact of the case is similar to the fact of *Orissa Industrial Infrastructure Development Corporate* vs. *M/S MESCO Kalinga Steel Limited and Others* (With CA No. 2546 /2017 (@ SLP (C) No. 23759/2007 and CA No.2547/2017 (@ SLP (C) No.2683/ 2008)).

In this matter, the possession of land had been enjoyed by the company for around seven years without execution of the lease deed. No explanation has been placed on record for inaction on part of the company. In this regard, the company has also not

been able to prove that they were not negligent even after the timely initiation by the authorities for the execution of the lease dead with the Corporation.

The transfer had become void due to the company's own lapse and negligence. The company had forfeited the right to get the lease deed executed, as in the absence of execution of lease deed, the relationship of lessor and lessee never came into being under the legal perspectives.

The company waited for years after taking possession. The company is statutory authority – and it can act on the basis of written lease deed. The execution of the lease deed is necessary and it is in the public interest to prevent unauthorized leasing out of property on its behalf.

Lease is required to be executed in a presented format in the shape of formal development which is a sine quo non as per the law of the land. In the absence thereof, it would not be permissible to hold the relationship of lessor and the lessee.

The corporation is a statutory body and can act only in the mode prescribed. Further, one has to be aware of the fact that ignorantia legis neminem excusat, means Ignorance of Law is no excuse.

In this paradigm, the company should be aware of the legal procedure prost the allotment of the land and should be ready to accept the consequences for ignoring the required process of the law to be observed by them

The conduct of the company was not in line with the compliances and responsibilities required to be adhered under law, as it remained negligent in execute the lease deed. There was no contract which could have been enforced and it became void due to inaction of the company itself. The conduct of the company had no justification at any point of time not to execute the lease deed.

Henceforth, there is no equitable or legal consideration in favor of the company, wherein they could succeed in its petition against the Corporation.

Question 6

Luke Graves (Luke) is the long-serving Chief Executive Officer (CEO) of Hornbill plc, a UK listed company. He had a meeting with the newly-appointed Chairman of the company, Ross Plank (Ross), who is married to Luke's sister. A number of different items were on the agenda for discussion. Luke said that he had recently had a meeting with two institutional shareholders in the company, who together held 5% of the equity shares. He had also discussed the company's performance over the past few months with them and they had been pleased by the profit forecasts that he had given them. The company's results would be announced to the stock market within the next two weeks. Luke added that he had also discussed the company's main business strategies with these shareholders and had informed them that he intended to establish a strategy committee within the company, consisting of the executive directors and other senior executives. Luke and Ross later on discussed the retirement and re-election of Board of Directors at the next annual general marketing of the company. Luke said there was an issue with John, one of the directors, who would be retiring by rotation. John had been an independent non-executive director for almost nine years. He was very experienced and had contributed enormously while attending meetings of the Board. He was considered

to be too valuable to lose from the Board, but there was now a problem with his independent status. Luke felt that he was still as independent now as he was when he first joined the Board. Luke also informed Ross that he had arranged for additional training for two Board directors : one of the non-executive directors and also the marketing director.

(a) On the basis of above-mentioned facts, what weaknesses are discernible in the corporate governance practices of the company ?

(b) What would be your recommendations and suggestions regarding the appropriate practices to be followed on the weaknesses identified by you ? (6 marks each)

Answer 6(a)

On the basis of the facts of the case, following weaknesses in corporate governance are evident in Hornbill plc:

- The newly-appointed Chairman Ross Plank is brother-in-law of the CEO Luke and therefore has a close family connection with an existing board member. The Chairman cannot, therefore, be considered independent on appointment. The fact that the Chairman is non-independent and the relationship of Chairman and CEO should be disclosed in the annual report of the company.
- Luke, the CEO has disclosed price sensitive information i.e. the company's performance over the past few months and profit forecasts with the institutional shareholders before they have been announced to the stock market. Thus, Luke has violated stock market regulations by giving financial information to the shareholders that has not been made publicly available. If the institutional shareholders trade shares in the company before the announcement of the annual results, they would be liable for insider trading. Therefore, the institutional shareholders must be informed that they are insiders and should not deal in shares of the company until the information becomes public knowledge. The board should also discuss and consider the breach of rules and discourse of price sensitive information by Luke.
- The objective of establishing Strategy Committee comprising of executive directors and senior executives is also not clear. It is the responsibility of the board of directors to decide business strategy, and the executive management should implement those strategies decided by the board. Here, it is not clear what Luke means by establishing a strategy committee, but it should not be for the purpose of deciding strategies.
- It is also observed that, the CEO is taking on too many roles outside his proper area of responsibilities and there is a risk that the board of the company will be dominated by a single individual. This risk is increased because of the family connection between the CEO and the Chairman.

Answer 6(b)

Some of the recommendations and suggestions regarding the appropriate practices to be followed are-

- The Chairperson of the board is the individual charged with providing the board with effective leadership on all aspects of its role and setting its agenda. While

the chairperson is required to retain an objective viewpoint of the affairs of the company, the CEO is often required to become intimately involved in developing and executing management plans for the company. CEO's main responsibilities include developing and implementing high-level strategies, making major corporate decisions, managing the overall operations and resources of a company, and acting as the main point of communication between the board of directors and the corporate operations. This role clarity should be there among the Chairman Ross and CEO Luke in this case.

- The independence of the chairman is paramount to the successful implementation of good corporate governance practices at board level. Therefore, as a good governance, chairperson of the board should be independent and free of conflicts of interest at appointment.
- Collective decision making and discussions among the Board is also missing in the Company. It would have been appropriate for Luke to discuss his intentions to establish a strategy committee with the board colleagues before announcing them to a few shareholders. The board as a whole should be responsible for deciding strategy and for deciding whether any new board committee should be set up.
- The Nomination and Remuneration Committee should consider the selection and re-appointment of Directors and makes its recommendation to the Board. It should assess the current Board's skills, experience and expertise to identify the skills that would best increase Board effectiveness.
- The responsibility for selection and appointment of directors should be done by the Nomination and Remuneration Committee and the CEO Luke should not try to influence the Chairman of the board regarding appointment or selection of any particular director.
- The Chairman or the Nomination and Remuneration Committee should make policy for the induction and training of directors, particularly Non-Executive Directors, although the task of arranging induction and training may be delegated to the company secretary. The CEO may arrange technical training for another executive directors.

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BANKING – LAW & PRACTICE

(Elective Paper 9.1)

Time allowed : 3 hours *Maximum marks : 100*

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

Question 1

Case Study :

The accounting system followed by the banks in India, differs from the general accounting system followed by companies and other business entities. Nevertheless, all banks are required to prepare and present their Annual Financial Statements as per specified formats in compliance with the provisions of Banking Regulation Act (B.R. Act), the Companies Act, RBI directions and the ICAI Accounting Standards. Banking Companies are required to provide a statement of all the accounting policies followed in preparing these financial statements and also required to comply with disclosure/additional disclosure requirements as advised by Reserve Bank of India (RBI) from time to time relating to capital, lendings and others.

Like any other business entity banks also follow the mercantile system of accounting. However there is a slight difference in the methodology followed by banks when compared to other commercial entities. The reason of difference is that the banks are entering the transactions of customers first, in ledgers (which are subsidiary books under conventional accounting) rather than in Journals. This is so because, accounts of customers which are maintained in ledgers should be accurate and must be free from errors so that accuracy is being maintained as to the transactions.

Financial Statements of banking companies are an important source of information for a variety of stakeholders. These financial statements are prepared after an extensive compliance with the directions and guidelines issued by RBI and other regulatory authorities, and therefore, contain a treasure of useful information. One should necessarily focus on :

- *Requirements regarding accounts and audit of banking companies.*
- *Features of accounting system of banks.*
- *Books of account of banks.*
- *Presentation and formats used for financial statements.*
- *Accounting treatment of various items.*
- *Disclosure requirements.*

Sections 29 to 34A of the B.R. Act deal with the accounts and audit of banking companies.

Section 29 of the B.R. Act casts a responsibility on every banking company incorporated/operating in India which are involved in transacting the business of banking through its branches, prepare and submit Balance Sheet and Profit & Loss Account for the financial year in the specified formats set out in III-schedule of the

Act as on the last working day of that financial year. Such Balance Sheet and P&L Account should be signed by the manager or the principal officer and at least by three directors, if there are more than three directors and if only three directors then all of them should sign the same. However, for a foreign bank operating in India, the manager or principal officer of the concerned bank should sign these statements. The central government has the powers to amend the formats of Balance Sheet and P&L Account as given in section 29 of B.R. Act and thereafter the banks are required to prepare the financial statements in these formats only.

According to section 30 of the B.R. Act, the Balance Sheet and P&L Account prepared are to be audited by a duly qualified person as per applicable law for the time being in force without prejudice to anything contained in the Companies Act or any other law for the time being in force. Where the Reserve Bank of India is of opinion that it is necessary in the public interest or in the interest of the banking company or its depositors so to do, it may at any time by order direct that a special audit of the banking company's accounts, for any such transaction or class of transactions or for such period or periods as may be specified in the order, shall be conducted by the same or by a different auditor. The RBI may either appoint a person duly qualified under any law for the time being in force to be an auditor of such banking company or direct the auditor of the banking company to conduct such special audit and the auditor shall comply with such directions and make a report of such audit to the Reserve Bank of India and forward a copy thereof to the banking company too.

As per section 31 of the B.R. Act, every banking company has to submit three copies of annual accounts consisting of Balance Sheet along with P&L Account prepared in accordance with section 29 of B.R. Act together with Auditor's Report to RBI within three months from the end of the period to which they relate. In the case of Regional Rural Banks (RRBs), they shall furnish the Balance Sheet and P&L Accounts to NABARD instead of RBI.

Under section 32 of the B.R. Act, a banking company (not other types of banking entities) has to submit three copies of Balance Sheet and P&L Account to the Registrar of Companies when it submits the same to RBI. Such banking company, also within a period of six months from the date of accounts and Auditors' Report, publish the same in a newspaper which is widely circulated where the banking company has its principal place of business. This compliance has to be done according to Banking Companies Regulation (Rules), 1949. As per section 33 of the B.R. Act, in the case of foreign banks operating in India required to display a copy of audited accounts and Balance Sheet at a clear place in their notice board for public display. This has to be done before 1st Monday in the month of August every year.

Banks have to maintain a 'Regulatory Disclosure Section' on their website, where all the information relating to disclosures will be made available to the market participants.

Bank which have been listed on stock exchanges in India and abroad have to comply with terms of SEBI (LODR) Regulations, 2015 including reporting and other compliances regulations in a timely manner failing which they would be facing penal action including fines. Disclosures related to individual banks within the groups would not generally be required to be made by the parent bank.

In order to encourage market discipline, Reserve Bank of India has over the years

developed a set of disclosure requirements, which allow the market participants to assess the key points of information on capital adequacy, risk exposure, risk assessment provisions and key business parameters to provide a consistent and understandable disclosure framework that enhances comparability. Banks are also required to comply with the Accounting Standard-1 (AS-1) on 'Disclosure of Accounting Policies' issued by the Institute of Chartered Accountants of India (ICAI). The enhanced disclosures have been achieved through the version of Balance Sheet and Profit & Loss Account of banks and enlarging the scope of disclosures to be made in 'Notes to Accounts'. As a standard practice to bring in uniform reporting 'Summary of Significant Accounting Policies' and 'Notes to Accounts' are to be shown in Schedule 17 and 18 by banks. RBI through its Master Circular No. : RBI/ 2015-16/99 DBR.BP.BC.No. 23/21.04.018/2015-16 dated July 1, 2015 has provided detailed guidelines in this regard.

In the backdrop of the above you are required to give answer to the following :

(a) Banks in India prepare their Annual Financial Statements as per specified formats. Explain where such formats have been prescribed for the banks to prepare their annual statement of accounts. Also explain the 'Act' which have a bearing on financial statements of banks ? (6 marks)

(b) State the principal books of accounts which are being maintained by banks in India. In what respects the balance sheet of a bank is different from Balance Sheet of a company. (8 marks)

(c) What are the particulars of Liabilities and Assets to be provided in the Balance Sheet of a Bank as being prescribed under the Banking Regulation Act ?

(6 marks)

(d) As a standard practice to bring in uniform reporting 'Summary of Significant Accounting Policies' and 'Notes to Accounts' are to be shown in Schedule 17 and 18 by banks. What are being required under major disclosure ? Also state the mandatory requirements of SEBI (LODR) Regulations 2015 which the banks have to comply relating to listing of securities on stock exchange. (8 marks)

(e) (i) What are the items to be adjusted before disclosing Net Profit in the Profit and Loss Account of a bank ? (4 marks)

(ii) Financial Statements of Banking Companies are an important source of information for a variety of stakeholders. Who are such stakeholders and why they need such statements ? (4 marks)

(iii) Explain how the bank manages the economic risk due to fluctuations in the forex market. (4 marks)

Answer 1(a)

A banking company being a body corporate has statutory obligation to present annual financial statements in terms of formats prescribed under the Companies Act, 2013 / Banking Regulation Act, 1949 (BR Act, 1949). The Banks, under the Banking Regulation Act, 1949 have to prepare and submit Balance Sheet and Profit & Loss account for the

financial year, in the specified formats – Form A & Form B. RBI has also notified detailed guidelines in this regard including disclosure norms.

Section 29 of the BR Act, 1949 casts a responsibility on every Banking company incorporated/operating in India which are involved in transacting the business of banking through its branches, prepare and submit Balance Sheet and Profit & Loss account for the financial year, in the specified formats set out in the III Schedule of the Act, as on the last working day of that financial year. The central government has the powers to amend the formats of Balance Sheet and P&L as in Section 29 of the BR Act, 1949.

The BR Act, 1949, the Companies Act, 2013, RBI directions, ICAI Accounting Standards and other applicable provisions have a bearing on the Financial Statements of the Banks. The Central Government has also the power to appoint the management, the Board of the Directors and also have power to issue directions.

Besides these regulatory provisions having bearing on the financial statements of banks the norms of disclosure of accounting policies and the Notes on accounts indicating how the figures have been arrived at in the balance sheet also plays a vital role.

Such balance sheet and P&L account should be signed by the Manager or the Principal Officer and at least three directors if there are more than three directors and if only three directors are then all of them should sign the same. For a foreign bank operating in India, the Manager or Principal Officer of the concerned bank should sign.

Answer 1(b)

(i) The following books of accounts are mainly maintain by Banks in India:

(a) Ledgers of Savings Bank, Current Account, Cash credit, Loans, FD Accounts, Recurring Deposit Accounts, Investment Ledgers, Bill discounted/ purchase (Inland & Foreign) etc.

(b) Registers for collection (inland & foreign), cash, clearing, Safe deposit lockers, DD/Pay order issued, DD's paid, Bank Guarantee issued, Bills Margin, LC issued, Clearing cheques returned, NEFT/RTGS issued etc. Pension payment, PPF accounts, Demat accounts, etc.

(c) Registers for P& L heads, Suspense account etc.

(d) General Ledger

(e) Cash book/Day Book

(f) P& L registers.

Note: There are differing practices among banks in maintaining registers for various heads of accounts. However under Core Banking Principal books of account are maintained in different software modules.

(ii) Under the Companies Act, 2013, a company has to prepare and submit financial statements as per Schedule III of the Act. However banks under the Banking Regulation Act, 1949 have to prepare and submit their Balance Sheet, Profit & Loss Account in specified formats – Form A and Form B. RBI has also notified detailed guidelines in this regard in respect of these including disclosure norms.

Answer 1(c)

FORM A - Form of Balance Sheet Under BR Act

Balance sheet of Bank xxx

Balance sheet as on 31st March 20.....(Year)

Particulars	*Schedule*	*As on 31-3-20xx (current year)*	*As on 31-3-20xx (previous year)*
Liabilities			
Capital	1		
Reserve and surplus	2		
Deposits	3		
Borrowings	4		
Other liabilities and provisions	5		
Total		**xxx**	**xxx**
Assets			
Cash and balances with RBI	6		
Balance with banks and money at calls & short notice	7		
Investments	8		
Loans & Advances	9		
Fixed assets	10		
Other assets	11		
Total		**xxx**	**xxx**

Schedule 12. Contingent liabilities

Answer 1(d)

As per RBI's directions banks should disclose the accounting policies regarding key areas of operations at one place (under Schedule 17) along with 'Notes to Accounts' in their financial statements. A suggestive list includes:

- Basis of Accounting, Transactions involving Foreign Exchange, Investments – Classification, Valuation, etc. Advances and Provisions thereon, Fixed Assets and Depreciation, Revenue Recognition, Employee Benefits, Provision for Taxation, Net Profit, etc.

Mandatory Requirements of listing of banks on Stock Exchange as to the composition of the Board of Directors, Composition and quorum of the Audit Committee, Non-

Executive Directors compensation, the appointment, re-appointment of the Statutory Auditors and fixation of their fees and also to have the following committees under various regulations of SEBI (LODR) Regulations 2015:

i. Stake holder Relationship Committee

ii. Risk Management Committee

iii. Nomination & Remuneration Committee

All listed banks for the purpose of disclosures as per SEBI (LODR) Regulations comply with the regulations 30,31A,33,34,35,51,52 and 62 relating to website.

The banks are also required to have vigil mechanism as per regulations 22 and sound system of corporate governance as per regulations 24 and 27 as well as a grievance redressal mechanism required under regulation 13 of SEBI (LODR) Regulations 2015.

Answer 1(e)(i)

The net profit disclosed in the Profit and Loss Account after:

(i) Provisions for taxes on income, in accordance with the statutory requirements,

(ii) Provisions for doubtful advances

(iii) Adjustments to the value of "current investments" in government and other approved securities in India, valued at lower of cost or market value,

(iv) Transfers to contingency funds and other usual or necessary provisions.

Answer 1(e)(ii)

Employees, Management ,Depositors, Borrowers, Investors, Academics, Research bodies, Economists, Analysts, Regulatory Authorities/ Bodies, Students are the stake holders in general of the financial statement of Banking Company.

The Financial statements are being used by the stakeholders and the regulatory authorities to find out the performance and operations of the bank as well as quality of assets and for assessing the financial health of the banks.

Answer 1(e)(iii)

Economic risk refers to unfavorable economic conditions in buyer or seller's country which may affect both parties in fulfilling their obligation on the buyer side, economic risk may result in buyer's insolvency or inability to accept the goods and services. On the other hand the seller may experience difficulty in providing or supplying the goods.

Once the bank recognizes its risk relating to economic risk because of dealing in forex it can be reduce it with the help of the following tools: forecast, risk estimation, benchmarking, hedging, netting, matching, leading and lodging, stop loss, reporting and review.

Question 2

(a) State in brief the factors attributing to the increased importance of credit risk modelling in the banks. (4 marks)

(b) Explain the various types of 'Market Risk' involved in banking business.

Differentiate between 'Counter Party Risk' and 'Country Risk'. *(8 marks)*

Answer 2(a)

The increasing importance of credit risk modeling can be attributed to the following three factors: ·

1. Banks are becoming increasingly quantitative in their treatment of credit risk.
2. New markets are emerging in credit derivatives and the marketability of existing loans is increasing through securitization / loan sales market.
3. Regulators are concerned to improve the current system of bank capital requirements especially as it relates to credit risk.

Credit Risk Models have assumed importance due to the fact that they provide the decision maker with insight or knowledge that would not otherwise be readily available or that could be obtained at a high cost. In a marketplace where margins are fast disappearing and the pressure to lower pricing the credit risk models give their users a competitive edge.

Answer 2(b)

Types of Market Risk involved in banking business are as under :

Interest rate risk : Interest rate risk is the probability that variations in the interest rates will have a negative influence on the quality of a given financial instrument or portfolio, as well as on the institution's condition as a whole. The risk affects the Net Interest Margin (NIM).

Currency risk : Currency risk is the risk where the fair value or future cash flows of a given financial instrument fluctuate as a result from changes in the currency exchange rates.

Price risk : Price risk occurs when the fair value or future cash flows of capital and debt financial instruments (stocks, bonds, indexes and derivatives connected with them) fluctuate as a result from market prices' changes, no matter whether these changes are caused by factors typical for individual instruments or for their issuer (counterparty), or by factors related to all the instruments traded on the market. It arises if investment is sold prematurely.

Default or Credit Risk : Credit risk is more simply defined as the potential of a bank borrower or counterparty to fail to meet its obligations in accordance with the agreed terms. For most banks, loans are the largest and most obvious source of credit risk. It is the most significant risk, more so in the Indian scenario where the NPA level of the banking system is significantly high. It is prevalent in case of loans.

Operational Risk : It arises due to failed internal processes, people or system or from external events like, frauds, incompetency of staff, faulty documentation, non-compliance etc.

Strategic Risk : This risk arises due to adverse business decisions, improper implementation of decisions.

Counterparty Risk and Country Risk

Counterparty Risk : This is a variant of Credit risk and is related to non-performance of the trading partners due to counterparty's refusal and or inability to perform. The counterparty risk is generally viewed as a transient financial risk associated with trading rather than standard credit risk.

Country Risk : This is also a type of credit risk where non-performance of a borrower or counterparty arises due to constraints or restrictions imposed by a country. Here, the reason of non-performance is external factors on which the borrower or the counterparty has no control.

Question 3

(a) A customer approached you as bank on 1st January, 2018 for sale to him :

(i) US Dollar 2,00,000 delivery on 31st March, 2018

(ii) US Dollar 1,00,000 delivery on 30th March, 2018

Assumptions to be taken as to Rate and Margin :

— Spot interbank 66.5000/5100

— Forward premia January 0.1350/0.1450

February 0.3050/0.3150

March 0.5500/0.5600

April 0.7700/0.7800

— Exchange margin @ 0.125%.

Calculate the rates to be quoted to the customer by the bank. Take last two digit in the multiples of 25. (6 marks)

(b) Explain and narrate all those important factors having influence on forex markets movements more frequently. (6 marks)

Answer 3(a)

(1) The Importer customer approached on 01.01.2018 for buying of US $ 2,00,000 delivery on 31st March, 2018.

Sport interbank rate	Rs. 66.5100 (being import sale)
Add : Premium up to 31.03.2018	0.5600
	67.0700
Add : Exchange margin @ 0.125%	0.0838
	67.1538

Rounded off to Rs. 67.1550

(2) US $ 1,00,000 delivery on 30th March, 2018

Sport interbank rate	Rs. 66.5100
Add : Premium up to 30.03.2018	0.5600
	67.0700
Add : Exchange margin @ 0.125%	0.0838
	67.1538

Rounded off to Rs. 67.1550

The rates to be quoted by the bank for USD 2,00,000 @ 67.1550 and US $ 1,00,000 @ 67.1550.

Answer 3(b)

The factors that influence the forex markets measurement are:

Foreign Exchange Rates - Fundamental factors

(i) *Balance of Payments* - Surplus leads to a stronger currency while a deficit resulting to weakening of a currency.

(ii) *Economic Growth Rates* - Rise in value of imports leads to a fall in the currency and vice- versa.

(iii) *Monetary Policy* - The way Central bank attempts to influence and control interest rates and money supply.

(iv) *Interest Rate* - High interest rate attracts overseas capital and appreciates currency in short run, in the longer term, however high interest rates slow the economic growth, thus weakening the currency.

Foreign Exchanges Rates - Technical factors

(v) *Governance Government Control* - This can lead to unrealized value of currency resulting in violent exchange rate.

(vi) *Speculation* - Speculative forces can have a major effect on exchange rates.

Alternative Answer 3(b)

1. *Interest Rate Differentials* : Higher rate of interest for an investment in a particular currency can push up the demand for that currency, which will increase the exchange rate in favour of that currency.
2. *Inflation Rate Differentials* : Different countries' have differing inflation rates, and as a result, purchasing power of one currency may depreciate faster than currency of some other country. This contributes to movement in exchange rate.
3. *Government Policies* : Government may impose restriction on currency transactions. Through RBI, the Government, may also buy or sell currencies in huge quantity to adjust the prevailing exchange rates.
4. *Market Expectations* : Expectations regarding change in Government, change

in taxation policies, foreign trade, inflation, etc. contribute to demand for foreign currencies, thereby affecting the exchange rates.

5. *Investment Opportunities* : Increase in investment opportunities in one country leads to influx of foreign currency funds to that country. Such huge inflow will result into huge supply of foreign currency, thereby bringing down the exchange rate of the concerned country.

6. *Speculations* : Speculators and Treasury Managers influence movement in exchange rates by buying and selling foreign currencies with expectations of gains by exploiting market inefficiencies. The quantum of their operations affects the exchange rates.

Question 4

(a) What are the popular types of mortgages obtained by a banker ? How the mortgage(s) is/are enforced by the bank ? Cite the relevant provisions of the Banking Regulation Act or of Code of Civil Procedure as applicable. (6 marks)

(b) Differentiate between 'pledge' and 'hypothecation' of goods as security. Which mode of security would a banker prefer ? (6 marks)

Answer 4(a)

Popular types of mortgage and their enforcement by the bank are under:

i. Mortgage by deposit of title deeds (Equitable Mortgage)

ii. Simple mortgage

iii. English mortgage

Enforcement of all these types of mortgages is by way of filing a suit for sale of mortgaged properties. The procedure for filing a suit for a sale is provided for in the Code of Civil Procedure, 1908. The Section 16(c) of the Civil Procedure Code provides that a suit for sale of mortgaged property shall be filed in the Court within whose jurisdiction the mortgaged property is situated. Order 34 of the Civil Procedure Code provides for various things to be adhered to while filing suit for sale of mortgaged property. When a suit for sale is filed, the Court after hearing the parties passes a preliminary decree. Through the preliminary decree it directs the mortgagor to pay the mortgage debt within a certain period and in the event of his failure to pay the money due under the mortgage, the Court orders for sale of mortgaged properties by passing a final decree. After passing of the final decree, the mortgagee with the help of the Court gets the mortgaged property sold in execution of the mortgage decree.

Answer 4(b)

Difference between Pledge and Hypothecation

Pledge : Section 172 of Indian Contract Act, 1872 defines pledge, as a bailment of a debt or performance of a promise. In pledge, there is actual or constructive delivery of goods by the pledger to the pledgee for securing a debt. At times pledge may be created by a pledger handling over the key to a godown containing the goods or giving a documents to tittle to the goods duly endorsed in favour of the pledgee. The nature of

charge is fixed. The contract Act gives the pledgee the right to sell the goods if the pledgor fails to repay the debts by giving reasonable notice. At the same time the pledgee has a duty to return the goods to the pledgor once the debt is repaid. The ownership of security is with borrower and possession is with bank till repayment of the loan. Bank has to take care of the security and return the same if loan is repaid. No registration of charge with ROC required. Limitation period is not applicable. Parties are - Pledger / Pawner (borrower) and Pledgee / Pawnee (Bank).

Hypothecation : Defined in SARFAESI Act 2002 (section 2n) as charge on movable property in favour of secured creditor without delivery of possession. Nature of charge is equitable. Hypothecation refers to pledging property as security or collateral for a debt without transfer of the tittle or possession. By its very nature, nature banks run a high risk in hypothecation. Hence the facility is generally given to borrower whose integrity is beyond doubt. Sometimes the borrower may hypothecate the same stock to several banks and obtains multiple finance. Registration with ROC under section 125 of Companies Act, 2013 is required. Limitation period is 3 years. Both possession and ownership is with borrower. Parties – Hypothecator (borrower) and Hypothecatee (bank).

As a banker pledge is more preferred as a security than the hypothecation. But practically in banking industry maximum advances are granted under hypothecation and very rarely the advances are granted under pledge.

As a banker, pledge is more preferred as a security than hypothecation.

Question 5

(a) Explain the following terms with reference to 'Bonds' :

(i) Coupon rate

(ii) Yield to Maturity

(iii) Redemption value. *(3 marks)*

(b) Based on the behaviour of the bond market, a set of theorems for bond valuation has been developed. State briefly these theorems used for the purpose of bond valuation. *(9 marks)*

Answer 5(a)

Terms with reference to Bonds

i. *Coupon Rate* : The interest rate on the debt security is termed as coupon rate. (stated interest rate on a fixed income security / specified interest rate on a fixed maturity security which is fixed at the time of issue).

ii. *Yield to Maturity* : It represents the overall return on a debt security if it is retained till maturity with an assumption that all interest payments will be reinvested at the current yield on the security. It represents the total income one can receive on a debt security say a bond. (It is the theoretical internal rate of return earned by an investor who buys the bond today at the market price, assuming that the bond will be held till maturity and that all coupon and principal payments are made on schedule).

iii. *Redemption value* : The maturity value that a debt security holder (bond) may get. It may be at par value, at premium (higher than par value) or at a discount (less than par value).

Answer 5(b)

Theorems for Bond Value

Based on the behavior of the bond market a set of theorems for bond valuation has been put forward by some authors. The theorems are as under:

1. When the required rate of return ('r') is equal to the coupon rate the value of the bond is equal to the par value.
2. When the required rate of return is greater than its coupon rate the value of the bond will be less than its par value.
3. When the required rate of return is less than the coupon rate the value of the bond will be greater than its par value.
4. When the required rate of return is greater than coupon rate the discount on the bond decreases as it approaches maturity.
5. When the required return is less than coupon rate the premium on the bond declines as it approaches maturity.
6. Bond price is inversely proportional to it's YTM.
7. The longer the term to maturity, for a given difference between YTM & Coupon rate, the greater will be the change in price with changes in price.
8. For an equal size increase or decrease in YTM, the bond price changes are not symmetrical. That is to say, in given maturity of a bond, the bond price change will be greater with a decrease in bond's YTM, than the change in bond price with an equal increase in bond's YTM.
9. Other things being the same, for a given change in YTM, the percentage of price change in respect of high coupon rate bond will be smaller than in case of bonds of low coupon rate.
10. A change in YTM affects the bonds with higher YTM in comparison to bonds with lower YTM.

Question 6

(a) Explain the following features of the Basel-III accord :

(i) Minimum Total Regulatory Capital Requirement

(ii) Counter Cyclical Buffer

(iii) Leverage Ratio. *(6 marks)*

(b) 'Although a depositor is a creditor of the bank, but he is not a secured creditor'. Elucidate with reference to banker-customer relationship. *(3 marks)*

(c) Explain the type of relationship between banks and their borrowing customers who borrow against securities from the bank. *(3 marks)*

Answer 6(a)

(i) *Minimum Total Regulatory Capital Requirement* : Under revised guidelines (BASEL III) minimum total regulatory capital will consist of the sum of the following categories:

(a) Tier 1 Capital (going-concern capital)

(i) Common Equity Tier 1 capital

(ii) Additional Tier 1 capital

(b) Tier 2 Capital (going-concern capital)

As of 2019, under Basel III, a bank's tier 1 and tier 2 capital must be at least 8% of its risk-weighted assets.

(ii) *Counter Cyclical Buffer* : As per Basel III norms regulators of banks of the countries are also responsible for regulating credit volume in their national economies. If credit growth is rapidly expanding than GDP growth, bank regulators can increase their capital requirements with the help of the Countercyclical Buffer to curb the excessive credit growth. The counter cyclical buffer suggested varies between 0% - 2.5% and it is meant to restrict excess credit growth which may turn out to be counter- productive. The aim of the Countercyclical Capital Buffer (CCCB) regime is twofold. Firstly, it requires banks to build up a buffer of capital in good times which may be used to maintain flow of credit to the real sector in difficult times. Secondly, it achieves the broader macro-prudential goal of restricting the banking sector from indiscriminate lending in the periods of excess credit growth that have often been associated with the building up of system-wide risk.

(iii) *Leverage Ratio* : It is defined as Ratio of Tier 1 Capital to Total Assets. According to Basel III this ratio should be a minimum of at least 3% even where there is no risk weighting. According to Basel III rules BCBS agreed to test minimum Tier 1 leverage ratio of 3% during the parallel run period by 2017. This was also made applicable for banks in India. During the period of parallel run, banks should strive to maintain their existing level of leverage ratio but, in no case the leverage ratio should fall below 4.5%. A bank whose leverage ratio is below 4.5% may endeavour to bring it above 4.5% as early as possible. According to the data released by RBI, most of the banks are maintaining leverage ratio of over 4.5%. (The ratio is calculated on quarterly basis).

Answer 6(b)

Banker- Customer Relationship

When a customer deposits money with his bank, the ownership of that money is transferred to bank who can use it as per its requirement without the permission of the customer, however it is obligatory on the part of a bank to honour the cheque issued by the customer if the cheque is in order and applicable funds are available in his account, the customer becomes tender (lender) and the bank becomes borrower. As such, the relationship is that of a Debtor and Creditor. Although a depositor is a creditor of the Bank, he is not a secured creditor. In case of liquidation or winding up of the Banks,

depositors do not get preferential treatment in repayment of their deposits. It is for this reason that deposits Insurance Corporation was set up and scheme of deposit insurance was started (which is at present Rs. One lakh per customer per bank).

