# GUIDELINE ANSWERS

## PROFESSIONAL PROGRAMME

Syllabus 2017

**JUNE 2024**

## MODULE 2

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
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These answers have been written by competent persons and the Institute hope that the GUIDELINE ANSWERS will assist the students in preparing for the Institute's examinations. It is, however, to be noted that the answers are to be treated as model answers and not as exhaustive and the Institute is not in any way responsible for the correctness or otherwise of the answers compiled and published herein.

The Guideline Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, students are expected to be updated with the applicable amendments which are as follows:

| **CS Examinations** | **Applicability of Amendments to Laws** |
|---|---|
| December Session | upto 31 May of that Calender year |
| June Session | upto 30 November of previous Calender Year |

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### MODULE 2

# SECRETARIAL AUDIT, COMPLIANCE MANAGEMENT AND DUE DILIGENCE

## MODULE 2 PAPER 1

***Time allowed : 3 hours*** ***Maximum marks : 100***

***NOTE :*** *Answer All Questions.*

## PART-I

### Question 1

(a) A former Security officer BK, of Equae Security Agency (ESA), leaked classified documents that revealed extensive global surveillance programs operated by the ESA. The leaked information included details about the bulk collection of phone records and internet communications.

BK's actions raised significant legal and ethical questions surrounding government surveillance and the protection of individual privacy. The case prompted global debates on the balance between clients security interests and the right to privacy.

BK faced charges for unauthorized disclosure of classified information, and henceforth ESA wants to be extra careful. What steps ESA should adopt for protecting and dealing with the confidential information in future ? Explain also "written confidentiality".

(*5 marks*)

(b) Z, purchased a property from X. Prior to the purchase, Z conducted a search on its own and failed to identify an existing lien on the property. After the purchase, it was discovered that there was a mortgage lien from a previous owner that wasn't cleared during the sale process. As a result, Z, faced legal complications and financial losses due to the oversight in his search. Z filed a lawsuit against X, arguing that X failed to disclose or address the existing lien during the transaction. The case might involve claims of negligence, misrepresentation, or breach of contract.

Identify and explain which type of search Z would have conducted and by whom. Also explain six other illustrations of this type of search.

(*5 marks*)

(c) What will be the views and actions taken by the Disciplinary Directorate of ICSI on receipt of any information or complaint on arriving at a prima facie opinion on the occurrence of the alleged misconduct and where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the :

(a) First Schedule and

(b) Second Schedule or in both the Schedules.

Also specify before whom the matter will be placed in both the cases.

(*2+2+1=5 marks*)

(d) KEK Bank fraud involved fraudulent issuance of Letters of Undertaking (LoU) and Letters of Credit (LoC) at one of its branches. The fraud was facilitated by incomplete KYC processes that allowed the perpetrators to exploit loopholes.

The fraud involved the misuse of a messaging network that enabled financial institutions to securely send and receive standardized messages related to financial transactions of customers. These messages covered a wide range of activities, including payment instructions, trade transactions, securities, treasury, and other financial transactions. The messaging system raised unauthorized credit from overseas branches of other banks. The lack of proper KYC scrutiny and oversight allowed the fraudulent transactions to go undetected for an extended period.

Identify the type of fraud in above case. List eight other major frauds which can take place with the help of incomplete KYC.

(*5 marks*)

**Answer 1(a)**

**Written Confidentiality:** For every business/organization it is important to have a written confidentiality describing both the type of information considered confidential and the procedures employees must follow for protecting confidential information and dealing with the confidential information.

However, ESA (Company), may adopt the following procedures for protecting confidential information:

(i) All confidential documents should be stored in locked file cabinets or rooms accessible only to those who are authorized.

(ii) All electronic confidential information should be protected via firewalls, encryption and passwords.

(iii) Employees should clear their desks of any confidential information before going home at the end of the day.

(iv) Employees should refrain from leaving confidential information visible on their computer monitors when they leave their work stations.

(v) All confidential information, whether contained on written documents or electronically, should be marked as confidential."

(vi) All confidential information should be disposed of properly (e.g., employees should not print out a confidential document and then throw it away without shredding it first.)

(vii) Employees should refrain from discussing confidential information in public places.

(viii) Employees should avoid using e-mail to transmit certain sensitive or controversial information.

(ix) Limit the acquisition of confidential client data (e.g., social security numbers, bank accounts, or driver's license numbers) unless it is integral to the business transaction and restrict access on a 'need-to- know' basis.

(x) Before disposing of an old computer, use software programs to wipe out the data contained on the computer or have the hard drive destroyed.

**Answer 1(b)**

Z should have done Property Title Search through a professional title search company.

A Property Title Search is the process of retrieving the history of a property right from the original

owner of the property to the current owner over a period of time. It provides documents which help in determining the relevant interests in property of the owner and other individuals, if any.

It is usually prepared by an Expert, who after visiting the Registrar's office and inspecting the property documents, issues a title certificate.

It is mandatory for a developer to annex a copy of the report in the 'agreement to sell' with the intended purchaser. This document will state if' there is any existing mortgage, litigation, condition or claim, which is likely to affect the title of the buyer adversely. In the same way, a bank is also assured of the title of the property. Banks usually do not finance an encumbered property or one under legal dispute because it reduces its security and increases risk exposure. In order to avail a housing loan, one of the preconditions is that the title of the property should be clear and marketable.

**Property Title Search includes:**

1. **Ownership:** Status of ownership- sole or joint and the documents stating the same.
2. **Deed Copy:** Recent deeds in respect to the property.
3. **Legal Description:** Description of the property in legal parlance.
4. **Chain documents:** Previous owner of the property.
5. **Possession:** Actual Possession of the property.
6. **Right of way**: Easementary Right - the Right of way given to the owner.
7. **Leases:** Leases on the property which can affect the property status.
8. **Mortgage:** Whether the property has been mortgaged.
9. **Tax Payment:** Details of tax payment in relation to the property.
10. **Bankruptcy Search:** Report of bankruptcy of the owner of the property.
11. **Municipal Service Lien**: Report of unpaid municipal dues like water, sewer, trash etc.
12. **Property Restriction:** Restriction on sale of property like sale in case of unsound owner.
13. **Plot Map:** Official copy of' Map of the plot.
14. **Property Zoning:** Property lying under which zone like Ecological Zone, Flood Zone, Earthquake Zone etc.
15. **Civil Court Record:** Any order of the Civil Court against the property and other things like Spousal Support Lien Search, Child Support Lien search, Power of Attorney, Special Assessment etc.

### Answer 1(c)

The Disciplinary Directorate of ICSI on receipt of any information or complaint arrive at a prima facie opinion on the occurrence of the alleged misconduct and where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the First Schedule, the matter is placed before the Board of Discipline and where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the Second Schedule or in both the Schedules, the matter is placed before the Disciplinary Committee of ICSI. In other words, if the Director (Discipline) is of the view that:

| Misconduct mentioned in | The matter is placed before |
|---|---|
| First Schedule | Board of Discipline |
| Second Schedule | Disciplinary Committee |

**(a) Matters placed before the Board of Discipline:** Where the board is of the opinion that a member is guilty of a professional or other misconduct mentioned in the First Schedule, it provides to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:

(i) reprimand the member,

(ii) remove the name of the member from the Register up to a period of three months;

(iii) impose such line as it may think lit which may extend to INR 1 lakh.

**(b) Matters placed before the Disciplinary Committee:** Where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule and the Second Schedule, it affords to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:

(i) reprimand the member;

(ii) remove the name of the member from the Register permanently or for such period, as it thinks fit;

(iii) impose such fine as it may think fit, which may extend to INR 5 lakhs.

**Answer 1(d)**

**Credit Fraud / Loan Fraud:** In this specific context, the fraudulent activities involve the misuse of credit facilities, such as raising unauthorized credit or obtaining loans under false documents. The fraudsters exploit weaknesses in the system to access credit without proper authorization or for purposes unrelated to the stated use.

**Major frauds which took place with the help of incomplete KYC:**

(i) To evade taxes, an individual routes savings transactions through multiple bank accounts.

(ii) An individual illegally obtains personal information/ documents of another person and takes a loan in the name of that person.

(iii) He/she provides false information about his/her financial status, such as salary/IT return and other assets, and takes a loan for an amount that exceeds his / her eligible limits with the motive of non-repayment.