Answer 6(c)

When a customer borrows against tangible securities, the following relationships are created depending on the transaction and security offered. A few examples in this regard are as under:

Security	*Charge*	*Borrower*	*Bank*
Insurance policy / book debts	Assignment	Assignor	Assignee
Property	Mortgage	Mortgagor	Mortgagee
Gold ornaments / shares	Pledge	Pledgor	Pledgee
Stocks / debtors / Car / Machinery	Hypothecation	Hypothecator	Hypothecatee

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INSURANCE – LAW & PRACTICE

(Elective Paper 9.2)

Time allowed : 3 hours *Maximum marks : 100*

NOTE: *1. Answer ALL Questions.*

2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.

Question 1

ABC Ltd. is a Public Limited Company, engaged in the business of exports of rice. It uses godowns of the Port Authorities for storage of the rice stocks meant for exports. The company has taken a Fire Insurance Policy cover from XYZ Insurance Ltd. which is a Public Sector Company. Satish who is a Development Officer with the Insurance Company has been assigned the account of ABC Ltd. to service and cater to all its requirements of service. The policy is effective from July of one year to June of the subsequent year.

On 21st and 22nd July, 2015, there were heavy rains with cyclonic storms, due to which the Port Authority's Godowns were severely flooded. On ceasing of the rains on 26th July, 2015, ABC Co. Ltd. found that most of the bags stored in the Port's Godowns had been washed away. Except for some clusters of rice here and there, all the stocks had been damaged and destroyed by the rain. The Company lodged a claim with the Insurance Company, asking for compensation under the Fire Insurance Policy. The Insurance Company while examining the claim, observed that :

— *The policy was due for renewal on 1st July, 2015 and the Insurance Co. had already sent a notice for payment of renewal premium to ABC Limited.*

— *ABC Ltd. had handed over a cheque for the premium as per the premium notice received from XYZ Insurance Ltd.*

— *The cheque was given to Satish, Development Officer on 27th June, 2015. The receipt of the cheque was duly acknowledged by Satish who had also issued a Cover Note for the period from 1st July, 2015 to 30th June, 2016.*

— *Satish however went on an official trip and deposited the cheque with his company branch on 16th July, 2015 after returning from his official trip.*

— *The accounts department deposited the cheque with the bank of the Insurance Company on 21st July, 2015 which was credited to the XYZ Ltd. account on 25th July, 2015.*

— *The Insurance Company however did not issue the regular policy till the event of the loss.*

— *ABC Ltd. was insured with XYZ Insurance Ltd. since the inception of its business 12 years back and no claims had been made so far by the Company.*

On receipt of claim from ABC Ltd. the Insurance Company analysed the claim papers and sent a reply to ABC Ltd. repudiating the claim on the following grounds that :

— *ABC Ltd. Co. was not covered on the date of loss, as no premium was paid for the cover.*

— *The premium was received by XYZ Insurance Co.'s accounts department on 25th July, 2015 after the loss had occurred and hence no insurance policy can be granted.*

— *Loss due to floods is not covered under Fire Insurance Policy.*

— *XYZ Insurance Co. was not bound by the Cover Note issued by Satish, Development Officer.*

ABC Ltd. Co., on receipt of reply from XYZ Insurance Ltd. has approached you as an Insurance Expert to advice them for resolution of the dispute. They have also appraised you with the following additional facts about the case :

— *Goods stored in the Godowns included 22000 tons of Rice acquired at a cost of ₹200 crores. The quantum of stocks was supported by the stock registers of the Port Authorities, which is also a Third Party record for confirmation.*

— *The stocks in the godown were covered by a Fire Insurance Policy of ₹250 crores.*

— *The stocks were pledged to a Nationalized bank for a loan of ₹75 crores. The outstanding amount on the date of fire was ₹60 crores*

— *The Bank has also sent a claim to the Insurance Co. to pay the claim amount directly to the bank as the name of the bank was also endorsed on the earlier policies.*

— *The District Collector of the area appointed by the State Government, as Relief Commissioner had also certified that the goods in the godown were lost in the floods and there was no salvage.*

Based on the above facts of the case, as an Insurance Expert, kindly advice ABC Ltd. Co. on the following issues :

(a) Validity of the Fire Insurance Policy on the day of the accident ?

(b) Tenability of the claim of Banker and ABC Ltd. for flood loss under Fire Policy.

(c) Claims settlement process as laid down by the Insurance Act, 1938.

(d) Liability of XYZ Co. Ltd. under the provisions of the Fire Insurance Policy.

(e) Role of IRDAI and Insurance Ombudsman in dispute resolution and settlement in the light of the given case. (8 marks each)

Answer 1(a)

The Fire insurance policy was very much valid and in force on the date of the accident. It is to be borne in mind that ABC Ltd. has been taking the policy, with XYZ Insurance Ltd. since inception of the business, almost 12 years back, which is quite long. The company had a fire cover without break for so many years. The company obviously was a reputed exporter and has extensively used the port facility for storage and dispatch etc. These facilities are run by independent statutory bodies and thus can

be trusted with the facts. The period for cover was to start on 1st July, 2015. A premium notice based on the existing policy coverage, terms & conditions was issued by the insurance company before the expiry of the existing policy and ABC Ltd. had issued the renewal premium cheque and handed over the same to the Development Officer, an employee of the insurer and noting at its records.

Development Officer (DO) is the employee of the Insurance company and hence an authorised representative. He had received the cheque on 27th June, 2015 before the expiry of the current policy and also had acknowledged it by issuing Cover Note pending issue of the policy document. The DO is an official to issue Cover Note and in fact it is part of his assigned duties to issue one. Moreover, it is in clear position in law that a Cover-Note is a valid document that brings into existence the relationship of insurer and insured between the parties and has validity for 60 days by when the normal formalities of issue of a policy could be completed. Secondly, the cover is not a new one but is only a renewal of the existing policy on the same terms as agreed to between the parties earlier. Thus it is clear that there exists a contract between the Parties, a valid Insurance Contract between the two parties on the subject matter of cover.

Thirdly, the provisions of section 64VB of the Insurance Act, 1938 clearly stipulate the payment of premium in advance before commencement of the cover. Facts indicate that the amount of premium was collected by the DO of the Insurance Company on 27thJune, 2015 which is prior to the commencement of the next year's risk cover. The insurer lodged the cheque for collection on receiving it from the DO Satish and the banker credited the insured account only on 25th July, 2015 due to intervening Government and bank holidays. However, it shall be noted here that once the premium is received by the Insurance Company, the risk is deemed to have been commenced and it is immaterial when they deposited the premium cheque in their accounts.

One other point to be noticed is that the cheque was honoured on presentation and that there was no indication that the customer had no balance in his account, the cheque was liable to be dishonoured on presentation etc. Issue of a cheque and its collection were a part of normal commercial activities. Thus it has to be concluded that the payment of the premium has been made by ABC Ltd. in the normal course and section 64VB's requirement has been complied with in all aspects. Thus all the pre-requisites evidencing the existence of a fire policy is satisfied and therefore, as on the date of the accident a valid insurance cover existed in favour of insured ABC Ltd.

Answer 1(b)

The claim of the insured ABC Ltd for loss of rice bags due to floods under a fire policy is valid and tenable. It is seen that the cover that existed was a Standard Fire insurance Policy. This policy generally covers losses arising out of fire and special allied perils such as storms, floods, typhoon, earthquake, inundation, lightening, strikes, and landslides. In the case of Standard Fire Policy with Special Perils covered, the risks of Storm, Cyclone, Flood, inundation and Earthquake risks are covered on payment of applicable additional premium. In the present case, the cause for loss is damage due to storms, flooding and consequent inundation, it is noticed that such a risk is covered under the standard fire policy, subject to other conditions being satisfied, the insurer is liable for the losses. A standard fire policy usually does not cover losses on account of damages caused by war and warlike operations, nuclear perils, pollution or contamination, electrical or mechanical breakdowns, burglary and house breaking.

Secondly, in the given case the claim of the Banker who had advanced loan to ABC Limited against the stocks which were lying in the godowns of the port authorities is also valid and tenable. The total loan advance by the bank was Rs.75 crores and the amount outstanding on the date of loss was Rs. 60 cores. This makes the bank as a Party with an insurable interest which will permit it to raise with the insured the question of the settlement of the claims. It will be within the rights of the bank to have the claim amount, to the extent of amount of the loan outstanding, to be released to it.

Answer 1(c)

The general procedure for seeking claim settlement is same in most forms of General Insurance.

Step 1 – Intimation/Submission of the Claim by the Insured

The insured would intimate the insurance company of the occurrence of a peril or risk which has caused loss of or damage to the insured property

Step 2 – Evaluation/Registration of Claim

The insurer would briefly initiate process check –

(i) Whether the policy has been issued by the insurer

(ii) Whether the policy is in existence

(iii) Whether correct premium has been received by the insurer

(iv) Whether the peril causing loss/damage is an insured peril

If the insurer is not satisfied and the necessary elements of insurance are not present, it may repudiate the insurance claim and intimate the insurer about the repudiation. In some cases, the insurer may ask for some other inputs about the insurance claim which he thinks necessary for processing the claim further. If on receipt of the additional input, the insurer is not satisfied, he may repudiate the claim and intimate the insured about the repudiation of claim. Only after getting satisfied about the claim, the insurer initiates the next step for claim processing.

Step 3 – Appointment of surveyor/loss assessor/investigator etc.

The insurer would immediately arrange for surveyor to be appointed who would look into the circumstances of the loss, assess the actual loss suffered in monetary terms and that which can be indemnified in terms of the contract, advise the insurer regarding compliance of the various terms conditions and warranties under the contract etc.

The loss assessor has also to advise the client on various aspects of loss mitigation, limitation and salvage. Loss investigation including forensic investigation and analysis may also come under the purview of a professional investigator.

Acid tests applied by the surveyor of the various principles – insurable interest, utmost good faith, proximate cause and of course contribution, help in deciding ultimately, if a claim is payable as well as quantum payable.

Submission of the claim form : The insured must fill all possible details in the claim form. He must lodge the claim form within 15 days of the fire to claim compensation. Delay in submission of claim from may result in non-acceptance of the claim.

Evidence of Claim : Along with the claim form, the insured must send certain proof of fire and other records, if available and if required. The evidence should enable the insurance company to determine the amount of loss.

Verification of Form : The claim form along with the supporting evidence is verified by the insurance company. The insurance company then appoints the surveyors to conduct an assessment of the actual loss.

Survey : After the receipt of the form, and necessary verification, the insurance company appoints the surveyors to assess the actual loss. The surveyors conduct the necessary investigations. They investigate into the cause of fire, the actual amount of property lost and other relevant details. The surveyors then make the report of their findings and assessment of the loss.

Appointment of the Arbitrator : There may be a dispute regarding the amount of claim. In such a case, an arbitrator is appointed, acceptable to both the parties, to settle the amount of the loss.

Settlement of Claims : If there is no dispute between the two parties, as to the amount of loss, the insurance company then makes necessary payment to the insured.

Answer 1(d)

Yes, insurers are liable for the loss as per the terms and conditions of the Policy because two important conditions have been fulfilled.

Firstly there exists the policy coverage. Secondly, the policy is valid as on the date of loss. Thirdly, the loss occurred due to a peril covered under the policy issued. With the client /policy holder complying with all the required formalities, the insurer is liable for the loss. The client has also informed the insurer of the accident immediately after it knew of its occurrence. Therefore it has to be concluded that there existed a policy on the date of the event in terms of which a claim has to be settled. It has to be assessed and the amount of compensation has to be determined. To assess the damage, the insurer has to appoint a surveyor who has to finalise his assessment to the insurer based on the documents submitted and facts of the case and this assessment will form the basis for settlement. In the present case, the loss has been established independently in that stocks those were in the garden 22,000 tons of rice had been verified by the stock record maintained by the Port Trust which is an independent statutory authority. Its certificate can be accepted primafacie. In addition, physical examination of the godown established the fact that the entire stock at godown had been either damaged or washed away due to the force of the storm coupled with heavy rain and there was no salvage at the godown. The district collector who was the Relief commissioner had confirmed about the total loss of the stock. It is thus crystal clear that the entire stock had been lost.

Hence this is a claim for total loss and accordingly the total cost of the stock is payable. The cost of acquisition of total stocks as reported by ABC Limited was Rs.200 crores which is payable subject to report from the surveyor and final assessment by the authorities of the insurance company. This also includes the amount payable to the bank.

Answer 1(e)

IRDAI is the Regulatory Authority for insurance business in India. The Act that established it has defined its powers under section l4 and apart from other duties outlined

in the section, the following is clearly indicated "to protect the interests of the policy holder with regard to settlement of claims and other terms and conditions". This specific object of the IRDAI has to be invoked by ABC Limited to support its claims for IRDAI's intervention in regard to this matter if the insurer does not act fairly and reasonably in the matter. The fact outlined in the question clearly established on liability of insurance company towards ABC Limited – claims whether there existed a policy. Whether the perils covered flood losses etc. - and it will, therefore, be very appropriate for ABC Limited to approach IRDAI seeking its intervention. Whilst IRDAI may intervene in this case and issue a direction to the insurance company. Past records establish the fact in an identical case, where a client has approached IRDAI for its intervention when its long period of negotiation with a public sector insurance company did not result in any solution. After examining all the factors IRDAI decided to intervene and passed an order directing the insurer to pay the claim. The insurer not satisfied with the IRDAI's direction, took the matter in appeal to the court which clearly indicated that IRDAI had all the necessary the powers and in fact an obligation to intervene on behalf of the insured. That step will not only be necessary to protect the interest of a policy holder but represented wholly and truly authority, obligation to control, nurture and develop the insurance industry. An insured can approach an Ombudsman with his case for settlement when the insurance company refuses to accept the claim or intends to settle it at a lower value than expected by the insured. The only drawback to this facility is that commercial claims of more than Rs. 20 lakh cannot be referred to Ombudsman. In this case ABC Limited cannot go to the Ombudsman to settle the claim since loss amount is above the limit. Alternative available is to move the Consumer Courts where no such limit of loss is fixed. An Ombudsman shall be selected from amongst persons having experience of the insurance industry civil servant from administrative service or judicial service. An insurance Ombudsmen is appointed for a term of 3 years. However, no person can continue as Insurance Ombudsman after he / she has attained 65 years of age (Proceedings before the Ombudsmen).

The Ombudsman may, if he deems fit, allow the complainant to adopt a procedure other than under sub-rule (1) or sub-rule (2) of rule l4 of Insurance Ombudsman Rules, 2017, for making a complaint, after notifying the parties to the dispute.

Recommendations made by the Insurance Ombudsman

Where a complaint is settled through mediation, the Ombudsman shall make a recommendation which it thinks fair in the circumstances of the case, within one month of the date of receipt of written consent on mutual basis for such mediation and the copies of the recommendation shall be sent to the complainant and the insurer concerned. If the recommendation of the Ombudsman is acceptable to the complainant, he shall send a communication in writing within fifteen days of receipt of the recommendation, stating clearly that he accepts the settlement as full and final. The Ombudsman shall send to the insurer, a copy of its recommendation, along with the acceptance letter received from the complainant and the insurer shall, thereupon, comply with the terms of the recommendation immediately but not later than fifteen days of the receipt of such recommendation, and inform the Ombudsman accordingly.

Awards by Ombudsmen

Where the complaint is not settled by way of mediation under rule 16 of Insurance

Ombudsman Rules, 2017, the Ombudsman shall pass an Award, based on the pleadings and evidence brought on record. The Award shall be in writing and shall state the reasons upon which the award is based. Where the Award is in favour of the complainant, it shall state the amount of compensation granted to the complainant after deducting the amount already paid, if any, from the award. However, the Ombudsman shall not award any compensation in excess of the loss suffered by the complainant as a direct consequence of the cause of action or shall not award compensation exceeding Rs. 30 lakhs (including relevant expenses, if any). The Ombudsman shall finalize its findings and pass an award within a period of 3 months of the receipt of all requirements from the complainant. A copy of the award shall be sent to the complainant and the insurer named in the complaint. The insurer shall comply with the award within 30 days of the receipt of the award and intimate compliance of the same to the Ombudsman. The complainant shall be entitled to such interest at a rate per annum as specified in the regulations, framed under the Insurance Regulatory and Development Authority of India Act, 1999, from the date the claim ought to have been settled under the regulations, till the date of payment of the amount awarded by the Ombudsman. The award of Insurance Ombudsman shall be binding on the insurers.

Question 2

(a) "Risk is inherent in nature." Discuss the different categories of risks encountered by Insurance companies. (6 marks)

(b) As a Compliance official, how would you ensure Own Risk and Solvency Assessment (ORSA) requirements by Companies as a part of Enterprise Risk Management ? (6 marks)

Answer 2(a)

Investing in the insurance business can be a daunting task if you are a newbie to start with. There are certain insurance risks that have effected this industry and the failure to do something to avert the risk can be detrimental to the success of your insurance company.

6 Common Risks faced by Insurance Companies

Some common types of Insurance Risks are given below:

1. *Liquidity Risk*

   Liquidity is the ease in which business assets can be converted into cash. This is an important aspect of consideration for success in an insurance company. Liquidity risks may arise due to a large number of claims in general insurance and a large surrender of policies in life insurance. This may lead to a loss of the company property in case when the company may not be able to raise the required cash.

2. *Actuarial Risks*

   Actual studies deal with the study of risks and quantifying the amount of compensation accorded to each risk. Actuarial risks may be caused by different factors such as mortality rate variance, perils and certain other variance. Calculations of the given risks may be subjected to a variety of adjustments.

One may consider current statistical data, some past experience and future possibilities but it is to be noted that in the future, there may be a great variance in the speculated and the risks amount.

3. *Reputation Risks*

   Reputation risks are faced when an insurance company has lost value in the insurance market. This has a great impact on the amount of revenue which will be raised by the insurance company. In the short run, it may not be an easy task to quantify the exact value caused by the reputation risks but adverse results may pop-up during auditing. In extreme cases, reputation risks may lead to bankruptcy also.

4. *Business Risks*

   Business risks that are faced by the insurance company are just the normal risks faced by many other businesses. Risks ranging from data breaches have resulted in a loss of the great amount of relevant data in the insurance industry. Other related business insurance risks include human capital loss, loss of damage and some of the relevant professional service mistakes that may be relevant. There is a lot to do when faced with these risks. A lot of professionalism is required to handle these risks, especially in the insurance industry.

5. *Strategic Risks*

   Strategic risks in the insurance sector require excellent strategic management skills to avert such risks. Strategic risks involve the process of identification, assessing and the management of the insurance strategy.

6. *Underwriting insurance Risks*

   Underwritings of risks results from the process of selection and approval of the risks that need to be insured. Insurance risks may also be caused by the use of an inflexible underwriting process of risks. The process of underwriting forms the basis of insurance and the failure to get it right at this step may result in great loses in the future.

7. *Insurance Risks (Pricing and Product Line Profit)*

   The risk arising from the exposure to financial loss from transacting insurance and / or annuity business where costs and liabilities experienced in respect of a product line exceeds the expectation in pricing the product line. Newer product lines experience losses due to the high expenses of operating an under-scale business.

   Insurers are always worried about their pricing and profitability, and the market price is not always correct. There is a persisting temptation to label a jump in claims as a temporary aberration or to cut rates to increase sales. Pricing and product- line profit issues are predominantly a higher- frequency and lower-severity risk.

Answer 2(b)

'Risk, in insurance terms, is the possibility of a loss or other adverse event that has the potential to interfere with an organization's ability to fulfill its mandate, and for which

an insurance claim may be submitted'. On the other hand, risk management ensures that an organization identifies and understands the risks to which it is exposed. Risk management also guarantees that the organization creates and implements an effective plan to prevent losses or reduce the impact of loss. A risk management plan includes strategies and techniques for recognizing and confronting these threats. Good risk management doesn't have to be expensive or time consuming; it may be as uncomplicated as answering these three questions:

- What can go wrong?
- What will we do, both to prevent the harm from occurring and in response to the harm or loss?
- If something happens, how we will pay for it?

An effective risk management practice does not eliminate risks. However, having an effective and operational risk management practice shows an insurer that your organization is committed to loss reduction or prevention. It makes your organization a better risk to insure. The essence of risk management policy of any corporate is to be innovative and still make a profit. The Enterprise Risk management policy essentially aims at solvency protection of a company. The supervisor or IRDAI in India establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks. The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.

The supervisor requires the insurer's enterprise risk management framework to provide for the identification and quantification of risk under a sufficiently wide range of outcomes using techniques which are appropriate to the nature, scale and complexity of the risks the insurer bears and adequate for risk and capital management and for solvency purposes.

As a Compliance Officer, it would be right on every Company Secretary to ensure the following:

- Documentation of enterprise risk management framework.

  The supervisor requires the insurer's measurement of risk to be supported by accurate documentation providing detailed descriptions and explanations of the risks covered, the measurement approaches used and the key assumptions made.

- Risk Management policy covered under the enterprise risk management.

  The supervisor requires the insurer to have a risk management policy which outlines how all relevant and material categories of risk are managed, both in the insurer's business strategy and its day-to-day operations. The supervisor requires the insurer to have a risk management policy which describes the relationship between the insurer's tolerance limits, regulatory capital requirements, economic capital and the processes and methods for monitoring risk.

As per Regulatory compliance, every company should have the following policies in place namely:

i. ALM Policy

The supervisor requires the insurer to have a risk management policy which

includes an explicit asset-liability management (ALM) policy which clearly specifies the nature, role and extent of ALM activities and their relationship with product development, pricing functions and investment management.

ii. Investment Policy

The supervisor requires the insurer to have a risk management policy which is reflected in an explicit investment policy which specifies the nature, role and extent of the insurer's investment activities and how the insurer complies with the regulatory investment requirements established by the supervisor, and establishes explicit risk management procedures within its investment policy with regard to more complex and less transparent classes of asset and investment in markets or instruments that are subject to less governance or regulation.

iii. ORSA Policy

The supervisor requires the insurer to perform its own risk and solvency assessment (ORSA) regularly to assess the adequacy of its risk management to ascertain this current, and future solvency position. The supervisor requires the insurer's Board and Senior Management to be responsible for the ORSA.

According to the ORSA manual, there are a minimum of five key principles that a robust ERM framework should encompass.

Risk Culture and Governance

Roles and responsibilities need to be well defined and within the organization a culture should be nurtured that supports accountability in risk making decisions.

Risk Identification and Prioritization

Clear management of the risk identification process is essential and responsibility for this process must be clear. You need to ensure these procedures are operating effectively throughout your organization. Putting the right risk assessment process in place through the use of ERM software can help tremendously.

Risk Appetite, Tolerance and Limits

To ensure that the risk strategy of the Board of Directors is made clear, a formal Risk Appetite Statement needs to be written and detailing associated risk tolerance and limits.

Risk Management and Controls

Throughout your organization ERM should operate to ensure risk is kept within the boundaries defined by the Risk Appetite Statement.

Risk Reporting and Communication

To ensure transparency of the risk management processes your key personnel require strong reporting and communication procedures. However, your organization should ensure that this does not impede active, informal management decisions on risk-taking.

Question 3

Ajay purchased a bus on a hire purchase loan from XYZ Finance Limited. The bus was used as private service vehicle only. The vehicle was insured under a comprehensive motor policy issued by ABC Insurance Limited. The vehicle met with an accident. Ajay filed a claim with ABC Insurance Ltd. who appointed a licensed Surveyor to assess the claim. The loss was assessed at ₹1,65,000. The insurance company deducted ₹46,000 on the ground that the driving license of the driver was not endorsed for driving of transport vehicle. The insurance company paid the balance amount of claim of ₹1,19,000 directly to the financiers XYZ Finance Ltd. Ajay filed a complaint before the Consumer Forum. As an Insurance Expert, you are required to advice on the following :

(a) Is the insurer justified in repudiating the claim ? Comment also on the actions of the insurer in the case cited. (6 marks)

(b) Discuss the scope of coverage available in a comprehensive motor insurance policy. Why is motor insurance mandatory in India unlike in other countries ? (6 marks)

Answer 3(a)

In the above case, the insurer is not rightly justified in repudiating the claim. Some of the common reasons for repudiation of motor accident claims include the following:

- When losses or claims are caused by unlicensed driver.
- When the vehicle is unroad worthy vehicle -e.g. wipers not working, smooth tyres etc.
- Reckless or negligent driving e.g. "Failure to take care" clause which refers to recklessness, which is not to be confused with negligence.
- "Breach of road traffic regulations" clause exceeding the speed limit at the time of accident
- Drunk driving by the drivers who are not "regular driver". In this regards some policies cover the regular driver only or a named driver or any licensed driver.
- Total loss policy - which applies only when the insurer deems the vehicle to be a totally depreciated.
- Vehicle inspection not carried out as per the rules. Insurers insist on inspecting the vehicle at inception of the policy. This is required to avoid any disputes in future about the pre-existing damages to the vehicle. If the policyholder neglects to comply, there will be breach of contract and the claim may be rejected.
- Material non-disclosure at the time of underwriting stage- With regards to the claims record, a break in insurance cover, prior applications for cover being rejected and judgements on credit record are all material to the assessment of the risk and it is imperative that the policyholders should disclose such information.
- Vehicles used for business should be disclosed to the insurer.
- Vehicle not parked securely at night. If the policyholder claims that the car is parked in a garage or off the street-at night, and in the event of the theft, it is found that it was regularly in the street, claim could be rejected.

- Security device not fitted, in case it is mandatory that a vehicle should be fitted with an alarm or a gear lock and it is not complied with the claim can be rejected.

Further, the action taken by the company is not justified for the following reasons:

First, if a person has a license to drive a heavy goods vehicle, it also means that he is entitled to drive a transport vehicle including a public service vehicle, hence repudiation on this ground is not tenable.

Secondly, the company is also not right in making a part payment of the amount of loss. The commission should direct the insurer to pay the balance amount including interest and costs.

Thirdly, the practice adopted by insurance companies of directly paying to the financier without informing the insured or without his consent cannot be justified. If the insurance policy issued in the name of the vehicle purchaser there is no question of paying the amount directly to the financier.

Answer 3(b)

A comprehensive motor insurance policy is a combination of a motor insurance for own-damage cover plus a third - party insurance policy. A comprehensive motor policy also does not cover all losses, the common exclusions or limitations in a motor insurance policy are as under:

- Consequential loss depreciation, wear and tear, mechanical and electrical breakdown, failures or breakages.
- Damages to tyres and tubes (50% in case of mishap).
- Accidental loss or damage under the influence of intoxicating liquor or drugs- Excesses or sometimes multiple excesses exclusion. Sometimes, in addition to standard excess, extra excess may be imposed.
- If there is an accident within six months of obtaining cover or between midnight and 6am- the most dangerous time on the road- an excess may apply.

Motor cover, is a statutory requirement under the Motor Vehicles Act. It is referred to as a 'third-party' cover since the beneficiary of the policy is someone other than the two parties involved in the contract i.e. the insured and the insurance company. The policy does not provide any benefit to the insured; however it covers the insured's legal liability for death/disability of third party loss or damage to third party property. Motor insurance, as the name suggests, is insurance of motor vehicles and are broadly classified as follows:

1. Private Cars.
2. Motor cycles and Motor scooters.
3. Commercial vehicles - sub divided into Goods carrying vehicles, Passenger carrying vehicles. and
4. Miscellaneous vehicles.

The coverage available under Motor insurance include.

Liability Coverage

When involved in an accident and if it is concluded that accident took place because of fault/negligence, the liability coverage will be of use. The following benefits are offered by the liability insurance plan:

- Covers the repair/replacement cost of the damaged property (of third-party).
- Covers the medical bills of the third party due to hospitalization or medical treatment.
- Vehicle owners should buy minimum liability insurance as per the legal obligation and the insurance policy will cover the same.
- The liability coverage will include the third-party injury, death or damage to the third party property.

Liability coverage is mandatory as per the Motor Vehicle Act, 1988.

Collision Coverage

If purchased 'collision coverage' the insurance company will bear the car repair expenses after the accident. In some cases, the cost of repairs will exceed the current market value of the vehicle. In such circumstances, the insurance company will pay the current market value of the car. The collision cover should be subscribed as per the age of your vehicle. If you are buying an insurance policy for a brand new vehicle, you should ensure that the collision coverage is included. If there is a lien on your vehicle, you should buy collision cover. The collision cover can be as low as possible for old vehicles.

Personal Injury Coverage

In addition to the mandatory liability insurance, you can include certain coverage to overcome various risk factors. Personal injury protection will cover all the costs associated with the accident. The medical bills of the driver and other passengers will be covered by the personal injury protection. Regardless of whose fault, the insurance company will pay the medical bills.

Comprehensive Coverage

Form B which is also known as Comprehensive Policy is an optional cover. A comprehensive insurance coverage will include all kinds of risk factors that are associated with your vehicle, driver, passengers, third-party vehicle, third-party driver, third-party vehicle passengers and third party property. The insurance policy will also cover the following risk factors:

Weather damage, Floods. Fire, Theft

In a country like India, people have not fully understood the necessity of insurance. Most of the people take insurance because there are tax sops attached, in case of general insurance the government does not make any policy mandatory except Motor third party liability insurance. This is because the Motor vehicle Act it is mandatory that

no vehicle can ply on the road without a valid third party insurance cover. In order to ensure the safety of the common public this policy has been made mandatory. However, it in the interest of the society that in India at least some policies should be made mandatory like Term life insurance plans, Health insurance policy, Personal accident insurance plans and Disability income insurance plans

Question 4

(a) Life insurance penetration is still dismally low in India. Why ? Do you believe that "Keyman Insurance" can help in improving the situation ? If yes, then how? (6 marks)

(b) "The digital economy will make usage-based, on-demand and all-in-one insurance lifestyle products more relevant". Explain the role and impact of technology in insurance business. (6 marks)

Answer 4(a)

We agree with the statement that Key Insurance Penetration is still dismally low.

Key Insurance penetration in India continues to be one of the lowest at 3.69%, according to the annual report by IRDAI. "Insurance penetration in India was at less than 1% when the industry opened up for private companies in FY 2000-01. The life insurance penetration was at 4.6% in 2009 but visibly showed a downward trend after that. Volatility in the stock market in 2008-2009 and regulatory changes in 2010 adversely impacted the sale of ULIP (unit-linked insurance plan) products and premiums. "Penetration in India reflected a flat trend of 2.7% from FY 2014-15 to 2016-17.

Reasons for Low Insurance Penetration

A Pre-launch Survey Report published by NCAER (National Council of Applied Economic Research) and IRDAI (Insurance Regulatory Authority of India), gave few insights into the reasons why insurance penetration is low in this country.

- Majority of insured households know that insurance is a better tool for emergency than any other savings instrument.
- About equal number of households whether insured or uninsured see life insurance as a long-term savings and risk coverage tool.
- About 50% of both rural and urban household have heard about health insurance policies.
- Majority of both insured and uninsured household felt that insurance is relevant for all classes.

However, there are a few missing links and clues that point to the leakages:

- Agents are the primary source of information about insurance for all households. A whopping 75% households have bought insurance because of agents' advice.
- Majority of households in both segments perceive 'accidents' and 'untimely death' as the two events relevant to insurance.
- About 13% of uninsured population feels that insurance is only relevant for the rich while another 25% have no idea about it.

- About 50% of uninsured population feels that insurance is neither a savings tool nor a protection tool.
- This population also does not know about the kind of losses insurance can compensate for or to what extent.

Key Person Insurance is also known as Keyman Insurance. This is an insurance taken by a company (or partnership firm) on the life of a Key Person who can an employee or a director of the company or partner of the firm. For example, let us assume that A is the founder and Promoter of ABC Limited and has invested in the equity shares of the company. He is also the Chairman of the Board of the Company. It is only because of him that the company has turned profitable and his presence adds significant value to the company. Under the above scenario, on death of A, the company ABC Limited could be impacted financially.

His absence could result in loss of potential income as some clients who are with the company because of him could move to other companies or there could be a drop in morale of the management and this company's performance and therefore revenue and profitability. Thus the company ABC Limited has an insurable interest in the life of Mr. A so the company can purchase a Keyman Insurance Policy from a life insurance company, where the Policyholder will be ABC Limited and the life insured would be that of Keyman i.e. Mr. A in this case. The company has an insurable interest in the life of Mr. A as in case of his death the company is likely to suffer losses. Only term insurance policy (where sum assured is payable only on the death of the life assured.

Sum assured in such cases is calculated based on the contribution of the Keyman to the Company and potential loss to the company in case of sudden death of the Keyman. From underwriting point of view it is important to establish the need for insurance of the Keyman i.e. whether the Life assured is indeed an indispensable person to the organization. This could be subjective based on certain statements made by the organizations but mostly it should translate into some visible benefit due to continuance.

The following factors are considered while considering the need for Key Person insurance:

(i) *Age* - Generally the assured is not too young or not too old. If too young the person might not have contributed significantly to the company's success. If too old the person might not have enough residual service to justify a minimum term of the policy.