(iv) A person takes a loan using a fictitious name and there is a lack of a strong framework pertaining to spot verifications of address, due diligence of directors/promoters, pre- sanction surveys and identification of faulty/incomplete applications and negative/ criminal records in client history.

(v) Fake documentation is used to grant excess overdraft facility and withdraw money.

(vi) A person may forge export documents such as airway bills, bills of lading, and Export Credit Guarantee Cover and customs purged numbers/orders issued by the customs authority.

(vii) Frauds related to the advances portfolio accounts for the largest share of the total amount involved in frauds in the Indian banking sector.

(viii) Deficient appraisal system, poor post disbursement supervision and inadequate follow up.

(ix) Siphoning of funds wherein the borrowed funds from banks are utilised for purposes unrelated to the operations of the borrower.

(x) Diversion of funds by:

a. Using of short-term working capital funds for long-term commitments not in conformity with the terms of sanction.

b. Using borrowed funds for creation of assets other than those for which the loan was sanctioned.

c. Transferring funds to group companies.

d. Investment in other companies by acquiring shares without the approval of lenders.

e. Shortage in the usage of funds as compared to the amounts disbursed/drawn, with the difference not being accounted for.

f. Over-valuation or absence of requisite collaterals.

(xi) Concealing Liabilities: Borrowers concealing obligations such as mortgage loans on other properties or newly acquired credit card debts in order to reduce the amount of monthly debt declared on the loan application.

(xii) Misstatement: Deliberately overstating or understanding the property's appraised value.

(xiii) Shot Gunning: Multiple loans for the same property being obtained simultaneously for a total amount greatly in excess of the actual value of the property.

(xiv) Delay in Action (higher lag time) by the Institutions for declaration of frauds resulting the borrower gets considerable time to erase the money.

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

**Question 2**

(a) A Company Secretary P of ABC Ltd. is of the view that the companies that practice positive ethics and effective compliance management program, deep within their culture, often enjoys healthy returns through employees and customers loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholders' returns. With reference to the above statement, do you agree that Compliance with the requirements of laws through a compliance management program can produce positive results at several levels. Comment.

*(5 marks)*

(b) As per the LLP Amendment Act, 2021, answer each of the followings :

(i) Explain the concept of "Small Limited Liability Partnership" under section 2(t) (new clause).

(ii) Specify the penalty payable for non-compliance of the LLP Act by a small LLP or a start-up LLP or by its partner or designated partner.

(iii) If a person has lived in India for 150 days during the financial year 2023-24, whether he can be considered as a resident of India, for being a designated partner of an LLP.

*(2+1+2=5 marks)*

(b) KPT, an assets management company, issued units of mutual fund, which are listed on recognized stock exchange(s), governed by the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations 1996, appointed a company secretary D as a compliance officer. Is the appointment of D valid ? List any three actions under Regulation 6 of the Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) [SEBI(LODR)] Regulations, 2015, for which the compliance officer of a listed company is responsible.

(*5 marks*)

(c) Pre-certification of forms is not a routine or mechanical exercise, but a serious task and involves sound application of mind in verifying the statements made in the respective forms and other points after due consideration of the provisions of the Companies Act. 2013, read with the relevant rules. Comment.

(*5 marks*)

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

**Question 2A**

(*i*) When the aggrieved investors, whose grievances against a listed company, registered intermediary or market infrastructure institution ("Entities") remain unresolved, the redressal of investor grievances through the revised SEBI Complaint Redressal Systems (SCORES) provides a facilitative platform for the benefits of the aggrieved investors. Elucidate.

(*5 marks*)

(ii) BNP a company was engaged in manufacturing of spare parts of automobiles. It was found that there were certain types of security interests or debts secured against the company's assets. BNP entered into an asset financing agreement where the company used assets, such as machinery or vehicles, as collateral for loans. As a result, the Charges were registered with the registrar under section 77(1) against these specific assets.

There was an omission or misstatement of particulars with respect to such charges and also for the modification of such charges. How the rectification can be done by Central Government in Register of Charges ? Also specify the other cases requiring rectification.

(*5 marks*)

(iii) Indicate the obligations of listed entity which has listed its specified securities i.e., equity or convertible securities under the Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) [SEBI(LODR)] Regulations, 2015, in each of the following cases :

(a) Prior intimation to Stock Exchange about Board Meeting

(b) Quarterly Financial Result

(c) Certificate from Practicing Company Secretary (PCS), and

(d) Record Date.