(ii) *Level of expertise* - high level of technical expertise or management skills makes a person indispensable. Qualification and experience in different fields is of great significance importance.

(iii) *Earning of Profit making track record of the company* - usually the key person's contribution translates into higher revenue or profitability over a period of time, especially when the person is in sales or marketing jobs or Managing Director or CEOs whose key performance indicator is driving profitability. However there could be other functional heads like Chief Human Resources Officer who may not contribute directly to Profitability but builds a good culture which motivates employees to stick on to the company and contribute to the success. However this needs to be demonstrated by the company taking the Key Person Policy.

There is no limit to the number of Key Person(s) in a company. This depends on the needs of the company. Usually, the sum assured under a Key Person policy is linked to the profitability of the company and the amount of insurance cover granted could be, minimum of the following 3 parameters:

(a) 3 times the average gross profits of the Company for the last 3 years.

(b) 5 times the average net profit of the company for the last 3 years.

(c) 10 times the total annual compensation package for the key man which includes salary, bonus and all other perquisites.

If there are more than 1 key person in the Company, the overall limit will be governed by the same principle and the sum assured granted to the various key persons will not exceed the overall limit arrived at by the above method.

So we can say that Keyman Insurance helps in increasing the penetration level in Insurance as it is been done in bulk for the employees of an organization.

Answer 4(b)

Insurers today are negotiating a unique and complex environment. Competition is intensifying as non-industry entrants and fintech innovators provide increasing choice and raise consumer expectations of frictionless, personalised experience. The digital technologies that enable the experience continue to develop, bringing with them a data explosion. And for insurers that can derive deep insights from that data there are exceptional opportunities to enhance agility, grow profitable business and differentiate themselves from the competition."

Yes, it's true that at present the digital economy will make usage-based, on-demand and 'all-in-one' insurance lifestyle products more relevant. Customers will prefer personalized insurance covers instead of the one-size-fits-all products currently available. Today, more than 80 percent of the premiums collected by insurers are lost to distribution costs. Digital models will make intermediaries in the insurance value chain - marked by their excessive dependence on human effort. Flexible coverage options, micro insurance and peer-to-peer insurance will become viable options in the long run. Reinsurers will provide risk capital directly to digital brands, and regulatory frameworks will accommodate shorter value chains. Lifestyle apps will re-imagine the insurer-insured relationships. Application Programming Interfaces (APIs) will enable the creation of insights-driven offerings as they integrate data from multiple sources. Deeper understanding of customer behaviors will lead to more accurate risk assessments, personalized premiums and value on a sustainable basis for better customer experience and brand loyalty, plus reduced false claims. Nowadays, insurance policy is being issued in digitalized manner and kept with repository. Some of the areas where technology is going to impact in a big way include:

(i) AI & Automation for Faster Claims

Robotic Process Automation (RPA) and AI will occupy center stage in insurance, driven by newer data channels, better data processing capabilities and advancements in AI algorithms.

(ii) Advanced Analytics & Pro-activeness

Premiums will become highly personalized, enabled by new sources of tech-enabled data such as internet of Things, mobile-enabled InsurTech apps and

wearables. With the connected devices market poised to grow strongly in the next five years, Property and Casualty (P&C) insurers will be able to extract real-time and accurate data on the loss exposure of individual consumers This will help them proactively respond with timely and highly personalized interventions.

(iii) InsurTech Partnerships

InsurTech firms have been showing significant growth in the areas of auto, homeownership and cyber insurance. Such strong growth will stimulate traditional insurers to either acquire technology capabilities or partner with InsurTech companies. With an increasing demand for innovative products and services from millennials, such collaboration will become a critical imperative. Overall, it will be a win-win situation- traditional insurers will benefit from faster results in establishing a tech culture and lnsurTech companies will get access to larger customer bases, funding and domain expertise.

(iv) Mainstreaming Blockchain

The need for huge volumes of customer data to be processed in real time by different insurance functions calls for easy and secure transfer of data across organizations and their diverse stakeholders. Blockchain technology provides the advantage of secure data management across multiple interfaces and stakeholders without loss of integrity.

Thus, technology is going to drive the insurance business in future, however, the key is to understand how and when to tap into this potential leveraging existing and new technologies.

Question 5

(a) Evaluate the pros and cons of portability feature introduced in health insurance policies in India. (6 marks)

(b) What is your opinion in linking insurance buying to Income tax sops ? Discuss the tax benefits available to an individual for life insurance policies. (6 marks)

Answer 5(a)

Portability is the right accorded to the policyholder to transfer the credit gained by the pre-existing conditions and time bound exclusions from one insurer to another insurer or from one plan to another plan of the same insurer. It is the right conferred on a policyholder who decides to move from one general or health insurer to another or to another plan of the same general or health insurer.

Portability is not applicable to fixed benefits payable under Health insurance policies issued by a Life Insurer. The advantage of portability is the carry forward of the credits accrued on account of having a policy with previous insurer Request for portability should be given by filling up a portability form to the existing insurer, earlier than 45 days but not before 60 days from the date of expiry.

Portability form should be submitted to the old insurer who shall send it through a portal to the new insurer. New insurer may request the claims history and other details from the previous insurer who shall submit the required details within a period of 7 days

from the date of receipt of request. An insurer may reject the request for portability if the policyholder approaches 60 days before or within 45days of the date of expiry of the insurance policy. However, an insurer may at their option consider the request for portability even outside the above period. New insurer is under obligation to accept or reject within a period of 15 days from the date of receipt of the portability form. If the new insurer does not convey any decision within the aforesaid 15 days he is deemed to have accepted the request for portability. No charges for portability can be levied either by the previous insurer or the new insurer No commission shall be paid to any agent or intermediary for the policy which is ported from one insurer to another insurer.

Answer 5(b)

A policyholder who takes a Life Insurance Policy is entitled to the following income tax benefits.

Section 80C of the Income-tax Act, 1961

Under section 80C of the Income-tax Act, 1961, any premiums paid for Life Insurance Policy on the life of the person, his/her spouse or children is eligible for a deduction from the Gross Total income of the person. The deduction is subject to the following conditions:

(i) The premiums paid in any year by the policyholder are allowed as a deduction up to a maximum amount not exceeding l0% (15% in case of certain persons with specified illness of ailments) of the Actual Capital Sum Assured under the Policy. Any amount in excess of the said 10%/15% will not qualify for deduction. This deduction is not applicable to deferred annuity policies. Actual Capital Sum. Assured is the amount guaranteed to be paid by the Life Insurance Company on the happening of the events insured under the policy. However, such Actual Capital Sum Assured shall not include premiums agreed to be returned and Bonuses declared from time to time.

(ii) If the policy holder (other than annuity policy) discontinues the Policy within two policy years, no benefit is available in the second policy year. Besides the deduction given in the first policy year will be treated as an income in the second policy year.

(iii) Deduction is allowed for the policies taken on the life of an individual, his wife/ husband and children.

(iv) Life Insurance Policies including deferred annuity policies are eligible. Pension policies are treated separately under section 80CCC of the Income-tax Act, 1961 hence not eligible undersection 80C of the Income-tax Act, 1961.

(v) Under section 80C of the Income-tax Act, 1961, many tax saving instruments are eligible for deduction and Life Insurance Policies is one amongst them.

(vi) The maximum amount which can be claimed as a deduction under section 80C,80CCC (deduction for pension policies) and 80CCD of the Income-tax Act, 1961 (contributions under the New Pension Scheme) cannot exceed Rs. 1,50,000/-.

Section 80 CCC of the Income-tax Act, 1961

Under section 80CCC of the Income-tax Act, 1961, the premiums paid for a pension

policy issued by a Life Insurance company is eligible for deduction. Any amount received under a Pension Policy on account of surrender of the Policy or as pension (annuity payments) is taxable on receipt. The limit is Rs. 1,50,000/- which is subject to overall limit of deduction under all the three sections 80C, 80CCC and 80CCD of the Income-tax Act, 1961 all put together.

Section 80CCD of the Income-tax Act, 1961

Central Government has notified contributions made under the New Pension Scheme administered by the Pension Funds Regulatory and Development Authority (PFRDA) as eligible for deduction under section 80CCD of the Income-tax Act, 1961. PFRDA collects contribution from subscribers and invests them as per fund options with some limited flexibilities, which can be selected by the Subscribers. PFRDA invests the funds of the subscribers like a Mutual Fund and manages them. Private Sector as well as self employed persons can join the New Pension Scheme and subscribe to the Scheme. Upon attaining the age of Superannuation at least 40% of the corpus must be utilized to purchase an annuity Policy from empaneled Life Insurance Company, who will then pay monthly annuity to the subscriber depending on the annuity option chosen. Up to 60 Years of the corpus can be withdrawn as commuted value at the time of superannuation. While the basic contribution under section 80CCD (l) of the Income-tax Act, 1961 is subject to the overall deduction under section 80C, 8iOCCC and 80CCD of the Income-tax Act, 1961 put together, Section 80CCD (1B) of the Income-tax Act, 1961, provides additional Rs.50,000/-deduction only for the contributions to the Pension scheme notified under the section by the Central Government i.e. PFRDA's New Pension Scheme The amount of contribution from employee is limited to 10% of salary.

Section 80DDD of the Income-tax Act, 1961

A Life Insurance Policy taken by an individual who has a dependent with some specified disabilities under the Section will be eligible for deduction up to Rs.75,000 per year for taking the Life Insurance Policy for such dependents. The deduction increased to Rs.1,25,000 per year where such dependents have serious disabilities. Such policies are taken by the Caretaker of such dependent (who must be a relative having insurable interest) on his own life and the dependent shall be the nominee who will get the benefits under the Policy. Upon the death of the caretaker. If the dependent predeceases the Caretaker, the amount allowed as deduction shall be deemed to be an income in the year in which such amount is received by caretaker and shall be taxed accordingly

Section 10(10D) of the Income-tax Act, 1961

In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—

any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, other than—

(a) any sum received under sub-section (3) of section 80DD or sub-section (3) of section 80DDA of the Income-tax Act, 1961; or

(b) any sum received under a Keyman insurance policy; or

(c) any sum received under an insurance policy issued on or after the 1st day of

April, 2003 but on or before the 31st day of March, 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured; or

(d) any sum received under an insurance policy issued on or after the 1st day of April, 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds ten per cent of the actual capital sum assured:

Provided that the provisions of sub-clauses (c) and (d) shall not apply to any sum received on the death of a person:

Provided further that for the purpose of calculating the actual capital sum assured under sub-clause (c), effect shall be given to the Explanation to sub-section (3) of section 80C of the Income-tax Act, 1961 or the Explanation to sub-section (2A) of section 88 of the Income-tax Act, 1961, as the case may be:

Provided also that where the policy, issued on or after the 1st day of April, 2013, is for insurance on life of any person, who is—

(i) a person with disability or a person with severe disability as referred to in section 80U of the Income-tax Act, 1961; or

(ii) suffering from disease or ailment as specified in the rules made under section 80DDB of the Income-tax Act, 1961, the provisions of this sub-clause shall have effect as if for the words "ten per cent", the words "fifteen per cent" had been substituted.

Question 6

With the deferment of applicability of IFRS in insurance business by IRDAI to year 2021, discuss relevant provisions and implications as applicable to insurance contracts from a CS perspective. Will this accounting reform bring in a positive stride for insurance business in India ? (12 marks)

Answer 6

IFRS 17 establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This Standard was published on l8th May 2017, effective for the Annual period on or after 0l January 2021 IFRS-17 is applicable to 3 types of insurance contracts:

- Insurance contracts, including inward reinsurance contracts accepted.
- Reinsurance contracts ceded.
- Investment contracts with discretionary participation features, by an entity which issues insurance contracts as well.

Separating components from an insurance contract

An insurance contract may contain one or more components that would be within the scope of another standard if they were separate contracts. For example, an insurance contract may include an investment component or a service component (or both). Unit

Linked Life insurance policies, for example, have an insurance component and investment component. It is a contract bundled with insurance element and investment element and is like Term insurance + Mutual fund. In such cases this principle applies. The standard provides the criteria to determine when a non-insurance component is distinct from the host insurance contract. Investment component to be separated from a host insurance contract only if that investment component is distinct. The entity shall then apply IFRS 9 to account for the separated investment component. After performing the above steps, separate any promises to transfer distinct non-insurance goods or services. Such promises are accounted under IFRS l5 'Revenue from Contracts with Customers'.

Level of aggregation

IFRS l7 requires entities to identify portfolios of insurance contracts, which comprises contracts that are subject to similar risks and managed together. Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together. (IFRS 17:14)

Each portfolio of insurance contracts issues shall be divided into a minimum of: (IFRS 17:16)

- A group of contracts that are onerous at initial recognition, if any,
- A group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
- A group of the remaining contracts in the portfolio, if any.

An entity is not permitted to include contracts issued more than one year apart in the same group. If contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group.

Recognition : An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

(a) the beginning of the coverage period of the group of contracts,

(b) the date when the first payment from a policyholder in the group becomes due; and

(c) for a group of onerous contracts, when the group becomes onerous.

Measurement

On initial recognition, an entity shall measure a group of insurance contracts at the total of:

- the fulfilment cash flows ("FCF"), which comprise.
- estimates of future cash flows.
- an adjustment to reflect the time value of money ("TVM") and the financial risks associated with the future cash flows, and
- a risk adjustment for non-financial risk.
- the contractual service margin ("CSM")

An entity shall include all the future cash flows within the boundary of each contract in the group. The entity may estimate the future cash flows at a higher level of aggregation and then allocate the resulting fulfillment cash flows to individual groups of contracts. The estimates of future cash flows shall be current, explicit, unbiased, and reflect all the information available to the entity without undue cost and effort about the amount, timing and uncertainty of those future cash flows. They should reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices. (IFRS I7:33)

Premium allocation approach

An entity may simplify the measurement of the liability for remaining coverage of a group of insurance contracts using the Premium Allocation Approach (PAA) on the condition that, at the inception of the group:

i. the entity reasonably expects that this will be a reasonable approximation of the general model, or

ii. the coverage period of each contract in the group is one year or less.

iii. Where, at the inception of the group, an entity expects significant variances in the fulfilment cash flows (FCF) during the period before a claim is incurred, such contracts are not eligible to apply the PAA.

Investment contracts with a DPF (Discretionary Participating Features)

An investment contract with a DPF (Discretionary Participating Features) is a financial instrument and it does not include a transfer of significant insurance risk. It is in the scope of the standard only if the issuer also issues insurance contracts. The requirements of the Standard are modified for such investment contracts.

Reinsurance contracts held

The requirements of the standard are modified for reinsurance contracts held, in estimating the present value of future expected cash flows for reinsurance contracts, entities use assumptions consistent with those used for related direct insurance contracts. Additionally, estimates include the risk of reinsurer's non-performance.

Modification of an insurance contract

Derecognition

An entity shall derecognise an insurance contract when it is extinguished, or if any of the conditions of a substantive modification of an insurance contract are met.

Presentation in the statement of financial position

An entity shall present separately in the statement of financial position the carrying amount of groups of:

(a) insurance contracts issued that are assets,

(b) insurance contracts issued that are liabilities;

(c) reinsurance contracts held that are assets; and

(d) reinsurance contracts held that are liabilities.

Insurance service result

An entity shall present in profit or loss revenue arising from the groups of insurance contracts issued, and insurance service expenses account arising from a group of insurance contracts it issues, comprising incurred claims and other incurred insurance service expenses. Revenue and insurance service expenses shall exclude any investment components.

Disclosures

An entity shall disclose qualitative and quantitative information about:

(a) the amounts recognised in its Financial Statements that arise from insurance contracts,

(b) the significant judgements, and changes in those judgements, made when applying IFRS I7; and

(c) the nature and extent of the risks that arise from insurance contracts.

Transition

An entity shall apply the standard retrospectively unless impracticable, in which case entities have the option of using either the modified retrospective approach or the fair value approach.

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

Time allowed : 3 hours *Maximum marks : 100*

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

Question 1

1. *Read the following case study carefully and answer the questions given at the end: Facts of the case : The plaintiff XYZ Ltd. is a Company publicly listed, organized and existing under the laws of USA, having its registered office at New York. Mr. ABC is duly authorised to sign, verify and institute the present suit. The plaintiff's group of companies is one of the world's most famous and well-known hotel and resort chain group using the trademark sleepingcat and its device. The plaintiff's flagship company sleepingcat Resort was launched in 1994 in Laguna Phuket under the trademark **sleepingcat** and its device. Hence, the mark is inherently distinctive of the business and products of the plaintiff and the continuous use of the trademark sleepingcat by the plaintiff group since the year 1994 has created goodwill and reputation in the said mark that is associated with the plaintiff and the plaintiff alone. The plaintiff Group's services and products under the trademarks sleepingcat and its device have been widely promoted inter alia through print and audio-visual media including television programmes, advertisements, articles and write-ups appearing in leading newspapers, magazines, journals, etc. all of which enjoy a wide viewership, circulation and readership all over the world. Many of these forms of media also have a substantial reach and circulation in India and are viewed by millions of Indians who travel abroad or who subscribe to the same in India every year. In addition, many people from all over the world including India access the plaintiff Group's websites : www.sleepingcat.com, www.sleepingcatspa.com, www. sleepingcatgallery. com, www.sleepingcatresorts.com that have been registered since as early as 1996 and become acquainted with the plaintiff Group's business, services and products which further contributed to the reputation and notoriety of the mark sleepingcat and its device of the plaintiff. The plaintiff Group, being prior in the adoption and use of the mark sleepingcat and its device, is its proprietor and thus, entitled to the use of these marks under common law rights, to the exclusion of all others. Apart from having common law rights in the mark sleepingcat and its device, the plaintiff also has statutory right in the same. It is submitted that the plaintiff has registered or has sought to register the mark sleepingcat and its device in more than 30 countries of the world. The plaintiff is, thus, the registered owner of the trademark sleepingcat as well as the device in various countries.*

   The defendant Mr. X is the Managing Director of defendant No. 2 which is sleepingcat Tours and Travels (Pvt.) Ltd. having its office at Dadar, Mumbai and at Regal Building, Parliament Street, New Delhi. It is the case of the plaintiff against the defendant that sometime in 2004 it came to the knowledge of the plaintiff that the defendants had applied for registration of the mark sleepingcat under the Trademarks Act, 1999. The plaintiff had filed opposition against the purported registration applications in

2004. The said application were thereafter abandoned in February 2005 since the defendants failed to file any counter statements to the oppositions filed by the plaintiffs predecessor in-title and thus, the cases were closed. In June, 2005 the defendants filed an application with trademark office seeking registration of the mark sleepingcat with device, opposition to which was filed by the plaintiff in May 2006 and September 2006 respectively. While the said applications were under contest before the trademarks registry, the defendant used the trademark for advertising his services. It adopted the website www.sleepingcattours.com which was created on 16th August 2003.

The plaintiff filed the suit against the defendant use of the trademark on 15 January 2019. It plead to the court that :

(1) The adoption of the mark sleepingcat and its device by the plaintiff is much prior to the filing of the application for registration of the mark sleepingcat and its device by the defendants and also much prior to the alleged use of it by the defendants.

(2) It is submitted that the defendants belong to the same trade/industry and therefore, there exists every reason for the defendants to have been aware of the plaintiffs marks and also the goodwill and reputation of the said marks worldwide.

(3) The plaintiff submits that there is no way in which the defendants could have honestly or by sheer coincidence adopted such a well known mark for their goods, except for ulterior gains. The conduct of the defendants is totally dishonest and is solely motivated to create mass deception and confusion by running a trade/business under an identical trademark. The defendants' activities are clearly motivated to encash upon the hard earned reputation and goodwill of the plaintiff's well known and recognized trademark sleepingcat and its device.

The following defence were raised by the defendant :

(1) The plaintiffs have no area of operation from India nor do they have any office in India, while the defendants are a company incorporated within India and have their area operations in India and have been actively conducting business since 1996 without any interruption. The plaintiffs are only trying to take advantage of the goodwill and reputation of the defendants and to encash on the presence of the defendants' business which the defendants have established for the last 12 years in India and abroad under the trademark of sleepingcat and its device.

(2) The defendant No. 2 is one of the leading tour and travel companies including camping and adventure sports and lay special emphasis on providing services to suit the clients and to provide such hospitality designed to fit into its natural surrounding, using indigenous resources as far as possible which may reflect the landscape and architecture of the area of travel and also catering to all such needs of clients visiting India and taking the advantage of the facilities and other opportunities available in India with regards to well known tourists spots in India.

(3) The plaintiffs are conducting a business of hotels, resorts and spas while the defendants are primarily conducting services relating to travel and tourism in India through their company and the trademark sleepingcat and its device. There is no trade connection between the business of the plaintiff and defendants.

Questions :

(a) Can an unregistered mark entitle for trademark protection ? *(10 marks)*

(b) What are the essential ingredients of 'passing off' ? *(10 marks)*

(c) Does the court have jurisdiction in the given case ? *(10 marks)*

(d) Is the current suit barred by limitation ? *(10 marks)*

Answer 1(a)

The trademark rights arise automatically as a result of using a mark on the goods or services. Registration of Trademark is not compulsory. An "unregistered trademark" is one which does not possess legal benefits. But in some cases, an unregistered trademark may get common law benefits. Unregistered marks are defined as marks which are not registered in relation to goods or services (that is names, marks or logos used in relation to a business) under the Trade Marks Act, 1999. Though under Section 27 of Trade Marks Act, 1999, no action for infringement is allowed for unregistered trademarks, it can still be protected by means of common law tort of passing off. To succeed in such an action, it is necessary to establish that unregistered mark has comparable goodwill or reputation in connection with the product, service or business with which it is used.

The facts of the case are similar to that of *Choice Hotels International Inc.* vs. *M Sanjay Kumar and Another* decided by the Delhi High Court on 9 February, 2015

The legal position emerging from the given case may be summarised as under:

(a) Section 29(5) of the TM Act 1999 relates to a situation where (i) the infringer uses the registered trademark "as his trade name or part of his trade name, or name of his business concern or part of the name, of his business concern" and (ii) the business concern or trade is in the same goods or services in respect of which the trade mark is registered.

(b) This is in the nature of a per se or a 'no-fault' provision which offers a higher degree of protection where both the above elements are shown to exist. If the owner/proprietor of the registered trade mark is able to show that both the above elements exist then an injunction order restraining order the infringer should straightway follow. For the purpose of Section 29(5) of the TM Act 1999 there is no requirement to show that the mark has a distinctive character or that any confusion is likely to result from the use by the infringer of the registered mark as part of its trade name or name of the business concern.

(c) However, in a situation where the first element is present and not the second then obviously the requirement of Section 29(5) is not fulfilled. Where the registered trade mark is used as part of the corporate name but the business of the infringer is in goods or services other than those for which the mark is registered, the owner or proprietor of the registered trade mark is not precluded from seeking a remedy under Section 29(4) of TM Act 1999 if the conditions attached to Section 29(4) are fulfilled.

(d) Given the object and purpose of Section 29(1) to (4), Section 29(5) cannot be intended to be exhaustive of all situations of uses of the registered mark as part

of the corporate name. Section 29(5) cannot be said to render Section 29(4) otiose. The purpose of Section 29(5) was to offer a better protection and not to shut the door of Section 29(4) to a registered proprietor who is able to show that the registered mark enjoying a reputation in India has been used by the infringer as part of his corporate name but his business is in goods and services other than that for which the mark has been registered.

(e) A passing off action is maintainable in the case of a well-known mark even if the goods and services being dealt with by the parties are not similar.

The, owner of an unregistered trademark may be able to prevent use by another party of an infringing mark pursuant to the common law tort of passing off. The action against passing off is based on the principle that 'a man may not sell his own goods under the pretence that they are the goods of another man'. Passing off is a species of unfair trade competition by which one person seeks to profit from the reputation of another in a particular trade or business.

Answer 1(b)

The three fundamental elements of passing off are Reputation, Misrepresentation and Damage to goodwill. These three elements are also known as the Classical Trinity, as restated by the House of Lords in the case of Reckitt & Colman Ltd vs. Borden Inc. It was stated in this case that in a suit for passing off the plaintiff must establish firstly, goodwill or reputation attached to his goods or services. Secondly he must prove a misrepresentation by the defendant to the public i.e. leading or likely to lead the public to believe that the goods and services offered by him are that of the plaintiff's. Lastly he must demonstrate that he has suffered a loss due to the belief that the defendant's goods and services are those of the plaintiff's.

Among the three, one of the essential ingredients of ‘passing off’ is goodwill. The classic case of passing off as it existed since its genesis always insist the existence of goodwill of a merchant in order to give him a locally enforceable right to sue for passing off. This has been explained by Kerly's in his book called Law of Trade Marks and Trade Names, wherein the concept of goodwill has always been categorized as local in character and the learned author observed thus:-

"Since an essential ingredient of passing off is damage (or prospective damage) to goodwill, he (the Plaintiff) must show that he had, at the date when the Defendants started up, in this country not merely a reputation but a goodwill capable of being damaged. Goodwill, however, is local; it is situated where the business is. Thus a foreign claimant may have a reputation in this country-from travellers or periodicals of international circulation or, increasingly, from exposure on the Internet-yet still fail in an action for passing off because he has here no business and so no goodwill. Such cases have been not uncommon in recent years, and have caused considerable difficulty. Where there is a substantial reputation here, our courts will often accept minimal evidence that a business exists here, but there has to be some".

This concept of goodwill and the insistence of localized business has been traditional concept of passing off which sometimes is called as classic case of passing off. However, this concept of passing off has undergone changes due to advent of technology and modernization. For the said reason the tendency to insist localized goodwill has been

transformed into proving reputation of a global character. All this would mean that courts entertaining the case of passing off can discount the localized existence of goodwill and the business in the territory specific if the substantial nature of reputation has been proved which has some kind of nexus in the territory where the protection is sought and the said concept in the modern language is called trans-border reputation whereas the goodwill is always local in character, the concept of reputation is dynamic and is all encompassing.

The reputation of a person can transcend boundaries by virtue of its advertisement in the newspapers, media circulation, expatriate reputation due to cultural akinness and all other relevant factors which connect one country's business with that of another. This has been aptly explained by the Division Bench of this Court in the case of *N. R. Dongre* vs. *Whirlpool Corporation*, AIR 1995 Delhi 300 wherein the concept of trans-border reputation was approved in the following words:-

Thus a product and its trade name transcend the physical boundaries of a geographical region and acquire a trans-border or overseas or extraterritorial reputation not only though import of goods but also by its advertisement. The knowledge and the awareness of the goods of a foreign trade and its trade mark can be available at a place where goods are not being marketed and consequently not being used. The manner in which or the source from which the knowledge has been acquired is immaterial.

To prove the passing off action under the Trade Marks Act, 1999, following points need to be proved:

i. Owner has to prove that there is similarity in the trade names.

ii. Defendant is deceptively passing off his goods as those of the owners'.

iii. It is leading to confusion in the minds of the customers (whether a person of average intelligence and of imperfect recollection would be confused).

iv. Nature of the activity and the market consumption of the goods of the parties to the passing off action must be same.

v. Use of the same trademark or trade mark by the defendant must be likely to injure the business reputation of the plaintiff.

vi. Misrepresentation and loss or damage of the goodwill are also essential elements for a successful passing off action. This needs to be proved by the plaintiff for an interlocutory injunction.

Answer 1(c)

The plaintiffs have no area of operation from India nor do they have any office in India, while the defendants' area of operation is a company incorporated in India and have their area operations in India and have been actively conducting business since 1996 without any interruption. The plaintiffs are only trying to take advantage of the goodwill and reputation of the defendants and to encash on the presence of the defendant's business which the defendants have established for the last 12 years in India and abroad under the trademark of sleeping cat and its device.

The defendant No. 2 is one of the leading tour and travel companies including camping

and adventure sports and lay special emphasis on providing services to suit the clients and to provide such hospitality designed to fit into its natural surroundings, using indigenous resources as far as possible which may reflect the landscape and architecture of the area of travel and also catering to all such needs of clients visiting India and taking the advantage of the facilities and other opportunities available in India with regards to well-known tourist spots in India.

The plaintiffs are conducting a business of hotels, resorts and spas while the defendants are primarily conducting services relating to travel and tourism in India through their company and the trademark sleeping cat and its device. There is no trade connection between the business of the plaintiff and defendants.

The defendants are carrying on their business in India. The plaintiffs neither actually nor voluntarily reside and/or carry on business nor personally work for gain within the territorial jurisdiction of the Courts in India.

Section 135 of the Trade Marks Act, 1999 provides plaintiff centric jurisdiction to the parties. In the present case the plaintiff is offering his products and services for sale in India through the Internet. Further, the plaintiff has filed the case by making itself available to the court in India. Therefore this Court has jurisdiction to entertain and decide the present suit.

By inserting section 134(2) of the trademarks act, 1999 the Legislature has brought the trademarks law in tandem with the provisions under the Copyright Act. In section 62(2) of the Copyright Act as well as in Section 20 of the Code of Civil Procedure to enable the plaintiff to sue one who infringed his copyright within whose local limits he carried on business at the time of institution of the suit or other proceedings. The expression “carries on business” as provided under Section 62(2) and Section 134(2) of the Copyright Act and Trademarks Act respectively is restricted not only to the principle place of business but also covers branch or branches wherever the business is carried on.

In *Ultratech Cement & Anr* v. *Dalmia Cement Bharat Limited* the Bombay High Court held that even if one of the plaintiffs has place of residence or carries on business within the jurisdiction of the Courts, the Court is entitled to entertain the suit. The Court has further held that even if no cause of action arises at a subordinate place of business the plaintiff is still entitled to file a suit for infringement and passing off within the jurisdiction of the Court. There is a divergence from Section 20 of the CPC wherein the suits related to trademarks under can be filed even in a place other than the principle place of business i.e. where a branch office is situated, even if no cause of action arises.

Answer 1(d)

It has been decided in many cases that such statutory right cannot be lost merely on the question of principles of delay, laches or acquiescence. It was also held that a mere delay after knowledge of infringement does not deprive the registered proprietor of a trade mark of his statutory rights or of the appropriate remedy for the enforcement of those rights so long as the said delay is not an inordinate delay.

It is now well settled that an action for passing off is a common law remedy being an action in substance of deceit under the Law of Torts. Wherever and whenever fresh deceitful act is committed the person deceived would naturally have a fresh cause of

action in his favour. Thus every time when a person passes off his goods as those of another he commits the act of such deceit. Similarly whenever and wherever a person commits breach of a registered trade mark of another he commits a recurring act of breach or infringement of such trade mark giving a recurring and fresh cause of action at each time of such infringement to the party aggrieved.

The present suit is not barred by limitation. Generally limitation period is for 3 years from the start of cause of action. Article 88 and Section 22 of the Limitation Act, 1963 are to be read conjointly, it clearly provides that in case of a continuing breach of contract or in the case of a continuing tort, a fresh period of limitation begins to run at every moment of the time during which the breach or the tort, as the case may be, continues.

In the present case, admittedly, the defendants are subsequent users of the trademark SLEEPING CAT and SLEEEPING CAT device. It is a continuous cause of action. The passing off is one of the facet of tort. In case both the provisions are read, prima facie it appears to the court that the suit is not barred by limitation.

In *Timken Company* v. *Timken Services Private Ltd.*, the Delhi High Court held that if a new deceitful act is committed, the deceived party would naturally have a fresh cause of action in its favour. Thus, every time a party passes its goods off as those of another it commits an act of infringement. Similarly, whenever a party breaches another party's registered trademark, it commits a recurring act of breach or infringement of that mark, giving rise to a fresh cause of action to the aggrieved party.

Question 2

(a) *Ajit developed a method of hedge against price fluctuation in energy market. He used a simple concept of mathematics and familiar statistical approach to achieve the above purpose. Ajit termed it as innovative procedure to calculate the risk at this competitive time. Advise him on patentability of his innovation*

(b) *Rajesh is a poet and maintains a blog 'poet.blog.com'. He occasionally published his work on websites. He claims copyright infringement due to google's alleged copying and distributing one of his work. Google defend and said that it is using an automated program called Googlebot. The program creates index of the work available on internet. The program created a cached version of the site. The cached version was then included in search result of google search engine. One clicks on the link to the cached version, the user can view a snapshot of the page as it appear at the time the Googlebot found on site. Advise is there any copyright violation of Rajesh.* *(6 marks each)*

Answer 2(a)

For the protection under The Patents Act, 1970 the condition of patentability has to be satisfied. The criteria are threefold, i.e., Novelty, Inventive Step (Non-Obviousness) and Industrial Applicability (Utility). However, section 3 of the Act list out the inventions non patentable subject matter. Section 3 (k) states that a mathematical or business methods or a computer programme per se or algorithms are not inventions and hence not patentable. Mathematical methods are considered to be the act of mental skill. A method of calculation, formulation of equations, finding square roots, cube roots and all other methods directly involving mathematical methods are therefore not patentable. With development in computer technology, mathematical methods are used for writing

algorithms and computer programs for different applications and the claimed invention is sometimes camouflaged as one relating to the technological development rather than the mathematical method itself. A mathematical method is one which is carried out on numbers and provides a result in numerical form (the mathematical method or algorithm therefore being merely an abstract concept prescribing how to operate on the numbers) and not patentable. If low quality business method or mathematical methods are allowed to be patentable, it may damage the public perception of the patent system. It may create enormous monopoly power much more than the cost of so-called invention.

In the given case since it is a simple concept of mathematics and familiar statistical approach. It is therefore not patentable.

Answer 2(b)

Caching involves storage of an entire site or other complete set of material for a source for later use. It is a process used by internet browsers of storing "browsed" material in the browser computers' RAM or cache memory. The purpose of caching is to speed up repeated access to data and to reduce network congestion resulting from repeated downloads of data. Caching is an efficiency tool. It is something that a browser programmer does independently of the user. Cached copies are incidents of using the browser programme.

Section 52 (1)(c) of the Copyright Act, 1957 deals with the caching and categorise this as a fair dealing.

'Transient or incidental storage of a work or performance for the purpose of providing electronic links, access or integration, where such links, access or integration has not been expressly prohibited by the right holder, unless the person responsible is aware or has reasonable grounds for believing that such storage is of an infringing copy:

Provided that if the person responsible for the storage of the copy has received a written complaint from the owner of copyright in the work, complaining that such transient or incidental storage is an infringement, such person responsible for the storage shall refrain from facilitating such access for a period of twenty-one days or till he receives an order from the competent court refraining from facilitating access and in case no such order is received before the expiry of such period of twenty-one days, he may continue to provide the facility of such access.' There is no case of direct infringement on the part of Google since the entire process of displaying the search results and then viewing the cached page was a non-volitional act on the part of Google. As a side note, it must be mentioned that 'safe harbour' provisions relating to copyright infringement always mention that there can be no liability if the act was an automated process and not volitional.

In the given case, the reproduction of copyright work is happening due to caching memory which is essentially a technical nature of the computer. Therefore, it falls under the fair dealing.

In the case of *Field* v. *Google, Blake Fields*, who is an attorney and a poet, published certain poems on his blog. Google, in the course of indexing this blog, created a cached copy of his poems. In September of 2004, he filed a copyright infringement suit against Google claiming that caching of his poem "Good Tea" involved the unauthorised copying and distribution of his work. He claimed that when Google served, and users clicked on

the cached copy of his poems, Google was not only 'distributing' unauthorised copies of his work, but 'creating' an unauthorised copy as well. It is also relevant to note that Field registered his poems with the Copyright Office before publishing them on his website and he did not employ the feature that prevented Google from caching his website.

The court framed two issues to decide the matter: (1) Does the creation of a cached copy constitute unauthorised copying ? (2) When Google serves the cached copy to the user as a search result, does it amount to unauthorised distribution? The court found that no copyright infringement had occurred and delivered the judgement under the following broad heads:

Direct Infringement : There was no direct infringement since the entire process – starting from the display of search results and the subsequent viewing of the cached page – was a non-volitional act on the part of Google. This is consistent with the prevailing law on intermediary liability, which states that service providers cannot be held liable if the allegedly infringing act was an automated process. Bear in mind that Field did not accuse Google of infringement for creating the cached copy in the first instance or that users who viewed the cached copy were violating his copyright, and therefore Google was thereby liable for secondary infringement. Field appears to have taken the most tenuous defence – that the 'creation of new copies', when a user clicked the cached link, constituted copyright infringement.

Question 3

(a) Looking at the growth of mobile phones and other electronic devices in Indian market an Indian firm interested to make investment to market integrated circuits in India. The problem is the firm does not have the technology to manufacture IC (Integrated Circuits) therefore the Indian firm is negotiating with an American technology company for signing the technology agreement for IC. Advise the American company how the agreement can be signed between the American company and Indian firm and can American company apply to cancel the registration of Indian firm as a registered user of layout design in future if the American Company is dissatisfied with Indian firm. (6 marks)

(b) Texas based Rice Tec Inc. claimed that their invention pertains to a novel breed of rice plants and grains therefore UPSTO granted the patent on 'Basmati Rice Lines and Grains' in September, 1997 after three years examination and accepted all the 20 claims put forward by Rice Tec Inc. What was the consequence when India challenge the patent and why patent granted to three hybrid varieties Bas 867, RTI 1117 and RT 1121. (6 marks)

Answer 3(a)

When registered layout-design is intended to be allowed to be used by some other person, then such person is required to be registered with the Registrar as registered user. Registered proprietor and the proposed registered user shall have to make a joint application in writing to the Registrar in a prescribed manner along with agreement in writing (or a authenticated copy), entered into between them with regard to use of layout design showing particulars of the relationship, existing or proposed, including the degree of control by the proprietor over the permitted use which this relationship will confer. The particulars should also clarify whether the proposed registered user shall be sole registered

user and mention the place and duration of permitted use. After getting the compliance of requirements under the Act, the Registrar registers the proposed registered user.

The Registrar has the powers under the Act to cancel the registration as a registered user of layout design on any of the following grounds:

i. Registered user has not used the layout-design in accordance with the agreement;

ii. The proprietor or the registered user misrepresented, or failed to disclose some material facts at the time of application which would have an adverse bearing on the registration of the registered user;

iii. The circumstances have changed since the date of registration in such a way that at the date of such application for cancellation they would not have justified registration of the registered user;

iv. That the registration ought not to have been effected having regard to right vested in the applicant by a contract in the performance of which he is interested;

v. Registration may be cancelled by the Registrar of his motion or on the application in writing by any person on the ground that any stipulation in the agreement between the registered proprietor and the registered user regarding the topographical dimensions of the layout design is either not being enforced or is not being complied with;

vi. Registration may be cancelled by the Registrar if the layout-design is no longer registered.

The Registrar is required to issue notice in respect of every application received for cancellation of registration of registered user to the registered proprietor and each registered user (not being the applicant)of the layout-design. However, before cancelling of registration, the registered proprietor shall be given a reasonable opportunity of being heard.

Answer 3(b)

In the case of patent granted to Rice Tec Inc., an American private company based in Texas, India challenged the grant of patent in US.

Basmati rice, sought-after for its fragrant taste, was developed by Indian farmers over hundreds of years, but the Texan company Rice Tec obtained a patent for a cross-breed with American long-grain rice.

Rice Tec was granted the patent on the basis of aroma, elongation of the grain on cooking and chalkiness. However, the Indian government filed 50,000 pages of scientific evidence to the US Patents and Trademarks Office, insisting that most high quality basmati varieties already possess these characteristics. The US Patent and Trademarks office accepted the petition and will re-examine its legitimacy.

The patent - granted only in the US - provided Rice Tec control over basmati rice production in North America. Farmers had to pay a fee to grow the rice and were not allowed to plant the seeds to grow the following year's crops.

India feared the patent may severely damage exports from its own farmers to the US.

India has also objected to Rice Tec calling the rice 'basmati', insisting the name should be used only for rice grown in the Basmati region of India. The Indian government claimed similar status for basmati rice as that granted to Champagne, Cognac and Scotch whisky.

A team of agricultural scientists screened several research papers, reports and proceedings of seminars, conferences, symposia, journals, newspapers and archives for relevant supporting information to establish the existence of prior-art in this area in India.

The documentary evidences against the claim Nos. 15, 16 and 17 of the company for novelty were so strong that Rice Tec had to withdraw these claims. The company further withdrew 11 claims. Thus only five of the Rice Tec's original 20 claims survived the Indian challenges. The patent granted simply gives three hybrid varieties Bas 867, RT 1117 and RT 1121. The new rice has nothing to do with basmati. Importantly, none of the claims granted by the patent pertain to basmati rice as a generic category. Also, the Rice Tec. application was for a patent and not for basmati as a trade mark, so there is no question of Rice Tec getting exclusive rights to use the term basmati. The patent granted, therefore, neither prevents Indian Basmati from being exported to the US nor puts it at a disadvantage in the market.

Question 4

FACTS : Anand, the news reporter on behalf of the print media newspaper WORLDNEWS approach Alexander for his comments on the Indian foreign policy after the surgical strike of Indian force against Pak Sponsored terrorism. Alexander assured him to provide a piece of article written by him instead of the interview due to paucity of time. His Article was critical of the role of Pakistan and China on terrorism issue. Subsequently, he sends the article to Anand, which he submits to the WORLDNEWS as an editorial article after making certain corrections. The edited version of article is soft on China for his role of international terrorism. Based on above facts answer the following questions :

(a) Who owns the copyright on the given piece of article ?

(b) Is there any violation of the rights of the author of the copyright work ?

(6 marks each)

Answer 4(a)

In copyright, the Author and owners are two distinct personality. As per Section 17 of the Copyright Act, 1957, the Author becomes the owner of his copyright work. However, this is subject to the provisions of the Act. If the Author creates a work during the course of employment under the contractual obligation of any creative work, then in the absence of any contrary conditions, the employer will be the owner of the work owing to the Contract of employment.

However, if the contact of employment is not in between the creator and the owner of the publication, then the copyright work belongs to the author and owner of the work.

For instance Section17 (a) provides that where a work is made by the author in the course of his employment by the proprietor of a newspaper, magazine or a periodical

under a contract of service or apprenticeship for the purpose of publication in a newspaper, magazine or periodical, the said proprietor, in the absence of any agreement to the contrary will be the first owner of the copyright in the work in so far as it relates to the publication of the work in any newspaper, magazine or similar periodical or to the publication of the work for the purpose of being so published. Except in such cases, the author will be the first owner of the copyright in the work. In *V T Thomas* vs. *Malayala Manorama Co Ltd*, it was held that in the case of termination of the employment, the employee is entitled to the ownership of copyright in the works created subsequently and the former employer has no copyright over the subsequent work so created. It is based on this distinction between employees and the freelancers that the Court in this case, recognized authorship of the content and form of the cartoon series in favour of the freelancer Thomas. There thus exists disparity in the rights over copyright of a freelancer who contributes to a periodical and an employee who creates an original work in course of his employment under a contract of service.

In the given case, Alexander has written an article not in the capacity of the employee but as independent of such contractual obligations. Therefore, he remains the author and owner of the copyright work. WORLDNEWS or Reporter Anand cannot be the author or owner of the creative work published.

Answer 4(b)

There exists no copyright in news or facts or information, as the same are neither created nor have they originated with the author of any work, which embodies these facts. Facts may be discovered and discovery of facts cannot be given the protection of copyright.

The protection of copyright is afforded only when a fact or event or information or material is applied to create a form of work, literary or otherwise. When there is no copyright in news, there can be no infringement of an original 'idea' either, copyright may exist in the manner of expressing it. That being the position, any edited piece of work which had an established amount of skill, labour and capital put as inputs would amount to innovative thoughts and creation of the editor. Copyrighted material is that what is created by the author by his own skill and labour.

The news element in the information reporting current events contained in the literary production is not the creation of the writer, but is a report of matters that ordinarily are publici juris; let us put in different words, it is the history of the day. They can never be copyrighted and are part of the public domain available to every person.

Accordingly, there is no violation of the rights of Alexander.

Alternate Answer 4(b)

The Copyright Act provide two kinds of rights to author or the owner of the copyright work i.e. economic rights and moral lights. While economic rights are dealing with the commercial benefit of the copyright work, the moral rights are dealing with the right of integrity, alteration etc. The economic rights are subsisting in the copyright work for the number of years of copyright protection, wherein moral rights are perpetual.

In the given case, the moral rights of the author have been affected. His work was modified, altered without his permission and therefore changing the character of the information shared by the author. This amounts to copyright violation of moral rights.

Question 5

(a) Company ABC is a biotechnology related company. It created a new organism by doing the genetic manipulation with the traditional existing organism. Advice on the patentability of such genetic manipulation. (6 marks)

(b) Article 1(2) of the Agreement on Trade—Related Aspects of Intellectual Property Rights (TRIPS) states that intellectual property shall include protection of undisclosed information. Discuss India's National IP Rights Policy for future of Trade Secrets in India. (6 marks)

Answer 5(a)

In 1972, Anand Chakrabarty, a microbiologist, researcher to the General Electric Company filed a patent application in relation to a bacterium from the genus pseudomonas containing therein, at least two stable energy generating plasmids, each of the said plasmids providing a separate hydrocarbon degradative pathway. It was a man–made, genetically engineered bacterium capable of breaking down multiple components of crude oil. It was asserted that because of this property, which is possessed by no naturally occurring bacteria, the invention could treat oil spills.

The patent claims were of three types:

- First process claim for the method of producing the bacteria
- Second, claims for an innoculam comprised of a carrier material floating on water such as straw and the new bacteria, and
- Third, claims to the bacteria itself.

The Patent Examiner allowed the claims falling into the first two categories, but rejected the claim for bacteria. The decision rested on two grounds:

- That microorganisms are products of nature, and
- That as living things, they are not patentable subject-matter.

Later, the Patent Office Board of Appeals reiterated the examiners' decision on the ground that micro-organisms do not fall within the ambit of patentable subject matter since they are living things. Moreover the Court of Custom and Patent Appeals emphasized that this issue was not whether the claimed bacterium was living or inanimate but whether, it constituted an invention made by human intervention. The Court reaffirmed that the bacterium was not a handiwork of nature rather it was Charabarty's own invention. The four statutory categories of inventions, which can be granted patents are process, machine, manufacture and composition of matter. Therefore, on the question as to in which category would the invention fall, the Supreme Court held that Genetically Engineered oil consuming bacterium could be categorized either as composition of matter or a manufacture. The court read the term manufacture in accordance with its dictionary definition, to mean the production of articles for use from raw or prepared materials by giving to these materials, new forms, qualities, properties or combinations whether by hand labour or by machinery.

The court obviously turned back to legislative intent of the drafters of the US Patent Act to ascertain the rationale behind using general and broad terminology "any composition

of matter" or "manufacture." According to the court, this selection of broad language suggested that the drafters' goal was to stimulate innovation in a wide range of then unknown technologies and scientific fields, a goal that would be frustrated if Congress was repeatedly required to amend the statute so as to explicitly delineate new categories of patentable inventions. The court observed that the legislative history of the Patent Act connotes that the patentable subject matter includes "anything under the sun that is made by man." Chakrabarty simply shuffled genes, changing bacteria that already existed. The widest interpretation by the court, let the broadest amplitude to patentability to the living subject matter.

After this historic decision, the US biotech industry flourished and numerous patents have been granted on human made higher life forms such as transgenic crops, mice, fish, cows etc.

TRIPs supported the argument for patenting of microorganism in Article 27.3 of TRIPs. It excludes two specific classes of subject matter from patentability:

1. Diagnostic, therapeutic and surgical methods for the treatment of human and animal; and
2. Plants and animals other than microorganism and essentially biological processes for the production of plants or animal other than no biological and microbiological processes.

TRIPS allow patenting of the microorganism, however does not define microorganism leaving on member states to formulate their own standards relating to it. Indian Patent Act, 1970 through its Section 3 allows the patenting of microorganism and microbiological processes to be patentable. Therefore, India does not allow patenting of microorganism already in the nature, however genetically modified versions of the same microorganism that result in enhancement of its known efficacies are patentable.

Answer 5(b)

Article 39 of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) states that member nations must ensure that natural and legal persons have the "possibility" of preventing such information, within their control, from being disclosed, acquired or used by others without their consent, in a manner contrary to honest commercial practice. It can be inferred that the "possibility" referred to implies that trade secrets should be accorded protection within the legal system and not necessarily in the IP legislative framework of the member nation.

The 1989 General Agreement on Tariffs and Trade discussion paper on India establishes that trade secrets cannot be considered IP rights, because the fundamental basis of an IP right rests in its disclosure, publication and registration, while trade secrets are premised on secrecy and confidentiality. The paper goes on to state that the observance and enforcement of secrecy and confidentiality should be governed by contractual obligations and the provisions of appropriate civil law, not by Intellectual Property (IP) laws.

On May 12, 2016, India approved the National IP Rights Policy, which has seven objectives. One of these objectives is to ensure an effective legal and legislative framework for the protection of IP rights. The steps to be taken towards achieving this objective

include the identification of important areas of study and research for future policy development; one such area identified was the protection of trade secrets.

In a discussion paper on IP rights at the subsequent US-India Trade Policy Forum held on October 20, 2016, in New Delhi, India's representatives noted that India protects trade secrets through a common law approach and reiterated the country's commitment to the strong protection of trade secrets. It was agreed that a toolkit would be prepared for industry, especially small to medium-sized enterprises, to highlight applicable laws and policies that may enable businesses to protect their trade secrets in India. A training module on trade secrets for judicial academies may also be considered. A further study of various legal approaches to the protection of trade secrets will also be undertaken in India.

At present, Indian trade secrets law is a judiciary-made law, based on the principle of equity and common law actions against breach of confidence, with the jurisprudence as a whole revolving around an employee's obligations and duties towards the employer regarding confidential information gained during the course of employment. Indian jurisprudence regarding trade secrets is unclear on a number of important aspects, including:

- the scope of damages in the case of a breach of confidential information;
- theft of trade secrets by business competitors; and
- procedural safeguards during court litigation.

Further, in the absence of a specific trade secrets law, the courts have ruled in favour of the proprietor of information as literary work as defined under copyright law. The recent creation of the National IP Rights Policy has raised hopes for the enactment of a trade secrets law, since this is one of the objectives of the policy.

It can be safely deduced that India requires an exclusive legislation on Trade Secrets and Confidential Protection. It will not only boost the future of Intellectual Property in India, but also do wonders on the economic front. A country like India is supplicating now in its own mind for a legislation which will supplant the non- existing legislation on trade secrets. The initiative taken by the rest of the world in relation to the legislation on trade secrets should jolt India out of its slumber in order to be abreast with the world.

Question 6

Company ABC is specialised in the area of creating software as per the needs of the clients. It developed a software which enhance the performance of the computer in terms of speed. Company ABC wants to provide the IPR protection to the software. Please advise on this issue to the company. *(12 marks)*

Answer 6

Computer Software is a matter of Intellectual Property Rights protection and recognized at International Level by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). TRIPS provide patents as well as copyright protection to the computer software. However, there are conceptual differences between patents and copyright. Therefore, the protection of the computer software has to qualify the eligibility criteria of the patents or copyright to claim the protection of IPR.

For protection of software for patent rights, the eligibility criteria of novelty, non-obviousness etc. has to be with regard to the software. However, the Patents Act, 1970 excludes certain innovations from the purview of the Patent Act, 1970. Section 3 and 4 of the Act specify a list of subject matter that is not patentable, in particular "a mathematical or business method or a program per se or algorithm' is of a specific importance to a software innovation (Section 3(k)). The Indian Patent law does not contain any specific provision regarding the protection of computer software.

Computer software on the other hand is protected as applicable to literary and aesthetic works. Computer software which does not have a technical effect is protected under copyright law. A computer program is therefore dealt with literary work and the law and practice in relation to literary works will apply to computer programs.

For a copyright protection, computer software needs to be original and sufficient effort and skill must be put into to make it original work of the author.

A program which generates multiplication of tables or algorithm may not suffice the degree of efforts required for protection.

Apart from it, the work should be first published in India or if published outside India, the author on the date of publication should be citizen of India.

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FORENSIC AUDIT
(Elective Paper 9.4)

Time allowed : 3 hours *Maximum marks : 100*

NOTE: *1. Answer ALL Questions.*

2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.

Question 1

Case Study :

Jupiter Hospitals Ltd., (JHL) is a renowned corporate house owning a famous hospital called "Jupiter Hospitals". Two family groups (L and M) controlled the majority of the shareholdings in the company. The hospital is operated in Coimbatore, a non-metro city, where electronic and cheque transactions were not much high and patients mostly were making payments in cash.

The management of the company facing problems because of some disturbing events taken place during the financial year 2018-19. All these events are summarized as under :

(i) Robbery in Pharmacy :

A robbery took place in the pharmacy in the night of 29-3-2019 and cash of around ₹20 lakh was lost in the robbery. The robbers had entered through a window pane during 2 a.m. to 3 a.m. when none was present in the pharmacy. They decamped with all the cash in the cash chest, leaving nothing behind. No traces were found to have left behind by the robbers. Fingerprints were seen on the chest as they had not been wiped off. However, none belonged to an outsider (other than employees). The CC TV camera had turned defective a day earlier being 27-3-2019 and had been given for repairing and accordingly no help was available through CC TV recording.

Two key personnel in the pharmacy, the manager and the cashier, were supposedly doing a good job, showing remarkable growth in the night sales of the pharmacy. It is further to be noted that in nights high priced medicines were sold in huge quantities. The sales in comparison during day time was found to be less. The increase in sales was also having issues and complaints from the patients that the bills issued by the pharmacy for the goods purchased by them and cash received when asked to be verified for onward transmission for making claims, were not authenticated by saying that the same were not issued by the pharmacy. It transpired to the management that the employees involved are being in the habit of issuing the duplicate bills.

It was further reported by the internal stock auditor that there is collection of the expired goods in the pharmacy and why the same has not been got replaced or exchanged from the companies as per policy.

The police who came for investigation hence concluded that the act of robbery might have been done by a North Indian gang who were committing similar crimes in the locality and area and thus closed the case file.

Insurance policy for loss of cash in safe had expired on 20-3-2019 and was not been renewed, since it was felt that no robbery would take place in a hospital which is always having movement of patients. The management entrusted the work to a forensic auditor to investigate the issue.

(ii) Related Party Transactions :

There were complaints put in the suggestion box by the various persons that some directors were making money from the purchase contracts which the hospital was entering into with the concerns in which these persons were interested. Till 15th March, 2019, the hospital had made purchases of around 22 crore from such related parties. However, on comparison with the earlier year, this was marginally higher by 5% and was thus not taken care by the management of hospital.

The allegations were that the prices paid were higher than the market prices and that some of the concerns were not reputed and have been earmarked by the drug authorities also.

There was a Purchase Committee which monitored the purchases and so the allegations were initially ignored. However, when they started pouring in, the Audit committee decided to investigate the matter and entrusted the job of ascertaining the correctness of the allegations to the forensic auditor.

(iii) Drop in Hospital Revenues :

There is an arrangement between the two groups of the shareholders that each group will administer the hospital for three years on a rotational basis. Group L's tenure had ended on 31-3-2018 and during the current year, group M had taken over the administration. Despite the number of surgeries and of other patients had not been dropped, there was a sharp fall in the revenues of hospital in the year 2018-19, except from the pharmacy. The cashier desk was managed by a director or his relative for having control over the cash. Group 'L' desires a forensic audit of the affairs to be conducted and entrusts the same to an outside forensic auditor. In this backdrop you are being appointed as an 'Outside Forensic Auditor' to investigate all the three issues and required to give your report on the matters indicating :

(a) That it was not a robbery, but defalcation of goods camouflaged as cash sales and subsequent given shape of robbery. You are required to build up all such points from the details given on which you could have come to such conclusion. Make reasonable assumptions in this regard as being found necessary to draw up the report in the matter of robbery as reported. (10 marks)

(b) In respect of the related party transactions, suggest a suitable strategy to be applied to carry out the forensic audit in an effective manner. (10 marks)

(c) How the forensic auditor should plan his course of action to investigate and find out the cause of drop in revenue of hospital ? (10 marks)

(d) What are the consequences under the Companies Act, 2013 and Income-

tax Act, 1961 when the cause of drop in revenue is being proved ? State the steps to be taken by the company to remedy the situation so caused.
(10 marks)

Answer 1(a)

Robbery in the Hospital

Various points are being build up by the forensic auditor to prove that it was not a robbery. Those points are discussed as below:

i. The first suspicion is that no clue had been left behind by the robbers, which indicated that there is some collusion because there's nothing like a perfect robbery.

ii. The Hospital area is reasonably guarded area. Therefore it seems that it is difficult for outsiders to enter the premises and commit a robbery by breaking in some window open for making the entry.

iii. When a small cash chest is opened by fraudster using a duplicate key, it would have left some points or telltale evidence. In this perspective, it is inconceivable that there were none being found.

iv. Remarkable increase in night sales is hard to believe because in a hospital more sales take place during the day time.

v. The system login details to be seen to find out that the manager and the cashier had logged in during the night hours on the days of purported high night sales, to invoice fictitious sales.

vi. The date of robbery is few days prior to 31-3-2019, when stock taking would have been done and defalcation of stock would have been detected. To escape this, the manager and the cashier had punched in fictitious sales invoices and generate heavy cash available in the cash chest.

vii. It is worth to be noted that fraudsters had concentrated on high priced medicines, being sold in the nights -

- For making their defalcation exercise easier and
- For generating cash balance, purported to be shown as being robbed, whereas the same was defalcated.

viii. In the cash chest, there were no fingerprints of an outsider, because no outsider was involved. A smart robber inside the organization would have wiped off all the fingerprints easily, but not an outsider. This is a case of purported employee collusion where they knew the loopholes in the internal control system which the fraudsters used to their advantage. (Internal Control System Effectiveness needs to be reviewed.)

ix. In addition to this process, the following factors needs to be looked into by the auditor for corroborating his or her investigation in the matter:

- For Manager and Cashier, it has to be checked whether a background verification done on them when they were recruited. Auditors to check that.

- How many years of service, the Manager and Cashier has rendered to the hospital.
- Were there any previous records against them?
- They also need to be interviewed to get some details about them and their personal life.
- A market intelligence team could be deployed to check on their lifestyles to see if there is a sudden change.

x. The CCTV had not turned defective by its own. This was done by the two fraudsters deliberately and not got repaired immediately, so that there is no evidence through the CCTV available for this act. Further, all the CCTV cameras needs to be checked to see if there was any trace of people entering the premises at the time of robbery.

It is further to be seen by the auditor regarding the compliant of the customers as to the issue of duplicate bills. This indicates that the low price sale had been complying in high value sales by having duplicate bills. The modus operandi in this respect needs to be looked into under the light of following perspectives:

- On what basis duplicate bills were issued.
- How many duplicate bills were issued during the month?
- Was it issued only during night sales?

The increase in the items of the dead and expired goods in the pharmacy may attract the attention of the auditors to find out the reasons. It is also possible that the employees involved had purchased such goods from the market and piled up in pharmacy so that stock inventory gets tallied on 31-03-2019.

Answer 1(b)

Related Party Transactions

The Forensic Auditor to investigate such transactions may adopt the following strategy:

i. The register of contracts (form MBP-4) maintained under section 189 of the Companies Act, 2013 should be seen first. There is a specific query as to whether the transactions are at arm's length. The reply for the same is to be seen carefully.

ii. The Minutes of the various Board meetings in which the said Register was placed for the approval of the Board must be looked into, in order to find out the number of directors who had voted against the transactions or directors remaining neutral. The Auditor should have conducted interviews with them to ascertain their views. The reasons for voting against or remaining neutral could be crucial to the issue on hand. The remarks column, if found filled up in MBP-4, then merits special attention of the Forensic Auditor.

iii. The manner of working of the Purchases Committee must be looked into. The minutes of meetings of Purchase committee to be referred to ascertain the

procedure for selection of vendors. The criteria based on which the Committee had short listed the related party concerns must be seen. Whether aspects such as qualifications, experience, etc. were met with, are to be seen. Whether competitive quotations were obtained should be seen, including the aspect of whether bids were received from other reputed companies or not. Vendor comparison sheet should be reviewed.

iv. In respect of the quotes found higher, it is essential to ascertain as to who such parties were provided with higher quote. Whether there was collusive bidding to deliberately present a higher price, so as to make the prices of related party concerns lower, should be seen. In order to find out collusive bidding, one under to undertake the following activities:

- Analyze the purchase contracts entered into in the last 5 years to comprehend since when contracts started getting awarded to related concerns.
- A disk imaging of the procurement/ committee head and his team members should be performed. The emails and other communications needs to be reviewed to identify any red flags.
- Identify vendors who have been blacklisted or discontinued in the last 5 years and contact them to understand the reason for blacklisting or discontinuation.
- Is there any conflict of interest angle needs to be checked, i.e. any relationship exists between purchase committee members and the UBOs of the companies to whom contracts were awarded?

v. Since the value of contracts with related parties exceeds Rs. 20 crores, the domestic transfer pricing provisions of the Income-tax Act, 1961 will apply and be examined in this perspective. However, for the current year, domestic transfer pricing report of an auditor may not be available; the report of the earlier years will be useful.

vi. It should be seen how the Company had treated the related party transactions in the return of income. If the company had determined the arm's length price (ALP) at lower prices and thereby voluntarily agreed for primary adjustments. This will be very good evidence to intricate collusion and loss.

vii. If any Income Tax Assessment of any earlier year in which domestic transfer pricing was involved has been concluded, the income-tax assessment order, including all assessment correspondences must be seen. Forensic auditor will get valuable information from the same.

Answer 1(c)

Drop in Hospital Revenues

i. Major avenues from which Jupiter Hospital derives income need to be examined such as from surgery and room rent, from laboratory and Scan & X-Ray Unit and from OPD Patients.

ii. Hospital rate charts for last 3 years needs to reviewed and compared with current year to see if there is any major negative variance.

iii. The register of patients maintained at the three wings being surgical ward laboratory, scan and X – Ray and OPD must be verified. The same should be compared with the earlier year to compare the number of patients.

iv. Bank account in which payments get credited from patients' needs to be reviewed.

v. Bank and revenue account needs to be reconciled to see payment received has been completely accounted.

vi. Invoices/Bills to be reviewed to see if there are any red flags.

vii. Given that there is an increase in the number of patients opting for surgery, visiting the laboratory and using the scan facilities has not diminished, it is unlikely that there will be a reduction in the surgery fees charged (It is most likely that there will be a hike).

viii. In this scenario, the only obvious thing is that the receipts are under invoiced/ billed. Given that a director or his relative sits at the cash counter, this could easily happen.

ix. Reason for appointing a director or relative as Cashier needs to be checked.

x. Auditor should interview some patients who had recently undergone surgery, visited the lab, etc., to ascertain how much they have actually paid and what amount was stated in the receipt issued to them. Further, the auditor can interview employees or former employees so as to get some insider information.

xi. The Auditor may found that for surgeries, a mere acknowledgement was issued to patients which merely stated that they had paid the amount. There was no issue of proper receipt. Later on the receipts were prepared for lower amounts by Group M, so as to lower down the revenue and deflection of cash.

xii. For the lab, receipts issued are to be looked into as no test took place prior to the issue of the receipts.

xiii. Can arrange for some known persons to use the hospital facilities and gather live evidence as to payments and receipts issued and the modus operandi employed by the cashier.

The cumulative effect of the above leads to the inescapable conclusion, to be taken by the Forensic Auditor in his report that Group M had been suppressing the receipts of the hospital and same being drawn by them through the cashier's desk which was managed by their relative and to falsify, the drop in the revenue.

Answer 1(d)

Consequences of the Detection of Fraud

Under the Companies Act, 2013

Considering the consequence of corporate frauds on the growth of Corporates and Economy, the Companies Act, 2013 lists down frauds and prescribe penalties and punishments for violations.

Suppressing the sales is clearly an act of fraud committed on the company.

Section 447 of the Companies Act, 2013 deals with provisions relating to punishment for fraud.

The Section reads that 'Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.'

The Companies Act, 2013 has provided punishment for fraud as provided under Section 447 in around 20 sections of the Act e.g. u/s 7(5), 7(6), 8(11), 34, 36, 38(1), 46(5), 56(7), 66(10), 75, 140(5), 206(4), 213, 229, 251(1), 266(1), 339(3), 448 etc. for directors, key managerial personnel, auditors and/or officers of company.

Under the Income - Tax Act, 1961

Suppression of revenues will result in concealment of income by way of under reporting and negative reporting of the income.

Concealment will lead to levy of penalty u/s 270 of the Income Tax, 1961, which may be of 300% of the tax on such income.

Prosecution may also be launched on all the officers involved.

Remedial Measures

Since the financial year has not yet ended or assuming that returns have not been filed with ROC, remedial measures can be taken. A series of remedial actions, which could be taken in this matter are listed as below:

- JHL may rewrite the books of account of the company, after due correction of the necessary record like the cash receipts issued and draw up the financial statements reflecting the true and correct state of affairs of the company.
- The annual statements should reflect the true and correct state of affairs. In the notes on accounts, there should be a clear note to the effect that the accounts have been rewritten /recast to rectify the position emerging as a consequence of suppression of revenues of the hospital.
- The return of income filed for the AY 2019-20 should be based on the redrafted financial statements. In such a situation, the company may escape from the penal provisions of section 270A of Income Tax Act, 1961 and prosecution proceedings.
- Forensic Audit Report findings could be published in the Annual Accounts along with remedial action performed or planned to be performed.
- Action taken against fraudsters need to be mentioned.
- Total fraud amount needs to quantified and published accordingly.