(2+1+1+1=5 marks)

(iv) JKL file Ltd, a listed entity and incorporated under the Companies Act, 2013 didn't the Annual Return under section 92 on the following two grounds :

(i) the company has become inoperative, and

(ii) AGM scheduled on 30th September 2022 was not held.

Citing the relevant provisions of the Companies Act, 2013, answer each of the followings :

(a) Is there any remedy available to file the annual return which was not filed earlier on time ?

(b) Is the act of non-filing of return by JKL Ltd. in both the said cases justified ? and

(c) Specify two cases when a company can be relinquished from filing Annual Return.

*(2+1+2=5 marks)*

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

**Answer 2(a)**

Yes, Compliance with the requirements of laws through a compliance management program can produce positive results at several levels:

(i) Go to the extra mile and lays the foundation for the control environment.

(ii) Likely to avoid stiff personal penalties, both monetary and imprisonment.

(iii) Companies that embed positive ethics and effective compliance management program deep within their culture often enjoy healthy returns through employees and customers loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholder returns.

(iv) Safety valve against unintended non compliances/ prosecutions, etc.

(v) Cost savings by avoiding penalties/fines and minimizing litigation.

(vi) Better brand image and positioning of the company in the market.

(vii) Enhanced credibility/creditworthiness that only a law-abiding company can command.

(viii) Goodwill among the shareholders, investors and stakeholders.

(ix) Recognition as Good corporate citizen.

(x) The benefits of implementing and maintaining an effective compliance program far outweigh its costs.

(xi) Not only does the compliance management protect investor's wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner.

**Answer 2(b)**

As per the LLP Amendment Act, 2021:

(i) Under section 2(ta) new clause is inserted: "small limited liability partnership" means a limited liability partnership-

i. the contribution of which, does not exceed twenty-five lakh rupees or such higher amount, not exceeding five crore rupees, as may be prescribed; and

ii. the turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees or such higher amount, not exceeding fifty crore rupees, as may be prescribed; or

iii. which meets such other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed.

(ii) The insertion of Section 76A under LLP Amendment Act 2021 stipulates that the penalty payable for non-compliance of the LLP Act by a Small LLP or a Start-Up LLP or by its partner or designated partner or any other person in respect of such limited liability partnership, shall be one-half of the penalty specified, subject to a maximum of rupees 1 lakh for limited liability partnership and rupees fifty thousand for every partner or designated partner or any other person, as the case may be.

(iii) According to the LLP Act, every LLP is required to have at least 2 designated partners, out of which at least one has to be a resident of India. The LLP Act previously defined the term resident of India as a person who has stayed in India for 182 days during the immediately preceding 1 year. Pursuant to the Amendment Act, a person who has stayed in India for not less than 120 days during the financial year is entitled to become a designated partner of an LLP.

In the given case the person is in India for 150 days i.e., more than 120 days, during the financial year and hence is entitled to become a designated partner of an LLP.

**Answer 2(c)**

As per Regulation 6 of the SEBI (LODR) Regulations, 2015, a listed entity shall appoint a qualified company secretary as the compliance officer.

However, the requirements of this regulation shall not be applicable in the case of units issued by mutual funds which are listed on recognised stock exchange(s) but shall be governed by the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

As per SEBI (Mutual Funds) Regulations, 1996, the asset management company is required to appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors grievances.

So, KPT, an Asset Management Company may appoint Company Secretary D as Compliance Officer of the Company.

Under Regulation 6 of the SEBI (LODR) Regulations, 2015, the compliance officer of the Listed Company is responsible for the following actions:

(a) ensuring conformity with the regulatory provisions applicable to the listed entity in letter and spirit.

(b) co-ordination with and reporting to the Board, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in the manner as specified from time to time.

(c) ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations.

(d) monitoring email address of grievance redressal division as designated by the listed entity for the purpose of registering complaints by investors:

**Answer 2(d)**

It is duty of the Company Secretary in practice to check and verify thoroughly the correctness of the contents of the form before certifying it. The members in practice are, accordingly, expected to exercise due care, diligence and skill, while performing pre- certification.