Question 2

A multi-national software company (MNC) having operations globally received a series of allegations about Mr. AK, a manager in senior position at Mumbai. The allegation was that he was receiving bribes and for that he had been inflating certain payments to be made.

The employment records of the manager were impeccable. He had been with the company for a decade and had helped his division of which he was the manager to reach higher levels and increase in company revenues.

The complaints were initially ignored, but they were repeated month after a month, causing concern to the management. The Ethics Committee decided to look into the same and to have a forensic audit to look into the aspects involved.

In this backdrop you are required to answer :

How should the forensic audit be conducted by an auditor to examine the various aspects of the allegations and of higher payments covering the :

(a) First level investigations of the allegations. (5 marks)

(b) Subsequent level investigation of suspected fraud of higher payments. (7 marks)

Answer 2(a)

Bribery Complaint against Employee and First Level Investigation

The forensic auditor (FA) should take into account the fact that the employee was driving growth despite a slowdown in the market. The Board of the company was extremely happy with his performance, there were possible strategies being employed by him for the increase in the revenue.

Data Collection - IT : email backups, company mobile devices as per the company policy and applicable law, electronic data from the computer device of the suspect.

Data Collection - Paper Based: suppliers documentation since pre-vendor creation stage, quotes, bids, invoices, payments, delivery, acknowledgements, revisions to contracts, etc. for the alleged suspects tenure with the company.

Data Analytics will help identify Relevant Statistics:

1. Significant increase in business or particular product line in that business.
2. Significant increase indicates most likely vendors who could have received business by paying kickbacks.
3. Scrutinizing procurement procedure as to ascertain disproportionate increase in certain raw materials in comparison to corresponding revenues.
4. Review of vendor assessment procedure, analysis of vendor master for new vendors instead of old ones, or alternate vendor/ supplier development for certain process or raw material.
5. Tracking irregular inventory movement or unnecessary procurement of raw material.

Answer 2(b)

Subsequent Level Investigation

- In order not to arise any suspicion in the minds of AK, the FA should take up cases of few other senior managers also. The management should spread the word around that it was a routine investigation.
- FA should gather details of financial position and list of relatives of AK. These can be gathered from the statements and declarations periodically made by the employees with the company. Income tax (IT) returns filed by AK or his relatives in previous years can be referred. Notice, assessment orders and any such communication with IT Department can be verified from IT website or emails
- FA should conduct investigation into the financial affairs of the close relatives of AK. Normally, such employees do not buy assets in their own names, but in the name of the close relatives. If any new assets have been acquired during the last two or three years by them, FA should conduct a background check to see whether they possess the necessary means or qualifications to earn the alleged type of income disclosed by them. For example, if the earnings of the relatives are stated to be from commission, brokerage, tuition income, etc., then a closer scrutiny is required. Sometimes, in the name of wife or close relative, huge income is said to be earned from running beauty parlor. FA then should check whether there is actually such a parlor and if yes, whether the clientele is such that the alleged income can be earned therefrom.
- If any immovable property had been acquired in the recent years, it should be seen whether any extra consideration besides the one stated in the registered deed of conveyance had been passed on or not. This is an easy way to siphon out bribes received. Search report in his name relating to properties owned by AK or relatives from legal department /lawyers of the company.
- The lifestyle of AK should be investigated by FA to see whether the same is commensurate with the salary drawn from the company. Foreign trips or purchase of luxury cars in recent years can be tracked
- FA should find out whether the relatives of AK have vested financial interests in any company, which had been supplying work to or receiving any outsourced work of the MNC. This will give an indication of favoritism and close dealings between AK and these entities. In such case, certain bribes said to be padded on to these entities to get the work and accounted by MNC in some other manner, may not wholly flow out to these entities. AK may pocket a portion of it and the complaints could then be true.
- FA should investigate the major cash outflows made through AK to see whether there are any fees paid for bogus referrals, commission, consultation fee, etc. or to see whether they could be inflated by carrying out comparative study of the earlier periods, industry trends, tests of reasonableness, etc.
- An interview could be scheduled with the Target and presented these evidences to check for his response. Interviews of targets is an important step undertaken in forensic investigation assignments wherein the targets breakdown and

confess. Their confession statement is an important document in the court of law for initiating criminal proceedings against them.

- Evidences obtained as part of Data Analytics and Disc Imaging have to be thoroughly checked.

The findings should be evaluated in an unbiased manner by the FA to determine the correctness of the complaints.

Question 3

Thrivikram Dazzlers (TD) is a reputed diamond jewellery merchants in existence for the past two decades. Their jewellery store was located at Chennai and the branch was also operated at Mumbai.

TD had been regularly dealing with a client at Delhi named Sunil Raina & Co., (SR). SR generally electronically transfers funds to TD for purchases. An employee "EM" of them then would visit TD and take delivery of the jewellery ordered. EM had become familiar to TD, having been visiting the shop for the last three years regularly. On 24-3-2019, there was an electronic transfer of funds from SR for a sum of ` 16 lakhs. EM produced a letter in the company's letter head which stated that the articles purchased were gifts for special clients for certain services rendered and hence requested that invoice be made out in the name of EM for 3 necklaces and that the delivery be effected to EM.

TD mailed to SR and asked for a confirmation regarding supply of goods in the name of EM. A mail was received in reply confirming the same. TD hence complied with the same after receipt of mail from SR.

On 30-3-2019, TD received a phone call from SR asking them why the goods had not yet been delivered despite the payment being made on 24-3-2019. Only then it transpired that EM had defrauded SR and TD.

Both TD and SR approach you, a leading forensic auditor, to conduct a joint forensic audit and submit a report. Both are willing to cooperate with you in providing details and information and records.

(a) Outline the aspects to be considered of the transaction by the Forensic Auditor for taking course of action in detecting the truth of the employee EM. (8 marks)

(b) What would have been the course of action, taken by the Forensic Auditor, in case TD is a dealer in consumer products like costly refrigerators, TV sets, etc., and the goods delivered to EM were six costly TV sets ? (4 marks)

Answer 3(a)

Defalcation by employee of customer Sunil Raina & Co., Delhi

Following aspects are to be looked into by the forensic auditor for taking his course of action in detecting the truth.

(i) TD and SR should be asked to lodge a complaint with police about the incident taken place of taking delivery of goods by EM from TD by having invoice being made in his name.

(ii) The employment records of EM available with SR should be seen and must be looked into by whom he was referred for employment.

(iii) EM's immediate reporting manager needs to be interviewed to understand EM's general conducts during his employment and if there were any issues against him. In order to understand his general conduct, following concerns must be looked into:

- Did EM keep his Manager in loop when conducting company related transactions?
- EM's residence needs to be visited to interview few people staying in that area if they know him and his family and their social image.

(iv) His previous employment certificate should also be verified so as to analyze his conduct.

(v) Enquiries should be made to ascertain the service records with the earlier employees of EM in a secret way. It is possible that the earlier employer certificate given by EM to SR is a fake document.

(vi) If the employer really existed, then it should be investigated whether EM had any history of proved or unproved allegations against him during his employment and why he had left the job.

(vii) If the previous employer had not given a clean chit to the auditor then find as how the Human Resource Department of SR had hired him. There could be a collusion here with the HR.

(viii) The authorization letter in SR's letter head should be deeply looked into to find out that whether it is in legitimate company stationery or not? If yes, then a deeper scrutiny of the trial to find out as how EM could get hold of the same, should be investigated. Who signed the same must be seen and authenticity of signature of the person to be verified. If someone other than EM (forged), then here is an accomplice, which should be brought out of records.

(ix) TD sent a mail to SR asking for confirmation of delivery of goods to EM. This shows that a reasonable precaution was taken by TD prior to supply.

Forensic Auditor should find out whether TD send such mail to the official email id of SR or to some other email id mentioned in the "authorization letter" produced by EM. If it is an official email id, then TD is not at fault. If it was be the latter, then it could be a case of sheer negligence on the part of TD, or there could be an accomplice for EM in TD shop. These aspects merit attention and deeper scrutiny.

(x) If TD had sent the mail to SR to the official mail id and got back a confirmation mail, who sent it must be investigated. This person is clearly an accomplice of EM. In case of common id, IP address of device from where it is sent to be identified.

(xi) If this employee gave confirmation based on a superior's order, then it is SR which is at fault. In such cases, any act done by any of its employee (EM) will

be construed to be act done by an agent, which is binding on the principal SR. TD cannot be held liable in such a situation.

(xii) Checking mobile call logs to ascertain whether he has contacted any other employee in either of the companies.

The Forensic Auditor by applying the aforesaid course of action can find out the truth of the case for making out a report for TD and SR.

Answer 3(b)

Where the goods delivered were costly TV sets instead of Jewelry

In such case, apart from the course of action stated in Answer 3 (a) of this paper, the forensic auditor should also look into the following aspects:

1. How the delivery of goods were taken of?
2. Was it in TD's vehicle or was it arranged by EM?
3. If TD's vehicle, place of delivery is easy to track, if latter, the vehicle owner should be found out and place of delivery be ascertained the said place can be visited to find out if there is a nearby market for such goods.
4. E-way Bills are required under GST law for transportation, since the value of the products exceed Rs 50,000. The e-way bills should also be studied for clues, if any.

Question 4

Anustup Chandra Heavy Electricals Ltd., is a major player in the league of manufacture of heavy industrial boilers and steam turbine. The company had won a major bid for a big project in Colombo for fabrication of 10,000 MW boiler and turbine. The company outsourced some of the activities through a system of open tender and awarded contracts to eight different companies.

The company received complaints from three different bidders that there was a collusive bidding by four entities, to whom different contracts had been awarded by the company.

You are appointed to conduct forensic audit to determine whether the complaint made by the three different bidders is having any merit. Your approach be based on:

(a) What will be the indicators/red flags you will look for ? (4 marks)

(b) What will be your line of investigation, to determine whether there has been really any collusive bidding ? (8 marks)

Answer 4(a)

The forensic auditor in order to determine the merit of the complaint made by three bidders as to the collusive bidding shall look into following aspects as indicators/red flags:-

i. Whether the winning bids are low when benchmarked against the company estimates, past experience and industry standards.

ii. Whether the entities complained against, had very close price range, similar experience tenure, consistent in terms, conditions and technical specifications.

iii. Whether these entities were operating from same building with just different office/door numbers marked like say 23A, 23B, 23C, etc.

iv. Whether some of the qualified bidders who failed to make it to short list were internally rated good for performance, based on past experience and their marked reputation.

v. Unusual bid patterns (e.g. the bids are exact percentage apart, winning bid is just under thresh hold of acceptable prices, exactly at budget price, too high, too close round numbers, incomplete etc.)

vi. Conflict of interest angle needs to be looked into i.e. any relationship exists between procurement head and the chosen vendors

Answer 4(b)

The line of investigation after looking into the indicators/red flags shall consist of:-

i. Prepare a questionnaire for interviewing the complainants and those who failed but rated good and conduct interview of the complainants and investigate through confidential sources.

ii. Data collection paper trail: bid documents, requests for bids, bid comparison documents prepared internally, Bill of Quantities (BoQs), comparison line item wise and bid securities.

*Identify physical similarities in the bid documents like paper quality, colour schemes, type, faces, formatting, language, etc.

iii. Connection between bidders on inter-company connections, common address, contacts details, etc.

iv. Unusual bidding patterns comparing the financial and quantity data line item wise. Test whether they are exact percentages or value apart.

v. Conduct a physical verification check of the addresses given by the bidders in question to see whether they are operating from same building or not.

*Background check on all the final shortlisted bidders for finding out common ownership, employees, affiliations or prior involvement in the other collusive bidding schemes.

vi. Review the bid security details in order to identify whether issued by same bank and branch to group of bidders and/or issued to bidder by the same day in all the cases.

vii. Most bid documents have a special enquiry / audit enabler clause. Exercising that right on the winning bidder is conducted as a routine formality. Instead, a detailed inquiry can be made into the business of the winning bidder.

viii. Interviewing the winning bidder based on the information collected and from the above processes and as given by them in bid documents. Also have interview

of the three complainants and all of the other bidders who have lost the bid to find out the reasons of their failure.

Question 5

In a college, the cashier has been accused of embezzling fees collections. After the conclusion of forensic audit, the Forensic Auditor (FA) obtained a confession statement from the cashier admitting the embezzlement. Forensic Auditor plans to make use of the same in fortifying his conclusions and in the suit proposed to be initiated against the cashier.

(a) Discuss the aspects involved in construing the confession obtained as "admission". (4 marks)

(b) Examine whether the same will be accepted as evidence in the Court of Law. (5 marks)

(c) Can part of the confessional statement alone be used ? (3 marks)

Answer 5(a)

Evidentiary value of Admission of Guilt

In general, Admission is a voluntary acknowledgment of a fact. Importance is given to those admissions that go against the interests of the person making the admission. For example, when A says to B that he stole money from C, A makes an admission of the fact that A stole money from C. This fact is detrimental to the interests of A. The concept behind this is that nobody would accept or acknowledge a fact that goes against their interest unless it is indeed true. Unless A indeed stole money from C, it is not normal for A to say that he stole money from C. Therefore, an admission becomes an important piece of evidence against a person. On the other hand, anybody can make assertions in favor of themselves. They can be true or false. For example, A can keep on saying that a certain house belongs to him, but that does not mean it is necessarily true. Therefore, such assertions do not have much evidentiary value. According to Black's Law Dictionary [*Roosevelt* v. *Smith*, 17 Misc. Kep. 323, 40 N. Y. Supp. 381], "A voluntary acknowledgment, confession, or concession of the existence of a fact or the truth of an allegation made by a party to the suit."

An admission is any statement made by a party to a lawsuit (either before a court action or during it) which tends to support the position of the other side or diminish his own position. For example, if a husband sues his wife for divorce on the grounds of adultery, and she states out of court that she has had affairs, her statement is an admission. Any admission made by a party is admissible evidence in a court proceeding, even though it is technically considered hearsay (which is normally inadmissible). Attorneys tell their clients not to talk to anyone about their case or about the events leading up to it in order to prevent their clients from making admissions.

An admission is the testimony which the party admitting bears to the truth of a fact against him. It is a voluntary act, which he acknowledges as true the fact in dispute. An admission and consent is, in fact, one and the same thing, unless indeed for more exactness we say, that consent is given to a present fact or agreement, and admission has reference to an agreement or a fact anterior for properly speaking, it is not the

admission which forms a contract, obligation or engagement, against the party admitting. The admission is, by its nature, only the proof of a pre-existing obligation or guilt committed, resulting from the agreement or the fact, the truth of which is acknowledged.

Answer 5(b)

Admission of Confession whether be accepted as an Evidence

An admission is defined in Section 17 of the Indian Evidence Act, 1872, as a statement, oral or documentary, which suggests any inference as to any fact in issue or relevant fact, and which is made by any of the persons and under the circumstances mentioned in the three succeeding sections.

The section does not, therefore, contain a complete definition of the word “admission", in as much as it does not define the persons whose statements amount to admissions, nor the circumstances under which a statement must be made so that it may amount to an admission. This part of the definition of an admission is left to the interpretation of sections 18 to 20 of Indian Evidence Act, 1872.

Therefore, the question whether a statement amounts to an admission or not depends upon whether it was made by any of the persons, and in any of the circumstances, described in sections 18-20, and whether it suggests an inference as to a fact in issue or a relevant fact in the case. The fact that the statement suggests an inference in favor of the person who made the statement and/or does not make the statement as less an admission, as the question whether a statement is or is not an admission, different from the question whether an admission may or may not be proved in favor of the person making it.

So that a statement may be an "admission” in the sense in which this word is used in this set of sections, it must be an oral or documentary statement. A statement may be made otherwise than by word of mouth or writing, but such a statement can hardly be described as an oral or documentary statement.

Admissions by conduct are not governed by this set of sections, as inferences suggested by active or passive conduct are not oral or documentary statements. The proper section under which the relevance of admissions by conduct must be established is Section 8 of the Evidence Act, 1872 as a statement made by conduct will be admissible or inadmissible according to whether it falls or does not fall within “the terms of that section.”

If an admission is capable of two interpretations, an interpretation unfavorable to the person making it should not be put on his admission. The requirement is that an admission must be clear, precise, not vague or ambiguous.

Answer 5(c)

Can a part of the admission alone be used?

An admission must be used either as a whole or not at all [*Hanumant Govind Nargundkar* v. *State of Madhya Pradesh*, 1952 SCR 1091].

When a statement which is sought to be given in evidence forms part of a longer statement, evidence shall be given of so much of the statement as is necessary to the full understanding of the nature and effect of the statement.

Before any statement can be used as an admission it must be shown to be unambiguous and clear on the point at issue. In no matter, a confessional statement in part can be used, as held by the Apex Court.

Question 6

Vishnu Polymers Ltd., has got complaints from three anonymous persons which were found placed inside the employee's complaints box, that the internal financial controls for cash management in the company are weak and that the head cashier is defrauding the company by making defalcation of cash.

You are appointed to conduct the forensic audit to weigh the veracity of the complaints received, both regarding the weaknesses of the system, if any and about the charges on the head cashier being levied.

(a) What are the statutory and other aspects to be considered and look out for in this context, by the forensic auditor ?

(b) What will be the red flag indicators to look for by him ? (6 marks each)

Answer 6(a)

Weakness in internal control system and suspected fraud by Cashier

Internal financial controls in cash management

The main aspect of the complaint is that the internal financial controls for cash are weak.

Internal Financial Control : As per Section 134 of the Companies Act 2013, the term Internal Financial Controls means the policies and procedures adopted by the company for ensuring the following:

- Orderly and efficient conduct of its business, including adherence to the policies of the Company,
- Safeguarding of its assets,
- Prevention and detection of frauds and errors,
- Accuracy and completeness of the accounting records, and
- Timely preparation of reliable financial information.

Adherence to company's policies has also been emphasized here. No company shall have a policy of permitting its employees to make unlawful gains. The FA should therefore thoroughly study the internal control systems for cash.

Internal Financial Control over Financial Reporting : As per Guidance Note issued by ICAI on Guidance Note on Audit of Internal Financial Controls over Financial Reporting," Internal Financial Controls Over Financial Reporting (ICFR) shall mean:

"A Process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles".

A Company's internal financial control over financial reporting includes those policies and procedures:

- Pertaining to the maintenance of the records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company.
- It provides reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles, and those receipts and expenditures of the company are being made only in accordance with authorizations of management and director of the company.
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statement.

Investigation of internal controls by FA

1. The FA can conduct interviews with all mid-Level employees. Disgruntled employees are often the best source for this.
2. Both the aspects relating to cash receipts, cash outflows as well as cash management (like deposits into bank account, whether they are correct) should be thoroughly analyzed by the FA.
3. Monthly comparatives of cash expenses with previous period. Extraordinary increase or decrease in particular expense or payment to a particular party can be scrutinized.
4. Possibility of fictitious refunds should be analyzed by FA

Answer 6(b)

Cashier fraud : Red Flag Indicators

Following are the red flag indicators:

i. Frequent receipt of gifts;
ii. Disproportionate increase in the assets of the cashier;
iii. Unjustified favoritism shown to certain parties.
iv. Multiple refunds or cancellations just under review limit.
v. Excessive number of adjusting entries during specific period.
vi. Change in lifestyle of the cashier
vii. Collusion between cashier persons making payments

Investigation of the cashier on the basis of Red Flag Indicators

- FA should take access of the cashier's emails and all correspondences, company mobiles, as per the company's policy.
- Lifestyle of the cashier should be investigated to ensure that it is commensurate with the salary drawn from the company.

- In case if cashier has history of debts there is likelihood of engaging in opportunistic fraud. Hence FA should initiate background check of the cashier.
- Bank statement of the cashier has to be examined
- Enquiry into the assets acquired by the cashier or his close relatives during the last few years must be undertaken. Most companies ask for annual declarations in this regard and for filing of income-tax acknowledgments. These can also be looked into.
- Deploy a market intelligence executive to keep a track on movements of cashier and his family members. This has to be done discreetly.
- Enquiries can also be made with the HR Department of earlier employer to ascertain whether there have been any similar allegations levied against him.

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DIRECT TAX LAWS & PRACTICE

(Elective Paper 9.5)

Time allowed : 3 hours *Maximum marks : 100*

NOTE : *1. Answer ALL Questions.*

2. All the references to sections in the Question Paper relate to the Income-tax Act, 1961 and relevant to the Assessment Year 2019-20, unless stated otherwise.

3. Working notes should form part of the answer.

Question 1

Mukund Industries Ltd. (MIL), is a big corporate house, with presence in several industries and businesses, subsidiaries and sister concerns. As the Company Secretary, you are also a key person in the Group's taxation matters, including international taxation.

MIL holds a think tank meeting in the month of April, 2019 to arrive at a preliminary idea of its income-tax liability for the previous year 2018-19.

Abhinav Pvt. Ltd.'s activities

Abhinav Pvt. Ltd. (APL) is one of the group companies, having a small presence in the overseas market also. It has agricultural lands in country L with which India does not have a DTAA.

The global turnover of APL during this year was ₹ 210 cores. During the last 7 years, the company has been showing an increase of around 6% in its turnover, as compared to the earlier year.

During the PY 2018-19, APL derived business income of ₹140 lakh from its Indian operations, but made a loss of ₹ 10 lakh from its core business operations in country L.

From its agricultural operations in country L, APL made net surplus of ₹ 22 lakh. In country L, the income earned from other sources was ₹ 8 lakh.

In country L, tax paid is ₹ 5.4 lakh. Agricultural income is taxed there and business loss can be set off against any other income in the same year.

Results of Vaamana & Co.

MIL is a partner in a firm Vaamana & Co. On behalf of MIL, Mr. Vishnu, its director, is a working partner in the said firm. The Taxation Manager furnishes gist of the firm's workings, which are furnished infra.

The partnership firm, has earned net profit of ₹ 79 lakhs, before remuneration to working partners. Only depreciation pertaining to current year has been considered in this. The partnership deed provides for remuneration of ₹ 40 lakhs to the working partners, and this amount has also been actually paid by the firm.

The income from other sources earned by the firm during the PY 2018-19 is ₹76 lakhs.

The firm has brought forward business loss of ₹ 7 lakhs (eligible for set off) and unabsorbed depreciation of ₹ 6 lakhs, both pertaining to the AY 2018-19.

Workings of industrial undertaking owned by RPL

Rajalakshmi Textiles Pvt. Ltd. (RPL) is a subsidiary of MIL.

Two industrial undertakings are owned by RPL, units P and Q. Both units are eligible for claiming deduction u/s 80-IA.

During the PY 2018-19, unit P made a profit of ₹70 lakhs, while unit Q made a loss of ₹15 lakhs.

Gross total income of RPL is ₹590 lakhs.

Required :

(a) *Ascertain the tax payable by APL for the assessment year 2019-20. Show the complete workings.* *(15 marks)*

(b) *MIL desires to start a subsidiary company in an "International Financial Centre". he Board of directors desire to know the income-tax concessions available to such company. Outline the same to the Board.* *(9 marks)*

(c) *Compute the total income and tax payable by Vaamana & Co., for the assessment year 2019-20, along with the working notes.* *(11 marks)*

(d) *RPL wants to know whether the total deduction available u/s 80-IA is ₹70 lakhs (without considering loss made in Unit Q) or is ₹55 lakhs (after setting off loss of unit Q). Advice the assessee suitably.* *(5 marks)*

Answer 1(a)

The turnover of Abhinav Pvt. Ltd. 'APL' was less than ₹250 crores during the previous year 2016-17. Hence, the tax rates applicable is @ 25%.

Computation of Total Income and Tax Payable of APL for the AY 2019-20

Particulars		*Amount (₹ in Lakhs)*
Business Income		
Profits made from its Indian Operation	140 lakhs	
Less : Business loss from its core operation in Country L	(10) lakhs	130
Income from Other Sources in country L		8
Agriculture Income in Country L		22
Total Income		160

Tax @ 25%	40
Surcharge @7%	2.80
Total Tax including surcharge	42.80
Add : Cess @4%	1.712
Total Tax including surcharge and cess	44.512
Less : Double Taxation Relief (Note 1)	(5.40)
Net Tax Payable	39.112

Working Note: 1 Calculation of Double Taxation Relief

Particulars	*Amount (₹ in Lakhs)*
Business loss from its core operation in Country L	(10)
Income from Other Sources in country L	8
Agriculture Income in Country L	22
Total Income in Country L	20
Tax Paid in Country L	5.40
A) Average Rate of Tax in Country L [(5.4/20)*100]	27%
B) Average Rate of Tax in India [(44.512/160)*100]	27.82%
Rate to be applied for double taxation relief i.e. A or B whichever is lower i.e. 27% or 27.82% whichever is less	27%
Double Taxed Income	20
Double Taxation Relief (20 * 27%)	5.4

Answer 1(b)

Income Tax Concessions available to a company being unit located in an "International Financial Services Center"

Section 111A of the Income Tax Act, 1961 : Levy of Short Term Capital Gains @ 15% even if Securities Transaction Tax 'STT' not Paid: Second proviso has been inserted in section 111A (1) of the Income Tax Act, 1961 to provide that short term capital gains arising from:

- transaction undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Center
- would be taxable at concessional rate of 15%
- even if the securities transaction tax is not paid in respect of such transaction.

Section 115JB of the Income Tax Act, 1961 : Concessional Rate of MAT @ 9%: Sub-section 7 has been inserted in section 115JB of the Income Tax Act, 1961 to provide that in case of a company, being a unit located in International Financial Services Center and deriving its income solely in convertible foreign exchange, the minimum alternate tax shall be chargeable at the rate of 9% instead of 18.50%.

Section 115-O of the Income Tax Act, 1961: Exemption from levy of Dividend Distribution Tax 'DDT':

- Sub-section 8 has been inserted in section 115-O of the Income Tax Act, 1961 to provide that no tax on distributed profits shall be chargeable
- in respect of the total income of a company being a unit located in International Financial Services Center,
- deriving income solely in convertible foreign exchange for any assessment year on any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise) on or after 1st April, 2017 out of its current income
- either in the hands of the company or the person receiving such dividend.

Answer 1(c)

Computation of Total Income and Tax Payable by Vaamana & Co. for the AY 2019-20

Particulars	*Amount (₹)*
Net Profit before remuneration to working partners	79,00,000
Less : Unabsorbed depreciation of AY 2018-19	
This has to be subtracted while computing book profits as it is governed by section 32 of the Income Tax Act, 1961.	(6,00,000)
Book Profit as per section 40(b) of the Income Tax Act, 1961	73,00,000
Less : Remuneration to working partners:	(40,00,000)
A. First 3 lakhs 90% of book profit and 60% of balance = ₹44,70,000	
B. Amount Authorized by the deed = ₹40 lakhs	
A or B whichever is lower	
Business Income before considering set-off of brought forward business loss	33,00,000
Less : Brought forward Business Loss	(7,00,000)
Business Income chargeable to tax	26,00,000
Income from other sources	76,00,000
Total Income	1,02,00,000
Tax @ 30%	30,60,000
Surcharge, @ 12% as the total income exceeds ₹1 crore	3,67,200
Total Tax including surcharge	34,27,200
Less : Marginal relief (Note 1)	

Tax including surcharge cannot exceed Tax on 1 crore + Increase in Income beyond 1 crore	2,27,200
Tax before Health & Education Cess	32,00,000
Add : Cess @ 4%	1,28,000
Total Tax Payable by Vaamana & Co.	33,28,000

Note : 1 Calculation of Marginal Relief

Particular	*Amount (₹)*
Taxable Income	1,02,00,000
(A) Tax on Total Income of ₹1,02,00,000 @ 30%	30,60,000
Add : Surcharge @ 12%	3,67,200
Total Tax including surcharge	34,27,200
(B) Tax on Total Income of ₹1,00,00,000	30,00,000
(C) Excess Tax liability A-B	4,27,200
(D) Increase in Income beyond 1 crore	2,00,000
(E) Marginal Relief (D-E)	2,27,200

Answer 1(d)

As per the provision of section 80IA of the Income-tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any eligible business, there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to 100% of the profits and gains derived from such business for ten consecutive assessment years.

The deduction available u/s 80-IA of the Income-tax Act, 1961 is related to the unit and not to the assessee concerned. In other words, it is unit specific deduction and not assessee specific deduction.

Therefore, in the given situation, the deduction available to Unit P is ₹70 lakhs.

It cannot be reduced by the loss made by unit Q.

Further, deduction u/s 80-IA of the Income-tax Act, 1961, cannot exceed the gross total income of the assessee. This condition is also met here, since the gross total income of APL is ₹590 lakhs.

Question 2

(a) Ramesh Kumar, is employed by ABC Ltd., an Indian Company, which is a wholly owned subsidiary (WOS) of Finch Inc., of USA, a foreign company. Employee Ownership Plan (ESOP) shares were issued by the foreign holding company to Ramesh Kumar at a pre-determined price of ₹ 90 per share. On the

date of vesting of interest, the fair market value of foreign holding company's shares was ₹900 per share. The fair market value on the date of allotment of shares on 2nd June, 2018 was ₹1,170 per share. You are required to state :

(i) How is the value of perquisite relating to the shares so offered to be ascertained in the hands of Ramesh Kumar ?

(ii) Can he claim deduction in respect of pre-determined price of ₹90 per share paid by him to the company while working out the value of perquisite subject to tax ?

(iii) What will be the cost of acquisition of shares in the hands of Ramesh Kumar for the purpose of charge of capital gain when such shares are being subsequently sold by him ? (6 marks)

(b) Mohan, the owner of piece of land at Chennai, entered into an agreement with Reality Builders as a Joint Development Agreement for construction of a housing complex.

He is desirous to seek your opinion in the context of provisions of Income-tax Act, 1961 as to :

(i) The conditions specified under the Act for charge of capital gain;

(ii) When the capital gain shall be taxed;

(iii) How such capital gain has to be worked out. (6 marks)

Answer 2(a)

(i) Valuation of Perquisites for ESOP Shares: As per section 17(2)(vi) read with explanation (b) and (c) of the Income Tax Act, 1961, the taxable value of the perquisites in the hands of employee is to be calculated on the basis of Fair Market Value 'FMV' of the shares so offered under ESOP on the exercise date as reduced by the amount actually paid or recovered against such shares from the employee.

In the present case, FMV on the exercise date is ₹900/- per share and shares are offered to employee at ₹90/- per share, therefore, ₹810/- per share being the difference between the two prices be treated as taxable value of the perquisites in the hands of Mr. Ramesh Kumar for AY 2019-20.

Note : Assuming the FMV on Date of Vesting as the FMV on date of Exercise of Right as in the absence of Information regarding date of Exercise of right in the question paper.

(ii) Yes, Mr. Ramesh Kumar can claim deduction in respect of pre-determined price of ₹90/- per share paid by him to get the allotment of shares from the company while working out the amount of taxable value of perquisites.

(iii) As per section 49(2AA) of the Income Tax Act, 1961, the cost of acquisition of shares in the hands of employee would be the FMV on the exercise date. Therefore, in the present case, the cost of acquisition of shares in the hands of Mr. Ramesh Kumar would be ₹900/- per share.

Note : Assuming the FMV on Date of Vesting as the FMV on date of Exercise of Right as in the absence of Information regarding date of Exercise of right in the question paper.

Answer 2(b)

(i) *Capital Gain under Joint Development Agreement* : As per section 45(5A) of the Income Tax Act, 1961, Capital Gain in case of Joint Development Agreement shall be applicable, if the following conditions are being satisfied:

- The assessee (who is the owner of land / building) is an individual or HUF.
- There is transfer of a capital asset, being land or building or both.
- The assessee has entered into "specified agreement" with a builder / joint developer for development of housing project.
- "Specified agreement" means a registered agreement in which a person owing land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of share, being land or building or both in such project, whether with or without payment of part of consideration in cash.

(ii) The capital gains shall be taxable in the hands of the owner of land/ building as income of the previous year in which certificate of completion for the whole or part of the project is issued by the competent authority.

(iii) The stamp duty value of the share of owner of land / building in the developed property on the date of issue of certificate of completion (plus monetary consideration received if any) shall deemed to be full value of consideration received / accruing as a result of transfer of capital assets for the purpose of computation of capital gain.

In cases, where, the owner of the land / building transfers his shares prior to date of issue of such completion certificate, then capital gain on such transfer shall be calculated as per the normal provisions of the Act without considering the provisions of the section 45(5A) of the Income Tax Act, 1961.

Question 3

(a) Hari Vallabh Tea Ltd., is engaged in growing and manufacture of tea in Shimla. For the year ended 31st March, 2019, the company distributed dividend of 30 lakhs. The company is of the view that it has to pay dividend distribution tax (DDT) on 40% of such dividend u/s 115-O. The Assessing Officer is of the view that the DDT should be on the entire dividend distributed.