Pre-certification of forms is, therefore, not a routine or mechanical exercise but a serious task and

involves sound application of mind in verifying the statements made in the respective forms after due consideration of the provisions of the Act read with the relevant rules.

Before undertaking the work relating to pre-certification of forms, a Company Secretary in practice should thoroughly read the requirements of the provisions of the Act, the Rules made there under and familiarize himself with the actual practices that are followed in this regard. He should also:

(i) Ensure that letter of engagement/Board Resolution authorizing the professional for the particular assignment by the company is obtained.

(ii) Maintain a physical/scanned copy of all documents verified (subject to confidentiality requirement).

(iii) Also have the draft forms approved by the Company's personnel before the forms are filed, as part of documentation.

(iv) Obtain the signature(s) of the authorised signatories on the e-forms in presence of the professional.

(v) Ensure that all relevant documents and attachments in the form are legible and visible.

***(Alternative Question to Q. No. 2)***

**Answer 2A(i)**

The revised framework for handling of complaints received through SCORES platform for Entities and for monitoring the complaints by designated bodies is provided below:

**Submission of the Complaint and handling of the Complaint by the Entity:**

- All Entities shall review the investors' grievances redressal mechanism from time to time to further strengthen it and rectify the existing shortcomings, if any.
- All Entities who are in receipt of the complaints of the investors ("Complaint") through SCORES, shall resolve the complaint within 21 calendar days of receipt of such Complaint.
- The Complaints lodged on SCORES against any Entity shall be automatically forwarded to the concerned Entity through SCORES for resolution and submission of ATR. Entities shall resolve the Complaint and 'upload the ATR on SCORES within 21 calendar days of receipt of the Complaint. The ATR of the entity will be automatically routed to the complainant.
- The Complaint against the Entity shall be simultaneously forwarded through SCORES to the relevant Designated Body. The Designated Body shall ensure that the concerned Entity submits the ATRs within the stipulated time of 21 calendar days.
- The Designated Body shall monitor the ATRs submitted by the entities under their domain and inform the concerned entity to improve the quality of redressal of grievances, wherever required.
- SEBI may concurrently monitor grievance redressal process by entities and Designated Bodies.

**First review of the Complaint:**

- In case complainant is satisfied with the resolution provided by the entity vide the ATR or complainant does not choose to review the Complaint, the Complaint shall be disposed on SCORES. However, if the complainant is not satisfied, the complainant may request for a review of the resolution provided by the entity within 15 calendar days from the date of the ATR.

- In case the complainant has requested for a review of the resolution provided by the entity or the entity has not submitted the ATR within the stipulated time of 21 calendar days, the concerned Designated Body shall take cognizance of the Complaint for first review of the resolution through SCORES. The Designated Body shall take up the first review with the concerned Entity, wherever required. The concerned Entity shall submit the ATR to the Designated Body within the time stipulated by the Designated Body.
- The Designated Body may seek clarification on the ATR submitted by the Entity for the first review. The concerned Entity shall provide clarification to the respective Designated Body, wherever sought and within such timeline, as the Designated Body may stipulate. The Designated Body shall stipulate the timeline in such as manner to ensure that the Designated Body submits the revised ATR to the complainant on SCORES within 10 calendar days of the review sought.
- The Designated Bodies shall be responsible for:
    - Monitoring and handling grievance redressal of investors against respective entities under their domain.
    - Taking non-enforcement actions including issuing advisories, caution letters for non-redressal of investor grievances and referring to SEBI for enforcement actions.

**Second Review of the Complaint:**

- The complainant may seek a second review of the Complaint within 15 calendar days from the date of the submission of the ATR by the Designated Body. In case the complainant is satisfied with the ATR provided by the concerned Designated Body or complainant does not choose to review the Complaint within the period of 15 calendar days, the Complaint shall be disposed on SCORES.
- In case the complainant is not satisfied with the ATR provided by the Designated Body or the concerned Designated Body has not submitted the ATR within 10 calendar days, SEBI may take cognizance of the Complaint for second review through SCORES.
- SEBI may take up the review with stakeholders involved, including the concerned entity or/ and Designated Body. The concerned entity or/and Designated Body shall take immediate action on receipt of second review complaint from SEBI and submit revised ATR to SEBI through SCORES, within the timeline specified by SEBI.
- SEBI or the Designated Body (as the case may be) may seek clarification on the ATR submitted by the concerned entity for SEBI review complaint. The concerned entity shall provide clarification to the respective Designated Body and/or SEBI, wherever sought and within such timeline as specified. The second review Complaint shall be treated as 'resolved' or 'disposed' or 'closed' only when SEBI 'disposes' or 'closes' the Complaint in SCORES. Hence, mere filing of ATR with respect to SEBI review complaint will not mean that the SEBI review complaint is disposed.

**General provisions regarding investor grievance redressal:**

- Investors shall first take up their grievances for redressal with the entity concerned, through their designated persons/officials who handle issues relating to compliance and redressal of investor grievances.
- Investors who wish to lodge a Complaint on SCORES (complainant) are required to register themselves on www.scores.gov.in by clicking on "Register here" under the "Investor Corner". While filing the registration form, details like Name of the investor, Permanent Account Number (PAN), contact details, email id, are required to be provided for effective communication

and speedy redressal of the grievances. Upon successful registration, a unique user id and a password shall be generated and communicated through an acknowledgement email to the complainant.

- In order to enhance ease, speed and accuracy in the redressal of grievance, the investor may lodge the Complaint against any Entity on SCORES within a period of 1 year from the date of occurrence of the cause of action, where: o The complainant has approached the Entity for redressal of the complaint and the Entity has rejected the complaint or the complainant has not received any communication from the concerned Entity; or o The complainant is not satisfied with the reply received or the redressal by the concerned Entity.
- If any complaint filed on SCORES beyond the limitation period specified above, SEBI may reject such complaint.
- In cases where investors raise issues, which require adjudication on any third-party rights, on questions of law or fact or which is in the nature of a list between parties, or if investors are not satisfied with disposal on SCORES post SEBI review, they shall seek appropriate remedies through the Online Dispute Resolution mechanism in securities market. In addition, investors have the option to approach legal forums including civil courts, consumer courts etc.
- Investors can approach the Online Dispute Resolution mechanism or other appropriate civil remedies at any point of time. In case the complainant opts for Online Dispute Resolution mechanism or other appropriate civil remedies while the complaint is pending on SCORES, the complaint shall be treated as disposed on SCORES.

**Answer 2A(ii)**

Section 87 of the Companies Act, 2013 read with Rule 12 of the Companies (Registration of Charges) Rules, 2014 stipulates that the Central Government on being satisfied that -

(a) the omission to give intimation to the Registrar of Companies of the payment or satisfaction of a charge, within the time required under Chapter VI; or

(b) the omission or misstatement of any particulars, in any filing previously made to the Registrar with respect to any such charge or modification thereof or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,

was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company. The Central Government may on the application filed in Form No. CHG-8 by the company or any person interested on such terms and conditions as it deems just and expedient, direct that the time for the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or misstatement shall be rectified.

**Other Cases requiring Rectification are:**

(a) direct rectification of the omission or misstatement of any particulars, in any filing, previously recorded with the Registrar with respect to any charge or modification thereof, or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83.

(c) direct extension of time for satisfaction of charge, if such filing is not made within a period of three hundred days from the date of such payment or satisfaction.

**Answer 2A(iii)**

| S. No | Compliance | Regulation | Time Period | Event |
|---|---|---|---|---|
| (a) | Prior intimation to Stock Exchange about Board Meeting | 29(1) | At least 5 (Five) days in advance excluding the date of intimation & date of board meeting. | Intimation about the Meeting in which Financial Results viz. quarterly, half yearly, or annual, as the case may be due for consideration. |
| | | 29(2) | At least2 working days in advance excluding the date of intimation & date of board meeting. | Intimation about the Meeting in which following matters are due to consideration:<br>Proposal for Buyback of Securities Proposal for voluntary delisting of Listing entity from the Stock Exchange(s)<br>**Fund raising by following ways:**<br>Further Public Offer, Rights Issue, American Depository Receipts/ Global Depository Receipts/ Foreign Currency Convertible Bonds, qualified institutions placement, debt issue, preferential issue or any other method and for determination of issue price:<br>Declaration/Recommendation of Dividend Issue of Convertible Securities Including convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend Proposal for declaration of Bonus Securities |
| | | 29(3) | At least 11 working days in advance | (a) Any alteration in the form or nature of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof.<br>(b) Any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable |

| | | | | |
|---|---|---|---|---|
| (b) | Quarterly Financial Result | 33(3)(a) | Within 45 days of end of each quarter, other than the last quarter | The listed entity shall submit quarterly and financial results to the stock exchange. |
| (c) | Certificate from Practicing Company Secretary (PCS) | 40(9)/ (10) | Within 30 days from the of end financial year. | Certifying that all certificates have been issued within thirty days of the date of lodgment for transfer, subdivision, consolidation, renewal, exchange or endorsement of calls/ allotment monies. |
| (d) | Record Date | 42(2) | At least 7 working days in advance before the record date excluding<br>The date of intimation & record date | Notice to Stock Exchange for the record date and specifying the purpose of record date.<br>In the case of rights issues, the listed entity shall give notice in advance of atleast 3 working days (excluding the date of intimation and the record date) |

**Answer 2A(iv)**

**(a)** Where no Annual General Meeting (AGM) is held in a particular year, the Annual Return has to be filed within 60 days from the date on which the meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as prescribed. [Section 92(4)]

Consequently, the company cannot excuse itself from the obligation on the plea that AGM was not held. As per Section 403, if the Annual return under section 92 is not filed within the due date the same can be filed on payment of additional fee as may be prescribed, which shall not be less than one hundred rupees per day and different amounts may be prescribed for different classes of companies.

Further, where a company fails or commits any default to submit, file, register or record any document, fact or information under Section 92 before the expiry of the period specified, the company and the officers of the company who are in default, shall, without prejudice to the liability for the payment of fee and additional fee, be liable for the penalty or punishment provided under this Act for such failure or default.

**(b)** The management of the company cannot escape from the responsibility of filing the return, even if the:

(i) the company is inoperative, or

(ii) AGM is not held on time

**(c)** This section casts an important obligation on the part of management to file the returns and can be relinquished only when:

(i) the company is wound-up or

(ii) its name is struck-off from the Register maintained by the Registrar of Companies.

## PART-II

### Question 3

(a) Materiality can be defined as the magnitude of an omission or misstatement of information. Comment and list out any four principles which the auditor should adhere while forming his opinion.

(b) While maintaining quality with respect to customer & customer relationship acceptance & continuation of client relationship and specific assignments, explain the procedure, the audit firm SS and Co., should establish for evaluation of prospective clients and for their approval as clients.

(c) RST (auditors) found suspicion on the trustworthiness of in the financial statements of JKL Services, an aviation company, as unreliable and unfavourable. During the audit process, the auditors raised concerns about the reliability and accuracy of JKL's financial statements. They discovered irregularities, including complex off-balance-sheet partnerships and accounting manipulations designed to inflate profits and conceal debt. JKL Services filed for bankruptcy in 2022 after it was revealed that the company had engaged in extensive accounting fraud to conceal its financial information.

Define the term suspicion and list out eight transactions which may be considered as the surspicious transactions where the detailed audit is needed to be performed.

(*5 marks each*)

### Answer 3(a)

The assessment of what is material is a matter of professional judgement. Materiality can be defined as the magnitude of an omission or misstatement of information that, in the light of surrounding circumstances, makes it probable that the judgement of a reasonable person relying on the information would have been changed or influenced by the said omission or misstatement.

As the concept of Materiality is applied by the Auditor both in planning and performing the audit, and forming the opinion. Materiality consists of both quantitative and qualitative factors.

Determining Materiality is a matter of professional judgement and depends on the Auditor's interpretation of the user's needs. A matter can be judged material if knowledge of it is likely to influence the decisions of the intended users. Materiality is relative concept. In practice, Auditors evaluate materiality on a standalone basis. What is material for one Auditee may not reach the Materiality threshold for another. Materiality is a matter of professional judgement of the Auditor and its teams' experience.

Materiality is the threshold above which missing or incorrect information is considered to have an impact on the decision making of the Auditor. Information is considered as material if its omission or misstatement could influence the opinion of the Auditor. Materiality can also be construed in terms of net impact.