Examine the correctness of the rival contentions. (6 marks)

(b) When can uncontrolled transactions be said comparable to international transactions ? Which data can be used for the comparability of an uncontrolled transaction with an international transaction ? Furnish your answer in the context of transfer pricing provisions. (6 marks)

Answer 3(a)

The issue under consideration is whether dividend distribution tax u/s 115-O of the Income Tax Act, 1961 can be levied on the whole or part to be restricted to 40% being

proportion of business income of a company engaged in growing and manufacturing of tea. The issue came up before Supreme Court in *Union to India* v/s *Tata Tea and others* [2017] 398 ITR 260 (SC).

The Supreme Court observed that as per Entry 82 of List I, the union parliament has the competence to tax, "Income other than agriculture Income". Section 115-O pertains to additional tax at the stage of distribution of dividend by a domestic company which is covered by Entry 82 in List I. When dividend is declared to be distributed and paid to a company's shareholders, it is not impressed with character of the source of its income. Dividend is derived from the investment made in the company's shares and the foundation rests on the contractual relations between the company and the shareholders.

Dividend is not 'revenue derived from land' and therefore, cannot be termed as agricultural income in the hands of the shareholder. Hence, despite the company being involved in agricultural activities, in the shareholder's hands, the income is only dividend and not agricultural income.

The Calcutta High Court had upheld the vires of section 115-O but put a qualification that additional tax levied u/s 115-O shall be only to the extent of 40% which is the taxable income of the company engaged in growing and manufacturing of tea. The Supreme Court over turned this cap placed by the Calcutta High Court saying that section 115-O is within the competence of the Parliament and hence, no limits can be placed on the same.

Accordingly, applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the assessee that only 40% of the dividend distributed by the company is to be taxed u/s 115-O is not correct. The entire dividend distributed would be subject to dividend distribution tax u/s 115-O.

Answer 3(b)

CUP method under transfer pricing : As per rule 10B(3) of the Income Tax Rules, 1962, an uncontrolled transaction shall be comparable to an international transaction if:

i. none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

ii. reasonably accurate adjustments can be made to eliminate the material effects of such differences.

If the differences are material and the adjustments cannot be made, the transaction cannot be taken as comparable transaction, then such transaction shall be ignored.

The internal comparable (i.e. transactions entered into by the associated enterprise with unrelated party) as far as possible should be selected as these will provide mode reliable and accurate data as compared to external comparable data i.e. transaction with third parties.

As per Rule 10B(5) of the Income Tax Rules, 1962, In a case where the most appropriate method for determination of the arm's length price of an international transaction entered into on or after 1/4/14, is the method specified in clause (b), clause

(c) or clause (e) of sub-section (1) of section 92C, then, notwithstanding anything contained in sub-rule (4), the data to be used for analysing the comparability of an uncontrolled transaction with an international transaction shall be:

(i) the data relating to the current year; or

(ii) the data relating to the financial year immediately preceding the current, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year:

Provided that where the data relating to the current year is subsequently available at the time of determination of arm's length price of an international transaction during the course of any assessment proceeding for the assessment year relevant to the current year, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.

Question 4

(a) "All specified Indian companies are required to shift from existing Indian GAAP to Ind AS w.e.f. 1st April, 2016. The adjustments arising on account of shifting from existing Indian GAAP to Ind AS are required to be recorded in Other Comprehensive Income (OCI) at the date of such transition to Ind AS. Several of these items shall never be reclassified to statement of profit and loss whereas some of these items shall subsequently be reclassified to the statement of profit and loss".

In this backdrop in the context of provisions of the Income-tax Act, 1961, explain the treatment to be given to all those adjustments which are recorded in Other Comprehensive Income (OCI) and both would be and would never be reclassified to statement of profit and loss for the purpose of computation of book profits.

(b) "The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions". Explain the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA). (6 marks each)

Answer 4(a)

Ind-AS Companies: OCI - The treatment to be given to all those adjustments which are recorded in Other Comprehensive Income 'OCI' for the purpose of computation of book profits as being specified in section 115JB(2) of the Income-tax Act, 1961, are:

1. Those adjustments which are recorded in OCI and which would be reclassified to profit or loss account subsequently shall be included in book profits in the year in which these are reclassified to profit or loss.

2. Those adjustments recorded in OCI and which would never be reclassified to profit or loss shall be treated as under:

    i. Changes in revaluation surplus of Property, Plant or Equipment (PPI) and Intangible assets (Ind AS 16 and 38) shall be included in the book profit in

the year in which the Asset/ Investment is retired, disposed, realised or otherwise transferred.

ii. Gains and losses from Investments in equity instruments designated at fair value through OCI (Ind AS 109) shall be adjusted in book profits in the year in which investment is retired/disposed/ realised.

iii. Re-measurements of defined benefit plans (Ind AS 19) shall be adjusted in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS.

iv. Any other Item shall be adjusted in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS.

v. All other adjustments recorded in reserves and surplus (excluding capital reserve and securities premiums) and which would otherwise never subsequently be reclassified to profit and loss account, shall be included in book profits, equally over a period of 5 years starting from the year of first time adoption of Ind AS.

Answer 4(b)

Implication of Permanent Establishment 'PE' under DTAA

Double Taxation Avoidance Agreement 'DTAA' generally contain an article providing that business income is taxable in the country of residence unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia) of the Income-tax Act, 1961, the term 'Permanent Establishment' includes a fixed place of business through which the business of the enterprise is wholly or partly carried on. Accordingly, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) of the Income Tax Act, 1961 requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a permanent establishment.

Cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i). However, in the cases not covered by DTAAs, business income attributable to business connection is taxable.

As per section 9 of the Income Tax Act, 1961, there is a "business connection", certain business income will be deemed to accrue or arise in India, and hence become taxable. However, where there is a DTAA, in the absence of PE in India, even such business income may not get taxed.

Question 5

(a)(i) State the provisions of the Act applicable, and the rate at which the tax is either to be deducted or to be collected at source in the following independent cases :

- *A partnership firm is making sales of the timber which was procured and obtained by it under a forest lease.*

- *A nationalized bank receiving professional services from a registered society (resident) and had made a provision on 31st March, 2019 of an amount of ₹15 lacs against the service charges bills to be received relating to the services provided during the year.*
- *Payment of ₹5 lacs made to Mr. Phelps who is an athlete (resident) by a manufacturer of a swim wear as brand ambassador. (1×3=3 marks)*

(ii) *Specify all those circumstances under which an A.O. resorts to make 'Protective Assessment' and for which reason. Can such assessment order be made a basis for taking action to levy penalty under the Act ? (3 marks)*

(b) *Ram Manohar & Sons HUF, consisting of Karta Ram Manohar, his wife, two sons and daughter, is running Ragistan Departmental Stores. Both the sons, who are having professional/technical qualifications as a Chartered Accountant and as an Automobile Engineer started in partnership, a garage for the repairing of motor cars, with a clear understanding that the technical side of the business be looked after by the Engineer, while the general administration and finance part be taken care by the Chartered Accountant. They had taken an interest-free loan of ₹15,00,000 from the HUF for starting the venture. The business of garage resulted in a net profit of ₹12,50,000 for the year ended 31st March, 2019. The Assessing Officer proposes to assess the income from the business of motor garage in the hands of the HUF.*

Examine the validity of the proposition of the Assessing Officer in the light of a decided case law, if any. (6 marks)

Answer 5(a)(i)

- As per provisions contained in section 206C of the Income Tax Act, 1961, the partnership firm, on the sale of Timber which was obtained by it under the forest lease, has to collect the tax at source @ 2.5% on the value of such sales u/s 206C of the Income Tax Act, 1961.
- The provision of ₹15 lakhs made by the nationalized bank for receiving professional services being rendered by a Society (resident) shall be subject to deduction of tax at source under section 194J of the Income Tax Act, 1961 @ 10% of such amount of ₹15 lacs, at the time of payment or credit, whichever is earlier.
- Payment of ₹5 lacs to athlete (Resident) by a manufacturer of swim war as its brand ambassador shall be subject to deduction of tax at source as per section 194J of the Income Tax Act, 1961, @ 10% of such amount of ₹5 lakhs.

Answer 5(a)(ii)

Protective Assessment : The assessing officer resorts to complete the assessment under the Act for any year on "protective basis" where it appears to the authorities that certain/any income has been received during the relevant assessment year but apparently it is not clear that who has received such income.

The Assessing Officer then by initiating proceedings against all such persons complete the assessment as a protective measure for the same income in order to prevent the revenue leakage both in the hands of the person who is considered as liable

to tax and simultaneously also by including the same income in the hands of another person. The view of the A.O. behind such an assessment is to ensure that when the issue of income assessable is finally settled, the assessment of such income should not get time barred.

Protective assessment cannot be made a basis for levy of penalty under any provisions of Act because Act does not envisage "Protective Assessment" as an assessment for taking penal action against the assessee.

Answer 5(b)

Taxability of income of firm in the hands of HUF

The facts of the case are similar to that of the case of *CIT* vs. *Charan Dass Khanna & Sons* (1980) 123 ITR 194, where the Delhi High Court observed that if the investment made by the HUF in the business started by the coparceners plays a minor role and it is primarily the personal efforts, specialized skill and enterprise of the individual coparceners which resulted in setting up of a new business and earning of good profits, then it may not essentially be said that the income belongs to the HUF.

The Supreme Court has also supported this view in the case of *K S Subbiah Pillai* v. *CIT* (1999) 237 ITR 11 and held that where the remuneration and commission earned by the Karta were on account of the personal qualifications and expertise and not on account of the investment of the family funds, such income cannot be treated as income of the HUF.

In the given case, profits of motor garage were earned primarily because of the specialized skills acquired by both the partners in their respective fields and was used in the business of motor garage.

The initial capital taken from the HUF as interest free loan, of course, has its role but it is nevertheless a minor one as the business was conducted by both the brothers by putting their efforts and specialized skill.

Therefore, the income from the business set up by the brothers is assessable in the hands of the partnership firm and in their individual hands and not as the income of the HUF.

The proposition of the Assessing Officer to tax the profits of the business of motor garage earned by the two sons in the hands of the HUF is not valid.

Question 6

Examine the correctness of the following statements in the context of provisions contained in the Income-tax Act, 1961 relevant for the previous year 2018-19 :

(i) The additions to income made by invoking the provisions of section 68 are subject to normal rates of tax as applicable to the assessee.

(ii) Income received by certain foreign companies in Indian currency fulfilling prescribed conditions from sale of crude oil to any person in India is exempt from tax.

(iii) The provisions of AMT are applicable to all persons other than companies.

(iv) Resident and ordinary resident having no income chargeable to tax, but having interest in property outside India is not required to file a return of income u/s 139(1). (3 marks each)

Answer 6

(i) The statement is incorrect.

Tax rate for Unexplained Cash Credit : Section 115BE inserted by the Finance Act, 2012 of the Income Tax Act, 1961 and substituted by the Taxation Laws (second amendment) Act, 2016 is mainly to curb the practice of laundering of unaccounted money. This section for the purpose of taxation, besides others also includes the unexplained credits as specified in section 68 of the Income-tax Act, 1961. Section further imposes a condition that no deduction in respect of any expenditure for allowance or set off of any loss shall be allowed under any provisions of the Act in computing such deemed income. The tax at the rate of 60% plus 25% surcharge and 4% health and education cess be charged in case of Unexplained Cash credit.

(ii) The statement is correct

Exemption under section 10(48) : Section 10(48) of the Income Tax Act, 1961, provides exemption in the national interest relating to income of a foreign company received in India in Indian currency on account of sale of crude oil, any other goods or rendering of services, as may be notified by the Central Government in this behalf, to any person in India on fulfilling of the following conditions:

(a) The money has been received under an agreement entered into or approved by the Central Government.

(b) The foreign company is notified by the Central Government having regard to the national interest.

(c) The foreign company is not engaged in any other activity in India except receipt of income in India under such arrangement or agreement.

(iii) The statement is correct.

Applicability of Alternate Minimum Tax 'AMT' : Section 115JEE inserted by the Finance Act, 2012 has extended the levy of AMT on any person other than company who has claimed deduction under any sections except section 80-P in Chapter VI-A or under section 10-AA or under section 35AD would be subject to AMT.

However, the provisions of section 115JE shall not be applicable to an individual, HUF, AOP, BOI or Artificial Juridical Persons where the adjusted total income does not exceed ₹ 20 lakhs.

(iv) The statement is incorrect.

Obligation to file return in case of Foreign Asset: As per Section 139(1) of the Income Tax Act,1961 every resident and ordinary resident having any asset (including financial interest in any entity) located outside India or signing authority in any account located outside India is required to file a return of income in the prescribed form compulsorily, whether or not he has income chargeable to tax.

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LABOUR LAWS & PRACTICE

(Elective Paper 9.6)

Time allowed : 3 hours *Maximum marks : 100*

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

Question 1

University XYZ is a newly form State University in Jaipur, Rajasthan in 2007. University is providing variety of professional courses like MBA, MBBS, LLB, B.Tech., MCA, B.Ed. etc. The university is situated at the outskirts of city Jaipur, around 20 km from main busstand north-east direction. University provides residential facilities to students as well as academic and non-academic staff. For day scholar, it provides the community transport facility from University to Central Park, Jaipur.

The University has been ranked as the 7th upcoming University in higher education. Government of Rajasthan has invested around ₹500 crore for its development.

University has around 200 teaching staff in various departments and 250 non-teaching staff including bus driver, library staff, administrative staff. Teachers have formed association named 'XUTA' (XYZ University Teachers Association) and non-academic staff has formed 'XUTU' (XYZ University Trade Union).

Apart from specific complain, both groups have some general grounds of complain of the following nature :

— *University has not implemented 7th pay commission salary structure.*

— *Working conditions are harsh and not as per UGC guidelines.*

— *University not providing pension scheme of any nature.*

— *Infrastructure conditions of building and buses are pathetic.*

As per the guidelines of XYZ University, seats in the University for Rajasthan domicile is 85% reserved and 15% of seat are reserved for students from outside state. Around 300 students stay in the hostel of University and 450 students are day scholars. Students have their Union named as 'SXUA' (Student of XYZ University Association).

Students have certain regular complains to the University about poor infrastructure, poor conditions of buses/transport facility, lack of basic amenities, lock of good canteen and playing grounds. University has not responded to any complain of teaching staff, non-teaching staff and student's union positively. It has not deliberated on the issue at any forum showing their non-sensitiveness to the complaints.

On 15 January 2015, while commuting from Jaipur to University in early hours, the University bus met with an accident. Driver of the bus along with 2 students suffered injury. Ramlal, the driver due to accident lost his left eye and broken left hand. Students with minor injuries are safe.

Instead of making proper inquiry to the issue, the university administration issued a show cause notice of termination to Ramlal, saying that he was driving bus in inebirated conditions and therefore, he alone is responsible for the accident.

Ramlal is not the member of the "XYZ University Staff Union" on the day of accident and notice. His reply to the notice of termination was not taken into consideration on this ground. Realizing the injustice to Ramlal, the XUSU, XUTA and SXUA joined together and gheraoed the administrative head of University for 2 hours on 30 January, 2015. After the intervention of enforcement agency the matter was sorted out on that day. However, these three groups continued with strike in the University.

On the basis of above facts, please advise on the following issues :

(a) Whether the above mentioned dispute is an 'industrial dispute' ? (8 marks)

(b) Whether the University is an 'industry' ? (8 marks)

(c) Whether the faculties of University are workman ? (8 marks)

(d) Whether an individual dispute can be named as industrial dispute ? (8 marks)

(e) Whether students' union can raise an industrial dispute ? (8 marks)

Answer 1(a)

Section 2(k) of the Industrial Disputes Act, 1947 defines "industrial dispute "as any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any person. The dispute should relate to an industry as defined in Section 2(j) of the Industrial Dispute Act, 1947.

Therefore, going by the definition of "industrial dispute" as stated above, following may be concluded about the dispute of University XYZ:-

Existence of dispute or difference : Both academic and non-academic staff have common complaints apart from specific complaints like non-implementation of 7th Pay Commission Recommendations, harsh working conditions, University XYZ not providing pension scheme, pathetic conditions of infrastructure and buses etc., students have regular complaints of poor hostel facility, lack of basic amenities, good canteen and playground etc. Despite continuous complaints, there was no response from the side of University XYZ. Irresponsible behavior of University XYZ in terminating the driver Ramlal without conducting any inquiry, show cause notice and without any response towards his reply to termination letter further aggravated the situation. The continuous non-sensitive behavior of University XYZ towards complaints of academic staff, non-academic staff and students have caused them to join hands and go on strike on termination of Ramlal. Therefore, first requirement of existence of dispute is satisfied here.

Parties to the dispute : University XYZ is employer of academic and non-academic staff. The disputes can be raised by workmen themselves or their union or federation on their behalf. Ramlal is a non-academic workman of University XYZ and there is no requirement that he should be a member of trade union of non-academic staff on the date of dispute.

Therefore, the second requirement of between whom dispute should arose is also satisfied.

Subject matter of the dispute : The dispute should relate to employment or non-employment or terms of employment or conditions of labour of any person.

As dispute relates to dismissal of Ramlal - an employee, therefore, the third requirement is also satisfied.

Dispute in an Industry : University XYZ is an "Industry" as clarified in answer 1(b).

As all the requirements of definitions of section 2(k) of the Industrial Disputes Act, 1947 are satisfied, therefore, there exists "industrial dispute" in the present case.

Answer 1(b)

According to section 2(j) of the Industrial Disputes Act, 1947, "Industry" means any business, trade, undertaking, manufacture or calling of employers and includes any calling service, employment, handicraft, or industrial occupation or avocation of workmen.

In the case of *Bangalore Water Supply and Sewerage Board* vs. *A Rajiappa, AIR 1978* SC 548, the Supreme Court, laid down the following tests (known as "Triple Test") to determine whether an activity is covered by the definition of "industry" or not.

There is an "industry" in an enterprise, where there is

(i) systematic activity,

(ii) organised by co-operation between employer and employee,

(iii) for the production and/or distribution of goods and services calculated to satisfy human wants and wishes (not spiritual or religious but inclusive of material things or services geared to celestial bliss e.g., making, on a large scale, prasad or food) prima facie.

The Supreme Court observed that professions, clubs, educational institutions, co-operatives, research institutes, charitable projects and other kindred adventures, if they fulfil the triple tests listed above, cannot be exempted from the scope of Section 2(j). It was held that even a university would be an industry if it satisfies triple test.

As University XYZ satisfies triple test as follows:

(i) *Systematic Activity* : As University XYZ is providing variety of professional courses, providing residential facilities to students, academic and non-academic staff, providing community transport facility, is ranked 7th upcoming University in higher education, having an appreciable number of academic and non-academic staff which are having organized associations and trade unions…This all shows that University XYZ is carrying systematic activity of providing education.

(ii) *Organised by co-operation between employer and employee* : The University has such a huge academic as well as nonacademic staff and vast number of residential and day scholar students, it has got huge funds from Government of Rajasthan for development, 7th Pay Commission recommendations are applicable

to it… These all indicate that University XYZ is organized by co-operation between employer and employee.

(iii) Prima facie purpose of University is to render higher educational services to students, therefore third test of Bangalore Water Supply Case is satisfied.

As all the three tests are satisfied. Therefore, University XYZ may be considered as an "industry" in accordance with the Industrial Disputes Act, 1947.

Answer 1(c)

According to section 2(s) of the Industrial Disputes Act, 1947, "Workman", means any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be expressed or implied and for the purposes of any proceeding under this Act in relation to an industrial dispute. It includes any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of dispute.

In Bangalore Water Supply Case, it was held that educational institution is an industry in terms of Section 2(j) of the Industrial Disputes Act, 1947, though not all of its employees are workmen. It was held as under: "The premises relied on is that the bulk of the employees in the university is the teaching community. Teachers are not workmen and cannot raise disputes under the Act.

In the case of *E.S.I.C. Medical Officer's Association* vs. *E.S.I.C. & ANR.*, Indian Labour Journal, July 2014 the apex Court observed that a profession requires extensive training, study and mastery of the subject, whether it is teaching students, providing legal advice or treating patients or diagnosing diseases. Persons performing such functions cannot be seen as a workman within the meaning of Section 2(s) of the Industrial Disputes Act, 1947.

In the case of *Sunderambal* vs. *Government of Goa*, the Supreme Court held that the teachers employed by the educational institution cannot be considered as workmen within the meaning of Section 2(s) of the Act, as imparting of education which is the main function of the teachers cannot be considered as skilled or unskilled manual work or supervisory work or technical work or clerical work. The Court in this case also said that manual work comprises of work involving physical exertion as distinct from mental and intellectual exertion. The teacher necessarily performs intellectual duties and the work is mental and intellectual as distinct from manual.

Therefore, faculties of University XYZ do not fall in the definition of "Workman" under the Industrial Disputes Act, 1947.

Answer 1(d)

Till the provisions of Section 2A were inserted in the Industrial Disputes Act, 1947, it has been held by the Supreme Court that an individual dispute per se is not industrial dispute. But it can develop into an industrial dispute when it is taken up by the union or substantial number of workmen (*Central Province Transport Service* v. *Raghunath Gopal Patwardhan*).

In the case of Workmen of *Dimakuchi Tea Estate* v. *Dimakuchi Tea Estate*, the

Supreme Court held that it is not that dispute relating to "any person" can become an industrial dispute. There should be community of interest. A dispute may initially be an individual dispute, but the workmen may make that dispute as their own, they may espouse it on the ground that they have a community of interest and are directly and substantially interested in the employment, non-employment, or conditions of work of the concerned workmen. All workmen need not to join the dispute. Any dispute which affects workmen as a class is an industrial dispute, even though, it might have been raised by a minority group. It may be that at the date of dismissal of the workman there was no union. But that does not mean that the dispute cannot become an industrial dispute because there was no such union in existence on that date. If it is insisted that the concerned workman must be a member of the union on the date of his dismissal, or there was no union in that particular industry, then the dismissal of such a workman can never be an industrial dispute although the other workmen have a commonality of interest in the matter of his dismissal and the cause for which on the manner in which his dismissal was brought about directly and substantially affects the other workmen. The only condition for an individual dispute turning into an industrial dispute, as laid down in the case of Dimakuchi Tea Estate is the necessity of a commonality of interest and not whether the concerned workman was or was not a member of the union at the time of his dismissal. At the time of making reference for adjudication, individual dispute must have been espoused, otherwise it will not become an industrial dispute and reference of such dispute will be invalid.

Section 2A does not declare all individual disputes to be industrial disputes. It is only when a dispute is connected with a discharged, dismissed retrenched or terminated workman that it shall be treated as an industrial dispute. If the dispute or difference is connected with some other matter e.g. payment of bonus/ gratuity etc. then it would have to satisfy the test laid down in judicial decisions.

A perusal of Section 2A of the Industrial Disputes Act, 1947 would show that once the employee is aggrieved by his dismissal and the employer disputes his dismissal, the dismissal would be "Industrial dispute".

In this case, termination of Ramlal, an employee, though an individual dispute becomes Industrial Dispute by virtue of satisfying requirement of section 2A of the Industrial Disputes Act, 1947.

Answer 1(e)

The pre-requisite of raising an industrial dispute is that the person must be a 'workman'. A person cannot be a workman unless he is employed by the employer in any industry. The relationship of employer and workman is usually supported by a contract of employment which may be expressed or implied. This is also a must for regarding an apprentice as a worker (*Achutan* v. *Babar*, 1996-LLR-824 Ker.). But such a question cannot be derived merely on the basis of apprenticeship contract (*R.D. Paswan* v. *L.C.*, 1999 LAB 1C Pat 1026). The employee agrees to work under the supervision and control of his employer. Here one must distinguish between contract for employment or service and contract of employment or service. In the former, the employer can require what is to be done but in the latter, he can not only order what is to be done, but also how it shall be done. In the case of contract for employment, the person will not be held as a 'workman' but only an 'independent contractor'. There should be due control and

supervision by the employer for a master and servant relationship (*Dharangadhara Chemical Works Ltd.* v. *State of Saurashtra*, AIR 1957 SC 264).

Since there is no master and servant relationship between the students and the management of the University, hence the students' union cannot raise an industrial dispute.

Question 2

(a) Differentiate the role of work committee and conciliation officer in resolving industrial dispute.

(b) In what cases wages for the Strike period are paid ? *(6 marks each)*

Answer 2(a)

Section 3 of the Industrial Disputes Act, 1947 provides that the appropriate Government may by general or special order require the employer to constitute in the prescribed manner a Works Committee in industrial establishments, where 100 or more workmen are employed or have been employed on any working day in the preceding 12 months. The Works Committee will be comprised of the representatives of employers and workmen engaged in the establishment.

It shall be the duty of the Works Committee to promote measures for securing and preserving amity and good relations between the employer and workmen and, to that end, to comment upon matters of their common interest or concern and endeavor to compose any material difference of opinion in respect of such matters.

Section 4 of the Industrial Disputes Act, 1947, provides that with the duty of mediating in and promoting the settlement of industrial disputes, the appropriate Government may, by notification in the Official Gazette, appoint such number of Conciliation Officers as it thinks fit. The Conciliation Officer may be appointed for a specified area or for specified industries in a specified area or for one or more specified industries and either permanently or for a limited period.

The main objective of appointing the Conciliation Officers, by the appropriate Government, is to create congenial atmosphere within the establishment where workers and employers can reconcile on their disputes through the mediation of the Conciliation Officers. Thus, they help in promoting the settlement of the disputes.

Answer 2(b)

Pursuant to the provisions of the Industrial Dispute Acts, 1947, the payment of wages for the strike period will depend upon whether the strike is justified or unjustified. This also depends upon several factors such as service conditions of workmen, the cause which led to strike, the urgency of cause or demand of workmen, the reason for not resorting to dispute settlement machinery under the Act or service rules/regulations etc. No wages are payable if the strike is illegal or it is unjustified. Further, if the workers indulge in violence, no wages will be paid even when their strike was legal and justified (*Dum Dum Aluminium Workers Union* v. *Aluminium Mfg. Co.*). The workmen must not take any hasty steps in resorting to strike. They must, first take steps to settle the dispute through conciliation or adjudication except when the matter is urgent and of serious nature. Thus, in the case of Chandramalai Estate v. Workmen, it was observed that when workmen might well have waited for some time, after conciliation efforts had

failed, before starting a strike, and in the meantime could have asked the Government to make a reference, the strike would be unjustified and the workmen would not be entitled to wages for the strike period.

In the case of *Crompton Greaves Ltd.* v. *The Workmen* it was observed that for entitlement of wages for the strike period, the strike should be legal and justified. Reiterating this position, the Court held in Syndicate Bank v. Umesh Nayak that where the strike is legal but at the same time unjustified, the workers are not entitled for wages for the strike period. It cannot be unjustified unless reasons for it are entirely perverse or unreasonable. The use of force, violence or acts of sabotage by workmen during the strike period will not entitle them for wages for the strike period.

Question 3

(a) In deciding the liability of employer in case of accident of employee, discuss the concept of national extension of employment.

(b) Discuss in what cases the employer is not liable to pay compensation to employee. *(6 marks each)*

Answer 3(a)

According to Section 3 of the Employee's Compensation Act, 1923, to make the employer liable it is necessary that the injury caused to an employee by an accident must have arisen out of and in the course of employment.

It is well settled that the concept of "duty" is not limited to the period of time the workman actually commenced his work and the time he downs his tools. It extends further in point of time as well as place. But there must be nexus between the time and place of the accident and the employment. If the presence of the workman concerned at the particular point was so related to the employment as to lead to the conclusion that he was acting within the scope of employment that would be sufficient to deem the accident as having occurred in the course of employment (*Weaver* v. *Tradegar Iron and Coal Co. Ltd.*).

It is known as doctrine of notional extension of employment; whether employment extends to the extent of accident depends upon each individual case. A workman while returning home after duty was murdered within the premises of the employer. It was held that there was casual and proximate connection between the accident and the employment. Since the workman was on spot only for his employment and his wife is entitled for compensation (*Naima Bibi* v. *Lodhne Colliery Ltd.*). If an employee in the course of his employment has to be in a particular place by reason where he has to face a peril which causes the accident then the casual connection is established between the accident and the employment (*TNCS Corporation* v. *Poonamalai*, 1994 II LLN 950) and principle of notional extension applies.

Answer 3(b)

Proviso to Section 3(1) of the Employee's Compensation Act, 1923, specifies that in the following cases, the employer shall not be liable to pay compensation to the employee:

(i) When the injury does not result in disablement for a period exceeding 3 days.

(ii) When the injury not resulting in death or permanent total disability is due to any of the following reasons:

(a) the employee was at the time of accident, under the influence of drink or drugs, or

(b) the employee wilfully disobeyed an order expressly given or a rule expressly framed for the purpose of securing safety of workers, or

(c) the employee, wilfully disregards or removes any safety guards or safety devices which he knew to have been provided for the safety of the employee.

Thus, where an employee dies due to an accident arising out of and in the course of employment, it cannot be pleaded that death was due to any of the reasons stated from (a) to (c)(*R.B. Moondra & Co.* v. *Mst. Bhanwari*).

Question 4

(a) Discuss the right of a woman with regards to payment of maternity benefits.

(b) What is the ambit of workplace as defined under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 ?

(6 marks each)

Answer 4(a)

According to Section 5 of the Maternity Benefit Act, 1961, every woman shall be entitled and her employer shall be liable for the payment of maternity benefit at the rate of the average daily wages for the period of her actual absence during the period immediately preceding the day of her delivery, the actual day of her delivery and any period immediately following that day.

For the purpose of calculating average pay, the wages payable to her during the period of 3 calendar months immediately preceding the date from which she absents herself on account of maternity shall be taken into account. The minimum rate of wages shall be such as are fixed or revised under the Minimum Wages Act, 1948 or ten rupees, - whichever is the highest.

For the purpose of entitlement to the Maternity Benefit, a minimum eligibility period of actual working of women in such establishment is 80 days during a period of 12 months immediately preceding the date of her expected delivery. For the purpose of calculating the minimum of 80 days of work for the eligibility it is further mentioned that such period shall also include the days on which she was laid-off or it was a holiday declared under any law for the time being in force.

The maximum period of maternity benefit shall be twenty-six weeks of which not more than eight weeks shall precede the date of her expected delivery. The maximum period entitled to maternity benefit by a woman having two or more than two surviving children shall be twelve weeks of which not more than six weeks shall precede the date of her expected delivery.

However if the woman dies during the abovementioned period, the maternity benefit shall be payable only for the days up to and including the day of her death. Further provided that where a woman, having been delivered of a child, dies during her delivery

or during the period in which she was entitled to maternity benefit, leaving behind the child, the employer is liable to pay maternity benefit for the entire period, but if the child also dies during the said period, then, for the day upto and including the date of death of the child.

A woman who adopts a child below the age of three months or a commissioning mother shall be entitled to maternity benefit for a period of 12 weeks from the date the child is handed over to the adopting mothers or a commissioning mother, as the case may be.

Answer 4(b)

According to section 2(o) of the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, "workplace" includes—

a. any department, organisation, undertaking, establishment, enterprise, institution, office, branch or unit which is established, owned, controlled or wholly or substantially financed by funds provided directly or indirectly by the appropriate Government or the local authority or a Government company or a corporation or a co-operative society;

b. any private sector organisation or a private venture, undertaking, enterprise, institution, establishment, society, trust, non-governmental organisation, unit or service provider carrying on commercial, professional, vocational, educational, entertainment, industrial, health services or financial activities including production, supply, sale, distribution or service;

c. hospitals or nursing homes;

d. any sports institute, stadium, sports complex or competition or games venue, whether residential or not used for training, sports or other activities relating thereto;

e. any place visited by the employee arising out of or during the course of employment including transportation provided by the employer for undertaking such journey;

f. a dwelling place or a house;

Under Section 2(o), Workplace has been defined as private sector organisation / private venture / undertaking / enterprise / institution / establishment / society / trust / non-governmental organisation / unit or service provider and places visited by employee (arising out of or during the course of employment, including transportation provided by employer for undertaking journey). Hence, if harassment takes place even during transportation or during a lunch meeting at a restaurant, the same will be covered under the Act.

In the case of *Saurabh Kumar Mallick* v. *Comptroller & Auditor General of India*, the High Court observed that the following factors would have bearing on determining whether the act has occurred in the 'workplace':

- Proximity from the place of work;
- Control of the management over such a place/residence where the working woman is residing; and

- Such a residence has to be an extension or contiguous part of the working place.

Question 5

(a) Elaborate in what circumstances during the pendency of proceedings, change in condition of services are permissible ?

(b) In deciding the concept of 'worker' in Factories Act, 1948, whether relationship of master and servant is necessary ? (6 marks each)

Answer 5(a)

According to Section 33(2) of the Industrial Disputes Act, 1947 during the pendency of proceedings before any authority in respect of an industrial dispute, the employer is permitted to take following actions, in accordance with the standing orders applicable to workmen concerned in such disputes or where there are no such standing orders, in accordance with the terms of the contract, whether express or implied, between him and the workman:

(a) to alter, in regard to 'any matter not connected with the dispute, the conditions of service applicable to that workman immediately before the commencement of such proceedings.

(b) to discharge or punish, whether by dismissal or otherwise, that workman for any misconduct not connected with the dispute.

However such action of discharge or dismissal can be taken by an employer during pendency of proceedings only after he has paid wages for one month and made an application to the authority before which the proceedings are pending for approval of the action taken by the employer. The authority concerned shall, without delay, hear such application and pass within a period of three months from the date of receipt of such application, such order in relation thereto as it deems fit (unless extended on reasonable grounds).

According to Section 33(3) of the Industrial Disputes Act, 1947, employer shall obtain the express permission in writing of the authority before which the proceeding is pending before taking any such action mentioned in section 33(2) against a protected workmen.

Answer 5(b)

According to section 2(l) of the Factories Act, 1948, "worker" means a person employed, directly or by or through any agency (including a contractor). The definition of work makes relationship of employment mandatory for a person to be worker according to the Factories Act.

The expression "employed" does not necessarily involve the relationship of master and servant. There are conceivable cases in which where no such relationship exists and yet such persons would be workers. The expression a person employed, according to Justice Vyas, means a person who is actually engaged or occupied in a manufacturing process, a person whose work is actually utilised in that process. The definition of worker is clearly enacted in terms of a person who is employed in and not in terms of

person who is employed by. It is immaterial how or by whom he is employed so long as he is actually employed in a manufacturing process.

In the case of *Birdh Chand Sharma* v. *First Civil Judge*, Nagpur, where the respondents prepared bidis at the factory and they were not at liberty to work at their homes. They worked within certain hours which were the factory hours. They were, however, not bound to work for the entire period and they could go whenever they like. Their attendance was noted in the factory. They could come and go away at any time they liked. However no worker was allowed to work after midday even though the factory was closed at 7 p.m. and no worker was allowed to continue to work after 7 p.m. There were standing orders in the factory and, according to these orders a worker who remained absent for eight days presumably without leave could be removed. The payment was made on piece rate according to the quantum of work done, but the management had the right to reject such bidis which did not come up to the proper standard. On these facts the Supreme Court held that respondents were workers under section 2 (l) of the Act as there exists master and servant relationship between them.

Question 6

Critically analyse, is there any right to strike ? *(12 marks)*

Answer 6

Article 19(1) (c) of the Constitution of India guarantees freedom to form associations and unions, though reasonable restrictions on the freedom may be imposed in the interest of integrity and sovereignty of India, public order and morality. The right to strike in the Indian constitution set up is not absolute right but it flow from the fundamental right to form union enshrined under Article 19(1) of the Constitution. As every other fundamental right is subject to reasonable restrictions, the same is also the case to form trade unions to give a call to the workers to go on strike and the state can impose reasonable restrictions.

In the case of *All India Bank Employees Association* v. *I. T.*, the Supreme Court held that "the right to strike or right to declare lock out may be controlled or restricted by appropriate industrial legislation and the validity of such legislation would have to be tested not with reference to the criteria laid down in clause (4) of Article 19 but by totally different considerations."

Thus, there is a guaranteed fundamental right to form Association or Labour Unions but there is no fundamental right to go on strike. Under the Industrial Disputes Act, 1947 the grounds and conditions are laid down for the legal strike and if those provisions and conditions are not fulfilled then the strike will be illegal.

In the case of *T K Rangarajan* v. State of Tamilnadu, Supreme Court held that no fundamental right exists with the Government employees to go on strike.

The Trade Unions Act, 1926 provides immunity to the members or office bearers of a registered trade union from civil and criminal actions against certain acts, provided such acts are necessary in carrying out the lawful objectives of the trade union. The immunities provided in the Act provided limited right to strike provided the activities are done in furtherance of trade dispute.

It was held in the case of *Shri Ram A Vilas Service Ltd.* v. *Simson Group Companies*

Workers Union that so long as the strike does not indulge into acts unlawfully, tortuous court will not interfere with this legitimate right of the labour.

In the case of *B. R. Singh* v. *Union of India* (*B.R Singh* v. *Union of India*, (1989) 4 SCC 710) the court has recognized "strike" as a mode of redress for resolving the grievances of workers.

Conclusion

1. Right to strike is not a fundamental right guaranteed by the Indian Constitution.
2. Right to strike is a statutory right recognized under the Industrial Dispute Acts, 1947 and the Trade Unions Act, 1926.

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VALUATIONS & BUSINESS MODELLING

(Elective Paper 9.7)

Time allowed : 3 hours *Maximum marks : 100*

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

2. Working notes should form part of answer.

PART A

Question 1

A Private Limited Company has already in the business of manufacture and sale of imitation jewellery, is planning to take over the business of a similar Company (Target Company). Before take over the Management has approached you as Valuation consultant, to suggest on future profitability and valuation. Following information is obtained from the existing Management :

(i) The Target Company is doing business in 2 Segments i.e., wholesale and Retail. In Retail Segment there are two categories of products—budget and premium.

(ii) In the Retail Segment, the estimated Annual sale in the next financial period for the budget category is ₹200 Lakh and premium category is ₹100 Lakh. The sales for budget category is expected to grow by 20% year on year. Premium category is expected to grow 10% year on year.

(iii) In the Wholesale Segment—Company is having Annual orders for ₹200 Lakh. (Credit period allowed to Debtors is 2 months). The demand in this segment is expected to grow by 25% year on year.

(iv) Raw materials form 35% of the sale value for budget category and the Wholesale Segment, while they form 45% for the premium category. Creditors give one month credit for raw material purchased.

(v) The variable processing cost is 25% of the sale value for budget category and l5% of the sale value for premium category while it is 25% of the sale value in the case of Wholesale Segment.

(vi) Fixed costs are expected as follows : Rent ₹3,00,000 per month for processing and storage unit and ₹15,000 per month each for Ten showrooms. In third year 10% addition is expected for rent and thereafter there will be no change in rent for next 3 years. Administration overheads are expected at 10% of Sales for next 3 years. Rent of storage unit is to be apportioned between budget, premium and wholesale in their respective sales ratio and Rent for showroom is to be apportioned only to budget and premium categories in their respective sales ratio.

(vii) 10% of raw material requirements for all categories/segments are to be maintained as inventory.

(viii) The Equity Capital of the Company is ₹100 Lakh (10,00,000 Equity shares of

₹10 each) and the Company has a Term loan of ₹200 Lakh which is to be repaid in next 5 years with an interest of 10%, per annum (Interest is to be apportioned between budget, premium and wholesale in their respective sales ratio). Further, the Company has overdraft facility which carries an interest of 12% per annum, which will be availed in case of negative cash flows. (Interest on overdraft also to be apportioned between budget, premium and wholesale in their respective sales ratio).

(ix) The Company has the policy of maintaining minimum Bank Balance of ₹25 Lakh.

(x) The investment in plant and machinery is ₹200 Lakh and 15% per annum Depreciation is charged on straight line basis. Depreciation is to be apportioned between budget, premium and wholesale in their respective sales ratio.

(xi) Company has Furniture, Fittings, Computers and other assets of ₹100 Lakh and it is depreciated at 10% per annum on straight line basis. Depreciation is to be apportioned between budget, premium and wholesale in their respective sales ratio.

(xii) Tax rate to be assumed at 25%.

(xiii) Discount Rate can be considered as 10% (Discount factors are as below) :

Year 1	Year 2	Year 3
0.9091	0.8264	0.7513

(xiv) The risk free rate of return is 6% and the Market risk premium is 9%. Industry Beta is 1.125. Beginning period debt and equity value can be considered for Debt Equity Ratio (Overdraft can be ignored; for debt equity ratio). Growth to perpetuity can be assumed at 3%.

Based on the above information on Target Company, answer the following questions :

(a) Prepare projected Income Statement for 3 years (Category-wise and total)

(b) (i) Prepare projected Balance Sheets for 3 years and also calculate (ii) cost of Equity using CAPM model and (iii) Weighted Average Cost of Capital (WACC).

(c) Find out (i) Free Cash Flows to the Firm (FCFF) and (ii) Free Cash Flows to Equity (FCFE) (iii) Find out which category has highest EBITDA/Sales Ratio and PAT/Sales Ratio over the 3 years.

(d) (i) The Management would like to know the expected Value of the Target Company and the share price it can offer to buy the Company. (ii) What are the types of companies where management may find difficulties in using Discounted cash Flow Technique for Valuation ?

(10 marks each)

Answer 1(a)

Particulars	*Year 1*				*Year 2*			
	Budget	*Premium*	*Wholesale*	*Total*	*Budget*	*Premium*	*Wholesale*	*Total*
Sales	200.00	100.00	200.00	500.00	240.00	110.00	250.00	600.00
Sales Ratio-Three Categories	40.00	20.00	40.00		40.00	18.33	41.67	
Sales Ratio–Two Categories	66.67	33.33			68.57	31.43		
Less: Raw Materials	70.00	45.00	70.00	185.00	84.00	49.50	87.50	221.00
Less: Processing cost 50.00	15.00	50.00	115.00	60.00	16.50	62.50	139.00	
Gross Profit	80.00	40.00	80.00	200.00	96.00	44.00	100.00	240.00
Rent (Processing and Storage Unit)	14.40	7.20	14.40	36.00	14.40	6.60	15.00	36.00
Rent (show-rooms)	12.00	6.00	-	18.00	12.34	5.66	-	18.00
Administrative Overheads	20.00	10.00	20.00	50	24.00	11.00	25.00	60.00
Total Indirect Expenses	46.40	23.20	34.40	104.00	50.74	23.26	40.00	114.00
EBITDA	33.60	16.80	45.60	96.00	45.26	20.74	60.00	126.00
Less: Depreciation	16.00	8.00	16.00	40.00	16.00	7.33	16.67	40.00
EBIT	17.60	8.80	29.60	56.00	29.26	13.41	43.33	86.00
Less: Interest	9.82	4.91	9.82	24.56	6.40	2.93	6.67	16.00
EBT 7.78 3.89	19.78	31.44	22.86	10.48	36.67	70.00		
Tax (25%)	1.95	0.97	4.95	7.86	5.72	2.62	9.17	17.50
PAT	5.83	2.92	14.83	23.58	17.14	7.86	27.50	52.50

Year 3

	Budget	*Premium*	*Wholesale*	*Total*
Sales	288.00	121.00	312.50	721.50
Sales Ratio-Three Categories	39.92	16.77	43.31	
Sales Ratio–				
Two Categories	70.42	29.58		
Less: Raw Materials	100.80	54.45	109.38	264.63
Less: Processing cost	72.00	18.15	78.13	168.28
Gross Profit	115.20	48.40	125.00	288.60
Rent (Processing and Storage Unit)	15.81	6.64	17.15	39.60
Rent(show-rooms)	13.94	5.86	-	19.80
Administrative Overheads	28.80	12.10	31.25	72.15
Total Indirect Expenses	58.55	24.60	48.40	131.55
EBITDA	56.65	23.80	76.60	157.05
Less : Depreciation	15.97	6.71	17.33	40.00
EBIT	40.68	17.09	59.27	117.05
Less : Interest	4.79	2.01	5.20	12.00
EBT	35.89	15.08	54.08	105.05
Tax (25%)	8.97	3.77	13.52	26.26
PAT	26.92	11.31	40.56	78.79

Answer 1(b)(i)

Projected Balance Sheet for 3 Years

	Year 1	*Year 2*	*Year 3* (In Rs. Lakhs)
Equity & Liabilities			
Share Capital	100.00	100.00	100.00
Reserve & Surplus	23.58	76.08	154.87
Share Application Money Pending allotment			
Non Current Liabilities – Term Loan	160.00	120.00	80.00

Current Liabilities			
Trade Payables	15.42	18.42	22.05
Other Current Liabilities (OD)	37.94		
Total	**336.94**	**314.50**	**356.92**
Assets			
Non Current Assets			
Plant and Machinery	170.00	140.00	110.00
Furniture and fittings and others	90.00	80.00	70.00
Current Assets			
Inventory	18.50	22.10	26.46
Receivables	33.33	41.67	52.08
Cash and Bank Balance	25.10	30.73	98.37
Total	**336.94**	**314.50**	**356.92**

Answer 1(b)(ii)

Cost of Equity using Capital Asset Pricing Model (CAPM)

$E(Ri) = R_f + ßi [E(R_M) - R_f]$

E(Ri) = Expected return on Security

R_f = Risk free Rate

$E(R_M)$ = Expected return on Market $[E(R_M) - R_f]$ = Market Risk Premium

Bi = Beta

E(Ri) = 6 + 1.125 x 9 = 16.125

Therefore, Cost of Equity = 16.125%

Answer 1(b)(iii)

Weighted Average Cost of Capital = WACC

$WACC = W_E r_E + W_D r_D (1 – T) + W_p r_p$

Debt Equity Ratio is 2:1

So, 1/3 x 16.125 + 2 / 3 x 10 (1 – 0.25)

= 5.375 + 5.000

= 10.375%

Answer 1(c)(i)

Free Cash Flows to the Firm

Particulars	*Year 1*	*Year 2*	*Year 3*
EBIT	56.00	86.00	117.05
EBIT (1 – T) = NOPAT	42.00	64.50	87.7875
Add : Depreciation	40	40	40
Operating Cash Flows	**82**	**104.5**	**127.7875**
Less : Capex	-	-	-
(*Less / Add*) : Changes in Working Capital (Increase / Decrease)	36.42	8.93	11.14
FCFF (Free Cash Flow to Firm)	45.58	95.57	116.64

Answer 1(c)(ii)

Free Cash Flows to Equity

(In Rs. Lakhs)

Particulars	*Year 1*	*Year 2*	*Year 3*
FCFF as above	45.58	95.57	116.64
Less : Tax adjusted Interest payment	18.42	12.00	9.00
Less : Repayment of Loan	40	40	40
FCFE	-12.84	43.57	67.64

Answer 1(c)(iii)

Particulars	*Year 1*			*Year 2*		
	Budget	*Premium*	*Wholesale*	*Budget*	*Premium*	*Wholesale*
Sales	200.00	100.00	200.00	240.00	110.00	250.00
EBITDA	33.60	16.80	45.60	45.26	20.74	60.00
PAT	5.83	2.92	14.83	17.14	7.86	27.50
EBITDA/Sales	16.80	16.80	22.80	18.86	18.86	24.00
PAT / Sales	2.92	2.92	7.42	7.14	7.14	11.00

Particulars	*Year 3*		
	Budget	*Premium*	*Wholesale*
Sales	288.00	121.00	312.50
EBITDA	56.65	23.80	76.60
PAT	26.92	11.31	40.56
EBITDA / Sales	19.67	19.67	24.51
PAT / Sales	9.35	9.35	12.98

Answer 1(d)(i)

(Rs. in Lakhs)

Particulars		*Year 1*	*Year 2*	*Year 3*
Free Cash Flow to Firm (FCFF)		45.58	95.57	116.64
Discounting Factor (10%)		0.9091	0.8264	0.7513
Discounted Cash Flows		**41.44**	**78.98**	**87.63**
PV of Cash Flows for Explicit Period (1)	208.05055	WACC – 0.10		
		Growth rate- 0.03		
Cash Flows to perpetuity	1,223.91			
(PV of Cash flows on Year 3 / (WACC – g)				
PV of Cash Flows from Perpetuity (2)	919.52481			
Enterprise Value (1) + (2)	1,127.58			
Net Debt at present	200			
Equity Value	927.58			
Number of Equity Shares	10,00,000			
Equity Value per share (INR)	**92.757536**			

Answer 1(d)(ii)

Types of companies where we may find difficulties in using discounted cash flow valuation are:

(a) Private firm which is being managed by few individuals, the success of the firm largely depends on the skills of the people controlling the same. It would be

difficult to separate the individuals and the firm. The other employees may not be contributing intellectually so much to the success of the firm. A biotechnology firm, with no current product or sales, but with several promising product patents in the pipeline. Difficulty may be in estimating the future sales, profits and in turn near term cash flows.

(b) A cyclical firm, during recession. The subsequent impact could be adverse / worsening debt / equity ratios and ROI may also be affected which may create problems.

(c) A troubled firm, which is in the process of restructuring, where it is selling some of its assets and changing its financial mix. Using the historical data for earnings growth and cash flows of the firm may not give true picture and may lead to error/uncertainty in the valuation.

(d) A firm which owns a lot of valuable land which is currently unutilized. It would be very difficult to estimate the future earning from the same, which may lead to under valuation or overvaluation of the firm.

Question 2

(a) "There are a number of factors both macro-economic and micro-economic which have an impact on business. Valuation of a business involves making forecasts for the future".

Comment on the sources of uncertainties in business valuation in the light of the above.

(b) State under what conditions/assumptions the following statements are true (state only one important condition/assumption for each) :

(i) Fair Value of an asset is always equal to its Market Value.

(ii) Gordon's Dividend Growth Model provides a good estimate of intrinsic value of a share.

(iii) A Company can show Goodwill in its Balance Sheet. (5 marks each)

Answer 2(a)

Sources of Uncertainties : Uncertainty is part and parcel of the valuation process both at the point of time when the valuation is made and also on basis of how the business evolves over time. The valuation involves a process where the valuer has to make various forecasts about the future both in terms of general economic conditions as well as how the firm will perform individually.

Valuation uncertainty is defined as - *'The possibility that the estimate value may differ from the price that could be obtained in a transfer of the same asset or liability taking place at the same time under the same terms and within the same market environment'*.

It is important to note that a valuation is not a fact; it is an estimate of the most probable of a range of possible outcomes based on the assumptions made in the valuation process. Market valuations are estimates of the most probable price that would be paid in a transaction on the valuation date.

However, even where assets are identical and exchanged in contemporaneous transactions, fluctuations in the prices agreed between different transactions can often be observed. These fluctuations can be caused by factors such as differences in the objectives, knowledge or motivation of the parties. Consequently, an element of uncertainty is inherent in most market valuations as there is rarely a single price with which the valuation can be compared.

The valuation involves a process where the valuer has to make forecasts about the future both in terms of general economic conditions as well as how the firm will perform individually.

Uncertainties caused by these various conditions and factors can be broadly categorized into the following three groups based on the reasons / sources of these uncertainties.

Estimated/Model/Input Uncertainty : Even if our information sources are impeccable, we have to convert raw information into inputs and use these inputs in models. Any mistakes or mis-assessment that we make at either stage of this process will cause estimation error.

Further, uncertainty arises from characteristics of either the valuation model, or method, used. For certain asset types, more than one method may be customarily used to estimate value. However, those models may not always produce the same outcome and therefore the selection of the most appropriate method may of itself be a source of uncertainty.

Also uncertainty arises where there are a number of equally reasonable or feasible inputs or assumptions that can be used from the degrees of veracity that can be attached to the data inputs used in the valuation and their impact on the outcome.

Firm-specific Uncertainty : The specific risks associated with the firms Business, Modus Operandi may also add to uncertainty in the business valuation. The firm may do much better or much worse than we expected it to perform, and the resulting earnings and cash flows will be very different from our estimates.

Macroeconomic Uncertainty/Market Uncertainty : Even if a firm evolves exactly the way we expected it to, the macroeconomic environment can change in unpredictable ways. Interest rates can go up or down and the economy can do much better or worse than expected. These macroeconomic changes will affect value.

Further, uncertainty arises when a market is disrupted at the valuation date by current or very recent events such as sudden economic or political crises. The disruption can manifest itself in a number of ways, for example, either through panic buying or selling or by a loss of liquidity due to disinclination by market participants to trade. An outbreak of sudden trading activity in response to a crisis may cause rapid price changes that are not necessarily representative of those that would be agreed between parties acting “knowledgeably and prudently”. Conversely, a loss of liquidity will mean fewer contemporaneous or relevant recent transactions which may impact on the reliability of the valuation.

Answer 2(b)

(i) Fair value of an asset is always equal to its Market Value, when markets are efficient.

(ii) Gordon's Dividend Growth Model provides a good estimate of intrinsic value of a share, for a company having constant dividend pay-out ratio, return on the equity remains constant, cost of equity does not change with time and market is efficient.

(iii) A company can show Goodwill in its Balance Sheet.

It must be noted that a company cannot show its own goodwill in its own balance sheet; however, it buys / acquires goodwill from someone, then goodwill can be shown in the balance sheet. As per AS 26, the self-generated goodwill / own goodwill / internally generated goodwill are termed as unidentified intangible assets whose cost cannot be measured reliably. So they are not recognized in books / financial statements.

Question 3

(a) (i) What should be the contents of Valuation Report as per International Valuation Standards (IVS) and (ii) What is the difference between 'Valuation date' and 'date of the Valuation Report'.

(b) A Registered Valuer has been asked to determine the combined level of valuation discounts for a small equity interest in a private company. The Valuer concluded that an appropriate control premium is 15 percent. A discount for lack of Marketability was estimated at 25 percent. Given these factors, what is the combined discount ? *(5 marks each)*

Answer 3(a)

(i) As per International Valuation Standards (IVS) 103, where the report is the result of an assignment involving the valuation of an asset or assets, the report must convey the following, at a minimum:

(a) the scope of the work performed, including the elements mentioned in the para Scope of Work, to the extent that each is applicable to the assignment,

(b) the approach or approaches adopted,

(c) the method or methods applied,

(d) the key inputs used,

(e) the assumptions made,

(f) the conclusion(s) of value and principal reasons for any conclusions reached, and

(g) the date of the report (which may differ from the valuation date).

(ii) *Difference between 'Valuation date' and 'date of the Valuation Report'*

As per International Valuation Standards, the valuation date must be stated. If the valuation date is different from the date on which the valuation report is issued or the date on which investigations are to be undertaken or completed then where appropriate, these dates should be clearly distinguished. Valuation date means 'the date' or period for which financials or information is considered.

The date of Valuation Report is the date on which the report is signed. Valuation date must precede the date of Valuation Report and vice versa should not be done.

Answer 3(b)

The valuation of a small equity interest in a private company would typically be calculated on a basis that it reflects the lack of control and lack of marketability of the interest. The control premium of 15 percent must first be used to provide an indication of a discount for lack of control (DLOC). A lack of control discount can be calculated using the formula

Lack of control discount = 1 – [1 / (1 + Control Premium)]

In this case, a lack of control discount of approximately 13 percent is calculated as 1 – [1 / (1 + 15%)]. The discount for lack of marketability (DLOM) was specified. Valuation discounts are applied sequentially and are not added.

A combined discount of approximately 35 percent is calculated as 1 – (1 – 13%) X (1 – 25%) = 0.348 or 34.8%.

Question 4

(a) "Combined Value = Stand alone value of acquiring firm (V_a) + Stand alone value of acquired target firm (V_t) + Value of synergy ΔV_{at}" –Discuss this equation with reference to Synergy benefits in Merger of Companies.

(b) Why do Companies want to measure intellectual capital and what are the pitfalls in valuation of such assets. (5 marks each)

Answer 4(a)

Synergy results from complementary activities. For example, one firm may have a substantial amount of financial resources while the other has profitable investment opportunities. Likewise, one firm may have a strong research and development team whereas the other may have a very efficiently organized production department. Similarly, one firm may have well established brands of its products but lacks marketing organization and another firm may have a very strong marketing organization. The merged business unit in all these cases will be more efficient than the individual firms and hence, the combined value of the merged firms is likely to be grater than the sum of the individual entities (units) due to synergy created which enhances the operational efficiency and more business value.

Accordingly, the combined value of the firm is calculated using the following formulae:

Combined Value = Standalone value of acquiring firm (V_a) + Standalone value of acquired target firm (V_t) + Value of synergy Δ Vat.

Normally, the value of synergy is positive and this constitutes the rational for the merger. In valuing synergy, costs attached with acquisitions should also be taken into account. These costs primarily consist of costs of integration and payment made for the acquisition of the target firm, in excess of its value, Vt.

Therefore, the net gain from the merger is equal to the difference between the value of synergy and costs.

Net gain = Value of synergy ΔV_{at} – Costs.

Answer 4(b)

There a number of reasons why firms want to measure intellectual capital and the predominant reasons have been for strategic or internal management purposes. Specifically, the reasons include:

(i) Alignment of intellectual capital resources with strategic vision. To support the implementation of a specific via a general upgrading of the work with the companies' human resources (support and maintain a strategy concerning the composition of staff as regards seniority, professional qualifications, and age. Through the description of the staff profile, measuring, discussion and adjustment become possible).

(ii) To support or maintain various parties' awareness of the company.

(iii) To help bridge the present and the past (stimulates the decentralized development of the need for constant development and attention towards change).

(iv) To ensure that stock prices valued fairly, by making several competencies visible to current and potential customers.

(v) To make the company appear to the employees as a name providing an identity for the employees and visualizing the company in the public. Knowledge of employees and customers will stimulate the development of a set of policies to increase customer satisfaction and customer loyalty.

(vi) Assessing effectiveness of a firm's intellectual capital utilization- Allocate resources between various business units. Extract full value from acquisition and joint ventures.

(vii) Determine the most effective management incentive structures.

Pitfalls in Valuation of Intellectual Capital - The first problem with intangibles starts with identifying them unlike physical assets, intangible assets have no specific lifetime and are not marketable in the conventional sense, meaning no market exists where they can be sold and priced readily.

This not only increases the likelihood of information asymmetry where the same asset will be priced differently by people with different levels of information, but also of the risk of not being able to sell the asset. Moreover, the absence of intangible assets from the Balance Sheet leads to misleading profitability metrics and hence the decisions based on these metrics are flawed. For example, the absence of intangible assets will understate the total assets in the Balance Sheet, so ratios like Return on Asset and Return on Equity will be overstated. In the opposite case, if intangible assets are priced without any standardized method, there may be a tendency to overprice these intangible assets, leading to understated profitability ratios. In both cases, the investors are not getting the proper picture of a company's financial situation.

Alternate Answer 4(b)

Intellectual capital (IC) is increasingly recognized as an important strategic asset for sustainable corporate competitive advantages. Intellectual capital is one of the most important intangible assets in the firms. Empirical evidences suggest that Intellectual

capital has direct effect in the firm's value and performance. Companies may want to measure intellectual capital for internal and external reasons.

Internal Reasons

First, measuring intellectual capital can help an organization formulate business strategy. By identifying and developing its intellectual capital, an organization may gain a competitive advantage.

Second, measuring intellectual capital may lead to the development of key performance indicators that will help evaluate the execution of strategy. Intellectual capital, even if measured properly, has little value unless it can be linked to the firm's strategy.

Third, intellectual capital may be measured to assist in evaluating mergers and acquisitions, particularly to determine the prices paid by the acquiring firms.

Fourth, using nonfinancial measures of intellectual capital can be linked to an organization's incentive and compensation plan.

External Reasons

To communicate to external stakeholders what intellectual property the firm owns. Improving external reporting of intellectual capital can:

(1) Close the gap between book value and market value,

(2) Provide improved information about the "real value" of the organization,

(3) Reduce information asymmetry,

(4) Increase the ability to raise capital by providing a valuation on intangibles, and

(5) Enhance an organization's reputation.

PART B

Question 5

(a) 'Business Model defines how a Company provide value to customer and transfer payments to profits'.

Elucidate the above statement by highlighting the key components of a business model.

(b) Sandeep, an IT graduate, has developed an e-platform to assist farmers to sell their produce directly to the bulk customers in the nearby cities, was unsure of selecting a suitable business model and has approached you to suggest one. As a Business Model consultant, select a suitable business model to Sandeep for his e-platform Application, and explain its features, advantages and drawbacks.

(c) (i) Using Excel function, calculate the future value of an investment of ₹1,00,000/ over 5 years. The investment earns interest of 8% during the first two years, 6.5% in third year and 6% during 4th and 5th years, and also answer the following :

(ii) Which excel function is used for this calculation ?

(iii) Show how this function is used in excel spread sheet. (5 marks each)

Answer 5(a)

A business model embodies nothing less than the organizational and financial 'architecture' of a business. It is not a spread sheet or computer model, although a business model might well become embedded in a business plan and in income statements and cash flow projections. But, clearly, the notion refers in the first instance to a conceptual, rather than a financial model of a business. It makes implicit assumptions about customers, the behaviour of revenues and costs, the changing nature of user needs, and likely competitor responses. It outlines the business logic required to earn a profit (if one is available to be earned) and, once adopted, defines the way the enterprise 'goes to market'. But it is not quite the same as a strategy. The following key components must be considered while developing a business model:

(i) *High-level vision* : The Vision describes the business model in brief.

(ii) *Key objectives* : The top goals and the plan to measure them.

(iii) *Customer targets and challenges* : The types of customers along with their exact pain points. Targeting a wide audience won't allow business to hone in on customers who truly need and want product or service. Instead, when creating business model, narrow audience down to two or three detailed buyer personas. Outline each persona's demographics, common challenges and the solutions the business model will offer.

(iv) *Solution* : The primary way that the business model solves customer's problems. Solution could be a product, service, technology etc.

(v) *Value* : The core elements of the solution that make it unique and differentiated is value being offered to the customers. How will your company stand out among the competitors? Do you provide an innovative service, revolutionary product or a new twist on an old favourite? Establishing exactly what your business offers and why it's better than competitors is the beginning of a strong value proposition. Once you've got a few value propositions defined, link each one to a service or product delivery system to determine how you will remain valuable to customers over time.

(vi) *Pricing* : How you will package your solution and what it will cost.

(vii) *Messaging* : A clear and compelling message that explains why your solution is worth buying.

(viii) *Go-to-Market* : The channels that use to market and sell to customers. No business can function properly (let alone reach established goals) without key partners that contribute to the business's ability to serve customers. When creating a business model, select key partners, like suppliers, strategic alliances or advertising partners. Unless you're taking a radical approach to launching your company, you'll need a strategy that builds interest in your business, generates leads and is designed to close sales. How will customers find you? More importantly, what should they do once they become aware of your brand? Developing a demand generation strategy creates a blueprint of the customer's journey while documenting the key motivators for taking action.

(ix) *Investment required* : The costs required to make the solution a success.

(x) *Growth opportunity* : The ways that you will growth the business, including key

partnerships if you need them. It is important to leave room for future innovations. Review initial plan often and implement changes as needed.

Answer 5(b)

Suitable Business Model : Become a Marketplaces is the right business model for Sandeep.

Features of the Market Place Model : Marketplace model means providing of an information technology platform by an e-commerce entity on a digital and electronic network to act as a facilitator between buyer and seller.

The main feature of the market place model is that the firm will be providing a platform for customers to interact with a selected number of sellers. When an individual is purchasing a product from the firm, he will be actually buying it from a registered seller. The product is not directly sold by the firm. firm is just a website platform where a consumer meets a seller. Inventory, stock management, logistics etc are not supposed to be actively done by the firm.

Advantages

There are several advantages of using this form of business model. In this model the supply and demand would be brought together. Second, one of the greatest benefits is having Zero to little overhead, and no inventory. You can get a swanky office space if you want, or you can run the company virtually. When you manufacture a product, you take on a lot more risk and pressure to make sure that inventory is sold. When you are the marketplace, instead of worrying about manufacturing costs, you are simply bringing the sellers to buyers (and Vice versa) and facilitating a transaction, taking a small slice of the pie from each transaction. You give sellers a place to make a profit and reach consumers, while customers are happy to find exactly what they want, usually at a discounted price.

Disadvantages

The Becomes a marketplace is not a bed of roses. There also are some drawbacks:

- High web traffic is great, but the volume of product and brands on Become a marketplace makes it difficult to stand out from crowd.
- The benefit of a Become a marketplace don't come free. There would be some costs to the seller and buyer. Both the parties will see cost benefit analysis.
- Become a marketplaces have their own rules about what can be listed and hoe it can be listed, and you must be able to work within those constraints, as opposed to having your own.

These trends suggest the businesses that will be most successful moving forward are the ones that can limit overhead and effectively connect with customers through websites and mobile apps.

Answer 5(c)

(i) 100,000+(100,000*8%)+(108,000*8%)+(1,16,640*6.5%)+(1,24,222*6%)+(1,31,675*6%)= INR 1,39,575

(ii) Excel function to be used : FV SCHEDULE

(iii)

Interest	= FV SCHEDULE (100000,C4 : C8)
8%	
8%	
6.50%	
6%	
6%	

It is to be noted that in place of C4:C8 students may assume other cells also.

Question 6

(a) ABC Limited is engaged in the business of Manufacturing alloy components. The CFO of the Company estimates that the Turnover of Company for the forthcoming Financial Year will be ₹100 Crore and thereafter year on year the Company can achieve 10% growth. He has also estimated that Earnings Before Interest, Tax, Depreciation and Amortisations (EBITDA) for the forthcoming Financial Year will be 25% on Turnover.

He also informs the Management that the Company can maintain the 25% EBITDA, provided there is not much change in the expenditure, as the 80% of expenditure of the Company is variable in nature. However, the purchase head of the Company comes out with the information that price for one of important Raw Material—'A', which forms 50% of the total raw materials is likely to rise upto 30% during the next Financial Year. (Raw Material Cost is estimated to be 60% of the Total Variable Cost). An alternate Raw Material—'P' is available, however it is costlier and it will bring down present EBITDA margin to 20%. It is expected that price of Material— 'P' will be stable in the next Financial Year. Assume there is no change in fixed or other variable expenses except change in Material 'A's price, as a part of the management you are required to :

(i) Find out the impact on profitability by preparing a Sensitivity Analysis table, if the price of the Raw Material—'A' is increases by 10%, 20% and 30% for the next Financial Year. (5 marks)

(ii) Find out % of Variable and Raw Material cost on Sales if Material 'P' is used and also find out at what levels of increase in Material—'A's price, the Company can opt for use of Raw Material—'P'. (5 marks)

(b) Explain Working Capital Management through business modeling with practical example. (5 marks)

Answer 6(a)

(i) Sensitivity Table

	% of price change in Material A		
	10%	20%	30%
Turnover (Rs.)	100	100	100
EBITDA	25%	25%	25%
EBITDA (Rs.)	25	25	25
Total Expenses (sale – EBITDA)	75	75	75
% OF Variable Expenses	80%	80%	80%
Total Variable Expenses (Rs.)	60	60	60
% of Total Raw Materials	60%	60%	60%
Cost of Total Raw Materials(Rs.)	36	36	36
% of Materials-'A' in RM	50%	50%	50%
Cost of Material- 'A' (Rs.)	18	18	18
Expected Increase (Rs.)	1.8	3.6	5.4
Increased Cost of Material – 'A' (Rs.)	19.8	21.4	23.4
Impact on EBITDA (Present EBTIDA – Expected increase)	23.2	21.4	19.6
EBITDA% after price Increase	23.2	21.4	19.6

(ii) Usage of Material 'P'

Profitability using Material 'P'		
Turnover(Rs)		100
EBITDA(Rs)		20
Total Expenses (Rs)		80
Total Variable Expenses (Rs) (Total Expenses – Fixed Expenses)	(80-15)	65
% of Variable Expenses in Total coat	(65/80)%	81.25%
Total Cost of Raw materials (Raw Material cost using Material A + 5 cr)	(36 + 5)	41

% of Raw Material Cost	(41/80)*100	51.25
Cost of Material P		23
% of Raw Material 'P' in Raw Material Cost (23/41)*100		56.10
Difference in Profitable when Material A raises by 30%		0.40
(20- 19.6)		
At what % of material A price raise both material will be		27.78
Similar	2.22	

Upto 27.78% 0f Material A's price raise it can be used, beyond that Material P can be opted.

Answer 6(b)

Working capital management refers to a company's managerial accounting strategy designed to monitor and utilize the two components of working capital, current assets and current liabilities, to ensure the most financially efficient operation of the company. The primary purpose of working capital management is to make sure the company always maintains sufficient cash flow to meet its short- term operating costs and short-term debt obligations.

Working capital management commonly involves monitoring cash flow, assets, and liabilities through the ratio analysis of key elements of operating expenses, including the working capital ratio, collection ratio, and the inventory turnover ratio. Efficient working capital management helps maintain the smooth operation of the operating cycle (the minimum amount of time required to convert net current assets and liabilities into cash) and can also help to improve the company's earnings and profitability. Management of working capital includes inventory management and management of accounts receivable and accounts payables. The main objective of working capital management include maintaining the working capital operating cycle and ensuring its ordered operation, minimizing the cost of capital spent on the working capital, and maximizing the return on current assets investments.

For many Firms, the analysis and management of the operating cycle is the key to healthy operations. For example, imagine the appliance retailer ordered too much inventory–its cash will be tied up and unavailable for spending on other things (such as fixed assets and salaries). Moreover, it will need larger warehouses. Will have to pay for unnecessary storage, and will have no space to house other inventory.

Imagine that in addition to buying too much inventory, the retailer is lenient with payment terms to its own customers (perhaps to stand out from the competition). This extends the amount of time cash is tied up and adds a layer of uncertainty and risk around collection.

Now imagine our appliance retailer mitigates these issues by paying for the inventory

on credit (often necessary as the retailer only gets cash once it sells the inventory). Cash is no longer tied up, but effective working capital management is even more important since the retailer may be forced to discount more aggressively (lowering margins or even taking loss) to move inventory in order to meet vendor payments and escape facing penalties.

Taken together, this process represents the operating cycle (also called the cash conversion cycle). Companies with significant working capital consideration must carefully and actively manage working capital to avoid inefficiencies and possible liquidity problems. In our example, a perfect solution could look like this:

1. If the retailer bought excess inventory on credit with short repayment terms
2. Economy is slow, customer aren't paying as fast as was expected
3. Demand for the retailer's product offerings changes and some inventory flies off the shelves while other inventory is not selling.

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INSOLVENCY - LAW AND PRACTICE
(Elective Paper 9.8)

Time allowed : 3 hours *Maximum marks : 100*

NOTE : *Answer **ALL** Questions*

Question 1

Facts of the case :

SB Pvt. Ltd. supplied raw materials worth ₹15 lakh in January 2018 to a company named MR Ltd. MR Ltd. issued two cheques for ₹10 lakh, dated l5th April, 2018 and ₹ 5 lakh, dated 1st June, 2018, in favour of SB Pvt. Ltd. MR Ltd. had availed loan facility of ₹50 lakh from State Bank of India (SBI) and due to non-payment the account became Non-performing Asset (NPA) in the books of SBI.

The SBI started recovery measures and lastly filed Corporate Insolvency Resolution Process (CIRP) against the MR Ltd. with the Adjudicating Authority (AA), The Adjudicating Authority admitted the CIRP filed by the SBI and the order of moratorium was passed under section 14 of the Insolvency and Bankruptcy Code, 2016 (the Code) on 6th June, 2018.

The first cheque of ₹10 lakh lodged by SB Pvt. Ltd. returned unpaid by its banker for the reason of insufficiency of funds. The SB Pvt. Ltd lodged a criminal complaint under section 138 of the Negotiable Instruments Act, 1881 (NI Act) against MR Ltd. and its directors in the competent court having jurisdiction on 1st June, 2018. (i. e. prior to declaration of moratorium by the AA).

The second cheque of ₹5 lakh was also returned unpaid for the reason of insufficiency of funds and again a second criminal complaint was lodged by the SB Pvt. Ltd. against the MR Ltd. and its directors on l5th June, 2018 (i.e after declaration of moratorium by the AA).

The MR Ltd. and its Directors moved before the Adjudicating Authority and argued that during the period of moratorium proceeding petition under Section 138 of NI Act was not maintainable. This was opposed by the SB Pvt. Ltd. but the Adjudicating Authority directed the SB Pvt. Ltd. to withdraw the complaint case filed under Section 138 of NI Act treating it as a proceeding filed after order of moratorium with observation that such action amounts to deliberate attempt on the part of SB Pvt. Ltd. and sheer misuse of the process of law.

Aggrieved from the order of the Adjudicating Authority, the SB Pvt. Ltd. preferred appeal before the National Company Law Appellate Tribunal (NCLAT). The NCLAT accepted the appeal and set aside the order of the Adjudicating Authority.

Based on the above facts, answer the following questions :

(a) Citing relevant case law elaborate the decision of the Adjudicating Authority ? State with reasons, if aggrieved party prefers an appeal, will they succeed.

(10 marks)

(b) Section 14 of the Code states that after declaration of the moratorium no legal action can be maintained against the Corporate Debtor. What will be your answer when :

(i) Criminal action under section 138 of NI Act filed before the declaration of moratorium; and

(ii) Criminal action under section 138 of NI Act filed after the declaration of moratorium. (10 marks)

(c) What is effect of the declaration of the moratorium under section 14 of the Insolvency and Bankruptcy Code, 2016 ? (10 marks)

(d) Adjudicating Authority appoints Interim Resolution Professional (IRP) under the Insolvency and Bankruptcy Code - Enumerate his role, powers and duties. (10 marks)

Answer 1(a)

The above case is similar to the facts as was in the case of *Shah Brothers Ispat (P.) Ltd.* v. *P. Mohanraj & Ors*, decided by the NCLAT, New Delhi, on July 31, 2018.

Decision given by the Adjudicating Authority : The Adjudicating Authority opined that SB Pvt. Ltd. had violated order of moratorium issued by Adjudicating Authority, which was a deliberate attempt on part of the SB Pvt. Ltd. and sheer misuse of process of law. The SB Pvt. Ltd. was directed to withdraw the complaint filed under Negotiable Instruments Act,1881 and, in case the SB Pvt. Ltd. had not withdrawn, action for violation of moratorium would be taken against it.

Reasons on chances of success of aggrieved party on Appeal : Section 14 of the Insolvency and Bankruptcy Code, 2016 was apparently misunderstood by the Adjudicating Authority. The language of Section 14 nowhere prohibits the initiation of criminal action. If there would have been the intention of the law maker to include the prohibition of criminal action against the corporate debtor, it would have been specifically mentioned in section 14 itself.

The issue before the Appellate Tribunal is as under:

Whether the order of moratorium will cover a criminal proceeding under Section 138 of the Negotiable Instruments Act, 1881, which provides punishment of imprisonment for a term which may extend to three years or with fine which may extend to twice the amount of cheque or with both?

The decision to be given in the case with logical reasoning, may be mentioned as under:

The company cannot be imprisoned, therefore aforesaid punishment under Section 138 of the Negotiable Instruments Act, 1881 cannot be imposed against the MR Ltd. However, fine can be imposed by a court of competent jurisdiction on MR Ltd, if found guilty. The Directors of the MR Ltd. being parties can be imprisoned and also fine may be imposed on them.

The contention given by the MR Ltd. that the proceeding under Section 138 of the Negotiable Instruments Act, 1881 is covered by clause of sub-section (l)(a) of Section

14 of the Code, therefore, proceedings against the MR Ltd. including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority cannot proceed, is not acceptable by the Appellate Tribunal for the reasons being Section 138 of the Negotiable Instruments Act, 1881 is a penal provision, which empowers the court of competent jurisdiction to pass order of imprisonment or fine, which cannot be held to be proceeding or any judgment or decree of money claim.

Imposition of fine cannot held to be a money claim or recovery against the MR Ltd. nor order of imprisonment, if passed by the court of competent jurisdiction on the Directors, they cannot claim benefit of moratorium under Section 14 of the Code. In fact no criminal proceeding is covered under Section 14 of the Code, so the question of moratorium on the criminal complaint under section 138 of the Negotiable Instruments Act, 1881 stands nowhere.

Answer 1(b)

Section 14(1)(a) of the Insolvency and Bankruptcy Code, 2016, prohibits the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority.

The question arises here is whether the order of moratorium will cover a criminal proceeding under Section 138 of the Negotiable Instruments Act, 1881, which provides for imprisonment for a term which may extend to three years or with fine which may extend to twice the amount of cheque or with both.

Imposition of the fine cannot held to be a money claim or recovery against the Corporate Debtor. Same way order of imprisonment, if passed by the court of competent jurisdiction on the Directors, is not covered under Section 14 of the Code. In fact no criminal proceeding is covered under Section 14 of the Code.

Hence, filing of criminal complaint under section 138 of the Negotiable Instruments Act, 1881 either before or after the declaration of moratorium under section 14 of the Code will have no effect of moratorium.

Answer 1(c)

Section 14 of the Insolvency and Bankruptcy Code, 2016 deals with the declaration of Moratorium by the Adjudicating Authority after acceptance of the CIRP application filed by the financial/ operational creditor. It provides as under:

(1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:

(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;

(b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

(c) any action to foreclose, recover or enforce any security interest created by

the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

(2) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during the moratorium period.

(3) The provisions of sub-section (1) shall not apply to —

(a) such transactions as may be notified by the Central Government in consultation with any financial sector regulator;

(b) a surety in a contract of guarantee to a corporate debtor.

(4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process.

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 of the Code or passes an order for liquidation of corporate debtor under section 33 of the Code, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.

Answer 1(d)

Role and Powers of Interim Resolution Professional

Section 17(1) of the Insolvency and Bankruptcy Code, 2016 provides that from the date of appointment of the Interim Resolution Professional,

(a) the management of the affairs of the corporate debtor shall vest in the interim resolution professional;

(b) the powers of the Board of directors or the partners of the corporate debtor, as the case may be, shall stand suspended and be exercised by the interim resolution professional;

(c) the officers and managers of the corporate debtor shall report to the interim resolution professional and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional;

(d) the financial institutions maintaining accounts of the corporate debtor shall act on the instructions of the interim resolution professional in relation to such accounts and furnish all information relating to the corporate debtor available with them to the interim resolution professional.

Section 17(2) of the Code further provides that the interim resolution professional vested with the management of the corporate debtor, shall

(a) act and execute in the name and on behalf of the corporate debtor all deeds, receipts, and other documents, if any;

(b) take such actions, in the manner and subject to such restrictions, as may be specified by the Board;

(c) have the authority to access the electronic records of corporate debtor from information utility having financial information of the corporate debtor;

(d) have the authority to access the books of accounts, records and other relevant documents of corporate debtor available with government authorities, statutory auditors, accountants and such other persons as may be specified; and

(e) be responsible for complying with the requirements under any law for the time being in force on behalf of the corporate debtor.

Duties of Interim Resolution Professional - Section 18 of the Code provides that the person appointed as the Interim Resolution Professional shall perform the following duties:

(a) collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor, including information relating to,

(i) business operations for the previous two years;

(ii) financial and operational payments for the previous two years;

(iii) list of assets and liabilities as on the initiation date; and

(iv) such other matters as may be specified .

(b) receive and collate all the claims submitted by creditors to him, pursuant to the public announcement made under sections 13 and 15 of the Code;

(c) constitute a committee of creditors;

(d) monitor the assets of the corporate debtor and manage its operations until a resolution professional is appointed by the committee of creditors;

(e) file information collected with the information utility, if necessary; and

(f) take control and custody of any asset over which the corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor, or with information utility or the depository of securities or any other registry that records the ownership of assets including,

(i) assets over which the corporate debtor has ownership rights which may be located in a foreign country;

(ii) assets that may or may not be in possession of the corporate debtor;

(iii) tangible assets, whether movable or immovable;

(iv) intangible assets including intellectual property;

(v) securities including shares held in any subsidiary of the corporate debtor, financial instruments, insurance policies;

(vi) assets subject to the determination of ownership by a court or authority;

(g) to perform such other duties as may be specified by the Board.

Question 2

(a) Insolvency Professionals (IPs) are private persons, but are governed by Insolvency Regulator. Describe how the IPs are regulated ? (6 marks)

(b) ESI Ltd. filed Corporate Insolvency Resolution Plan (CIRP) with the Adjudicating Authority, which was accepted, and Expression of Interest (EOI) was invited. One N Ltd. filed EOI. It was noticed that N Ltd was incorporated just 7 days before submission of the EOI as joint venture between AE Ltd and other two companies. It was further come to the notice that AE Ltd. was completely held by Sawant Seth (through various companies and a trust), said Sawant Seth was son of Ravi Seth, who was promoter of ESI Ltd.

You as a Resolution Professional in this case, what would you suggest the Committee of Creditors and Adjudicating Authority about the acceptance or rejection of the EOI. Give reasons and quote the decided case law. (6 marks)

Answer 2(a)

It is true to say that Insolvency professionals (IPs) are private persons, but are governed by Insolvency Regulator (Insolvency and Bankruptcy Board of India).

The Insolvency and Bankruptcy Code, 2016 provides for IPs to act as intermediary in the insolvency resolution process. Insolvency professionals are a class of regulated but private professionals having minimum standards of professional and ethical conduct. Section 3(19) of the Code defines an 'insolvency professional' as a person enrolled under section 206 the Code with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207 of the Code.

Section 206 of the Code lays down that no person shall render his services as insolvency professional under this Code without being enrolled as a member of an insolvency professional agency and registered with the Board. Section 207(1) of the Code further lays down that every insolvency professional shall, after obtaining the membership of any insolvency professional agency, register himself with the Board within such time, in such manner and on payment of such fee, as may be specified by regulations. Section 207(2) of the Code empowers the IBBI to specify the categories of professionals or persons possessing such qualifications and experience in the field of finance, law, management, insolvency or such other field to act as insolvency professionals. The Insolvency and Bankruptcy Board of India has framed the IBBI (Insolvency Professional) Regulations, 2016 to regulate the working of Insolvency Professionals. These regulations are amended from time to time by the IBBI. Section 208 of the Code provides for the functions and obligations of IPs during any insolvency resolution, fresh start, liquidation or bankruptcy process.

IPs are required to follow Code of conduct, there performance is monitored by IPA and IBBI and also they are subject to disciplinary action by IBBI and IPA.

Thus, from the above discussions, it is very much clear that IPs though private professional, are regulated by the IBBI, the Insolvency Regulator.

Answer 2(b)

Persons not Eligible to be Resolution Applicant

Section 29A of the Insolvency and Bankruptcy Code, 2016 provides the list of

persons who are not eligible to be resolution applicant. Sub-clause (c) of section 29A provides as under:

A person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person:

….(c) at the time of submission of the resolution plan has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 or the guidelines of a financial sector regulator issued under any other law for the time being in force, and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor.

Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to non-performing asset accounts before submission of resolution plan.

The case is similar to *Arcelormittal India (P.) Ltd.* v. *Satish Kumar Gupta & Ors*, decided by the Supreme Court, dated October 4, 2018. The apex court in the case had opined as under:

(a) Section 29A(c) is a see-through provision; therefore, great care must be taken to ensure that persons who are in-charge of corporate debtor for whom such resolution plan is made, do not come back in some other form to regain control of company without first paying off its debts.

(b) Any person who wishes to submit a resolution plan acting jointly or in concert with other persons who happens to either manage or control or be promoters of a corporate debtor which is classified as an NPA and whose debts have not been paid off for a period of at least one year before commencement of corporate insolvency resolution process, will be ineligible to submit a resolution plan; and in order to become eligible under section 29A(c), he or it must 'pay off debt' before submission of the resolution plan.

(c) The antecedent facts reasonably proximate to point of time of submitting resolution plan is to be seen and if at a reasonably proximate point of time before submission of resolution plan, affairs of persons referred to in section 29A are so arranged as to avoid paying off debts of non-performing asset concerned, such persons must be held to be ineligible to submit a resolution plan.

(d) The term 'connected person' covers (i) a promoter or a person in management and control of resolution applicant, (ii) promoter or a person in management or control of business of corporate debtor during implementation of resolution plan and (iii) holding companies, subsidiary companies and associate companies or related parties of persons.

In view of the above, the Committee of Creditors and the Adjudicating Authority shall reject the Expression of Interest (EOI) filed by N Ltd.

Question 3

(a) WTC Ltd had been incurring losses since inception and was decided to wind up. The company had several pending litigation and that claim against the company

exceeded value of its assets and, thus, debt due to creditors could not be discharged in total. The company seeks your opinion for voluntary liquidation proceedings. Advise the company with the relevant provision under the Insolvency and Bankruptcy Code, 2016.

(b) 'Liquidation is the last process, when the resolution plan fails'. What are the triggers when there is no alternate except to move for the liquidation ?

(6 marks each)

Answer 3(a)

Voluntary Liquidation of Corporate Persons

Section 59(3) of the Insolvency and Bankruptcy Code, 2016 provides that voluntary liquidation proceedings of a corporate person registered as a company shall meet the following conditions:

(a) A declaration from majority of the directors of the company verified by an affidavit stating that (i) they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and (ii) the company is not being liquidated to defraud any person;

(b) The declaration under sub-clause (a) shall be accompanied with the following documents: (i) audited financial statements and record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later; (ii) a report of the valuation of the assets of the company, if any prepared by a registered valuer;

(c) Within four weeks of a declaration under sub-clause (a), there shall be - (i) a special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an insolvency professional to act as the liquidator; or (ii) a resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator.

The proviso appended to sub-section (3) of section 59 lays down that if the company owes any debt to any person, creditors representing two thirds in value of the debt of the company shall approve the resolution passed under sub-clause (c) within seven days of such resolution.

Thus, as per section 59(3) voluntary liquidation could only be undertaken if corporate debtor discharged its debts to satisfaction of creditors and if there was no litigation pending against corporate debtor. In the instant case since both these ingredients are not satisfied, hence the option for voluntary liquidation of the company could not be advised.

Answer 3(b)

Section 33 of the Insolvency and Bankruptcy Code, 2016 lists out the triggers for

initiating the liquidation process for corporate persons. Section 33 of the Code provides as under:

(1) Where the Adjudicating Authority,

(a) before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the corporate insolvency resolution process under section 12 of the Code or the fast track corporate insolvency resolution process under section 56 of the Code, as the case may be, does not receive a resolution plan under sub-section (6) of section 30 of the Code; or

(b) rejects the resolution plan under section 31 for the non-compliance of the requirements specified therein, it shall -

(i) pass an order requiring the corporate debtor to be liquidated in the manner as laid down in this Chapter;

(ii) issue a public announcement stating that the corporate debtor is in liquidation; and

(iii) require such order to be sent to the authority with which the corporate debtor is registered.

(2) Where the resolution professional, at any time during the corporate insolvency resolution process but before confirmation of resolution plan, intimates the Adjudicating Authority of the decision of the committee of creditors approved by not less than sixty-six per cent of the voting share to liquidate the corporate debtor, the Adjudicating Authority shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1).

(3) Where the resolution plan approved by the Adjudicating Authority is contravened by the concerned corporate debtor, any person other than the corporate debtor, whose interests are prejudicially affected by such contravention, may make an application to the Adjudicating Authority for a liquidation order as referred to in sub-clauses (i), (ii), (iii) of clause (b) sub-section (1).

(4) On receipt of an application under sub-section (3), if the Adjudicating Authority determines that the corporate debtor has contravened the provisions of the resolution plan, it shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub- section (1).

Question 4

(a) 'Insolvency and Bankruptcy Code also regulates cross border transactions'— Elucidate the relevant provisions of Insolvency and Bankruptcy Code, 2016.

(b) An application for Corporate Insolvency Resolution Process (CIRP) was filed by a Bank (being Financial Creditor) against RSI Ltd, which was admitted by the NCLT and an Interim Resolution Professional was appointed, the Committee of Creditors (CoC) was constituted. Vijay, who was a member of the suspended Board of Directors of RSI Ltd was neither allowed participation in CoC nor any information considered confidential was given, either by the resolution professional or the Committee of Creditors. Vijay made representations before the Adjudicating

Authority to attend the meeting and for information/documents. Will Vijay succeed in his claim for attending the Meeting of Committee of Creditors and obtaining information about the CoC proceedings. (6 marks each)

Answer 4(a)

Sections 234 and 235 of the Insolvency and Bankruptcy Code, 2016 make provisions to deal with cases involving cross border insolvency.

Agreements with foreign countries : Section 234 of the Code empowers the central government to enter into an agreement with other countries to resolve situations pertaining to cross border insolvency. Section 234 of the Code provides that the Central Government may enter into an agreement with the Government of any country outside India for enforcing the provisions of this Code. [Section 234(1)]

The Central Government may, by notification in the Official Gazette, direct that the application of provisions of this Code in relation to assets or property of corporate debtor or debtor, including a personal guarantor of a corporate debtor, as the case may be, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified. [Section 234(2)]

Letter of request to a country outside India in certain cases: Section 235 of the Code lays down that notwithstanding anything contained in this Code or any law for the time being in force if, in the course of insolvency resolution process, or liquidation or bankruptcy proceedings, as the case may be, under this Code, the resolution professional, liquidator or bankruptcy trustee, as the case may be, is of the opinion that assets of the corporate debtor or debtor, including a personal guarantor of a corporate debtor, are situated in a country outside India with which reciprocal arrangements have been made under section 234, he may make an application to the Adjudicating Authority that evidence or action relating to such assets is required in connection with such process or proceeding. [Section 235(1)]

The Adjudicating Authority on receipt of an application under sub-section (1) and, on being satisfied that evidence or action relating to assets under sub-section (1) is required in connection with insolvency resolution process or liquidation or bankruptcy proceeding, may issue a letter of request to a court or an authority of such country competent to deal with such request. [Section 235(2)]

The current cross border insolvency framework in India is dependent on India entering bilateral agreements with other countries. Finalisation of bilateral agreements is a long drawn process as it involves long term negotiations and thus takes a lot of time. Moreover, every trade is distinct and thus it would be difficult for the adjudicating authorities to enforce the agreements/treaties entered into with other countries.

Answer 4(b)

The facts of the case are similar to the case of *Vijay Kumar Jain* v. *Standard Chartered Bank*, Supreme Court of India, January 31, 2019.

In the matter, an appeal was filed with Supreme Court against orders rejecting the prayer of an erstwhile director for getting copy of the resolution plans from the Resolution Professional (RP). Both the NCLT and NCLAT ruled that appellant had no right to receive the resolution plans.

RP has contended that only the members of Committee of Creditors (CoC) are entitled to have resolution plans, as per section 30(3) of the Code read with Regulation 39(2) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. Relying on the Notes on Clauses to Section 24 of the Code, they argued that the members of suspended Board of Directors are permitted to participate in CoC meetings only for the purpose of giving information regarding the financial status of the debtor.

In this case the Supreme Court opined that the statutory scheme, makes it clear that though the erstwhile Board of Directors are not members of the committee of creditors, yet, they have a right to participate in each and every meeting held by the committee of creditors, and also have a right to discuss along with members of the committee of creditors all resolution plans that are presented at such meetings.

The Supreme Court expressly rejected the argument based on Notes on Clauses to Section 24 of the Code and noted that every participant is entitled to a notice of every meeting of the committee of creditors. Such notice of meeting must contain an agenda of the meeting, together with the copies of all documents relevant for matters to be discussed and the issues to be voted upon at the meeting *vide* Regulation 21(3)(iii) of CIRP Regulations. The Supreme Court said the expression 'documents' is a wide expression which would certainly include resolution plans.

Thus, members of erstwhile Board of Directors, being vitally interested in resolution plans that may be discussed at meetings of committee of creditors, must be given a copy of such plans as part of 'documents' that have to be furnished along with notice of such meetings.

Hence, Vijay will succeed in his claim for attending the meetings of CoC and obtaining information about the CoC proceedings.

Question 5

(a) Application for initiation of individual insolvency resolution process can be submitted by a debtor only in respect of debts which are not excluded debts. Which debts are to be treated as excluded debts ?

(b) How an asset reconstruction company may acquire rights or interest in financial assets of any bank or financial institution ? (6 marks each)

Answer 5(a)

Section 94 of the Insolvency and Bankruptcy Code, 2016 deals with the application by debtor to initiate insolvency resolution process. A debtor who commits a default may apply, either personally or through a resolution professional, to the Adjudicating Authority for initiating the insolvency resolution process, by submitting an application. [(Section 94(1)]

An application under sub-section (1) shall be submitted only in respect of debts which are not excluded debts. [Section 94(3)]

Excluded Debts : Section 79(15) of the Code defines excluded debts, which means:

(a) liability to pay fine imposed by a court or tribunal;

(b) liability to pay damages for negligence nuisance or breach of a statutory, contractual or other legal obligation;

(c) liability to pay maintenance to any person under any law for the time being in force;

(d) liability in relation to a student loan;

(e) any other debt as may be prescribed.

Answer 5(b)

Section 5 of the SARFAESI Act, 2002 provides for the acquisition of rights or interest in financial assets of any bank or financial institution. Section 5 provides as under:

(1) Notwithstanding anything contained in any agreement or any other law for the time being in force, any asset reconstruction company may acquire financial assets of any bank or financial institution -

(a) by issuing a debenture or bond or any other security in the nature of debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or

(b) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.

(1A) Any document executed by any bank or financial institution under sub-section (1) in favour of the asset reconstruction company acquiring financial assets for the purposes of asset reconstruction or securitisation shall be exempted from stamp duty in accordance with the provisions of section 8F of the Indian Stamp Act, 1899.

Provided that the provisions of this sub-section shall not apply where the acquisition of the financial assets by the asset reconstruction company is for the purposes other than asset reconstruction or securitisation.

(2) If the bank or financial institution is a lender in relation to any financial assets acquired under sub-section (1) by the asset reconstruction company, such asset reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.

(2A) If the bank or financial institution is holding any right, title or interest upon any tangible asset or intangible asset to secure payment of any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire the tangible asset or assignment or licence of intangible asset, such right, title or interest shall vest in the asset reconstruction company on acquisition of such assets under sub-section (1).

(3) Unless otherwise expressly provided by this Act, all contracts, deeds, bonds, agreements, power-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of

financial asset under sub-section (1) and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the asset reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, asset reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of asset reconstruction company, as the case may be.

(4) If, on the date of acquisition of financial asset under sub-section (1), any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third proviso to sub-section (1) of section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the asset reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the asset reconstruction company, as the case may be.

(5) On acquisition of financial assets under sub-section (1), the asset reconstruction company, may with the consent of the originator, file an application before the Debts Recovery Tribunal or the Appellate Tribunal or any court or other Authority for the purpose of substitution of its name in any pending suit, appeal or other proceedings and on receipt of such application, such Debts Recovery Tribunal or the Appellate Tribunal or court or Authority shall pass orders for the substitution of the asset reconstruction company in such pending suit, appeal or other proceedings.

Question 6

VN Pvt. Ltd. (VNPL) entered into a Sub-contract Agreement with KC Pvt. Ltd. (KCPL) to undertake road construction works. During the course of the project, disputes and differences arose between the parties and the same were referred for an Arbitration, Arbitration Award was delivered in favour of the KCPL. VNPL challenged the Award by making an appeal under Section 34 of the Arbitration and Conciliation Act, 1996. Meanwhile, VNPL sent a demand notice under the Insolvency and Bankruptcy Code and also initiated insolvency proceedings against KCPL. The KCPL claimed that there is a dispute and the award has been challenged and adjudication of which is pending.

NCLT as well as NCLAT admitted the insolvency petition stating that challenge of award could not be considered to be 'existence of dispute' under the Insolvency and Bankruptcy Code. The matter reached the Supreme Court.

What is 'dispute' within the meaning of the Insolvency and Bankruptcy Code, 2016 (IBC Code). Whether Award passed under Arbitration Act and challenged will be termed as existence of dispute under IBC Code. Comment with the help of decided case law. *(12 marks)*

Answer 6

Section 5(6) of the Insolvency and Bankruptcy Code, 2016 defines the meaning of

the word 'dispute'. According to this, the term 'dispute' includes a suit or arbitration proceedings relating to (a) the existence of the amount of debt; (b) the quality of goods or service; or (c) the breach of a representation or warranty.

The facts of the case is similar to the case decided by the Supreme Court of India in the matter of *K Kishan* v. *Vijay Nirman Co. (P.) Ltd.*, August 14, 2018.

The question before the Supreme Court was whether an arbitral award that has been challenged under Section 34 of the Arbitration and Conciliation Act, 1996 by the award debtor can form the basis for an action under Section 9 of the Insolvency and Bankruptcy Code, 2016. The Supreme Court overturned the decision of the National Company Law Appellate Tribunal (NCLAT) and held that the pendency of an application under Section 34 of the Arbitration and Conciliation Act, 1996 constitutes a 'dispute' under Section 8 of the Code. Accordingly, the challenge to the arbitral award bars the initiation of the corporate insolvency resolution process (CIRP), under Section 9 of the Code.

The Supreme Court had opined that operational creditors cannot use the Insolvency and Bankruptcy Code, 2016 either prematurely or for extraneous considerations or as a substitute for debt enforcement procedures. Such a company would be well within its rights to state that it is challenging the Arbitral Award passed against it, and the mere factum of challenge would be sufficient to state that it disputes the Award. We repeat that the object of the Code, at least insofar as operational creditors are concerned, is to put the insolvency process against a corporate debtor only in clear cases where a real dispute between the parties as to the debt owed does not exist.

The Supreme Court decision overturned the position assumed by the NCLT and the NCLAT that proceedings pending under Section 34 of the Arbitration and Conciliation Act, 1996 do not imply the existence of a dispute and that an arbitral award that has been challenged does not constitute a record of the operational debt. The Court held that whilst the final adjudication of a challenge to an award is pending under the Arbitration and Conciliation Act, 1996, the provisions of the Code may not be legitimately attracted.

This in effect is a harmonious construction by the Supreme Court of the two legislations, considering situations where a corporate debtor is put under the resolution process before final adjudication of a challenge to an award under the Arbitration and Conciliation Act, 1996. If the arbitral award is subsequently set aside under Section 34 of the Arbitration and Conciliation Act, 1996, the damage to the corporate debtor would be irreparable and the legal position under the two legislations thereby, irreconcilable.

Thus, the Award passed under the Arbitration and Conciliation Act, 1996 shows that operational debt is disputed and the Code cannot be invoked in respect of operational debt where an Arbitral Award has been passed against corporate debtor, which has not yet been finally adjudicated upon.

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