**The Auditor shall consider materiality while forming his opinion and adhere to following principles:**

1. The principle of completeness that requires the Auditor to consider all relevant Audit Evidence before issuing a report;
2. The principle of objectivity that requires the Auditor to apply professional judgement and professional skepticism in order to ensure that all reports are factually correct and that findings or conclusions are presented in a relevant and appropriate manner;
3. The principle of timeliness that implies preparing the report in due time; and
4. The principle of a contradictory process that implies checking the accuracy of facts and incorporating responses from concerned persons.

**Answer 3(b)**

The firm should establish procedures for evaluation of prospective clients and for their approval as clients. Evaluation procedures could include the following:

(a) Obtain and review available secretarial records, annual reports, annual return, minutes book and ROC returns, regarding prospective client.

(b) Enquire from third parties as to any information regarding the prospective client and its management and principals which may have a bearing on evaluating the prospective client. Enquiries may be directed to the prospective client's barters, legal advisers, investment bankers, and the financial or business community who may have such knowledge.

(c) Communicate with the outgoing Company Secretary. Request in writing if there are any unusual circumstances surrounding the proposed change which the firm should be aware of, so that it may determine whether it should accept nomination.

(d) Consider circumstances which would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.

(e) Evaluate the firm's independence and ability to serve the prospective client. In evaluating the firm's ability, consider needs for technical skills, knowledge of the industry and personnel.

(f) Determine that acceptance of the client would not violate the Code of Professional Ethics applicable to the firm, its partners and staff.

**Answer 3(c)**

Suspicion is the positive tendency to doubt the trustworthiness of appearances and therefore to believe that one has detected possibilities of something unreliable, unfavorable.

The following transactions relating to company formation and management may be considered as the suspicious transactions, where the detailed audit is needed to be performed are:

1. subsidiaries which have no apparent purpose:
2. companies which continuously make substantial losses;
3. complex group structures without cause;
4. uneconomic group structures for tax purposes;
5. frequent changes in shareholders and directors;
6. unexplained transfers of significant sums through several bank accounts;
7. use of bank accounts in several currencies without reason;
8. purchase of companies which have no obvious commercial purpose;

9. sales invoice totals exceeding known value of goods;
10. makes unusually large cash payments in relation to business activities which would normally be paid by cheques, banker's drafts etc.; and
11. transferring large sums of money to or from overseas locations with instructions for payment in cash.

**Question 4**

(a) Only a qualified Peer Reviewer can be empaneled by the Peer Review Board. Elucidate.

(b) The Practices and Precedence used by Auditor for forming the Audit opinion may be as per the historical perspective. Elucidate.

(c) Explain the principle of autonomy used in ethical practices.

(d) Citing the relevant provisions, enumerate the penalty amount, which will be payable under the Securities Exchange Board of India (SEBI) Act, 1992, for insider trading under section 15G, if any insider who counsels, or procures for any other person, to deal in any securities of any body-corporate on the basis of unpublished price- sensitive information and the amount of profits made by the person out of insider trading is INR 10 crore.

(e) The quantity, type and content of working papers vary with the circumstances, but they should be sufficient to show that the records agree or reconcile with the statements or other information reported on and that the applicable standards of field work have been observed. Comment.

*(3 marks each)*

**Answer 4(a)**

Only a qualified Peer Reviewer can be empaneled by the Peer Review Board. The Peer Review Board has been empowered to maintain a panel of Reviewers. Para 10 of the peer review Guidelines provides for the qualifications of the reviewer which is as under:

1. The nature and complexity of Peer Review require the exercise of professional judgement. Accordingly, an individual to be empaneled as Peer Reviewer shall (Qualifications): -
   (a) Be a member with at least 10 years of post-qualification experience as Company Secretary of which not less than 5 years should be as a company secretary in practice;
   (b) Be currently holding Certificate of Practice as issued by the Institute.
   (c) Have undergone the Training Programme for Peer Reviewers and qualified the Certification Programme for Peer Reviewers organized by the Institute.
2. Further to be empaneled as Peer Reviewer, a member shall not have (Disqualifications):-

(a) disciplinary action / proceedings pending against him during the past 3 years.

(b) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with imprisonment;

(c) been found guilty of professional or other misconduct by the Committee of Discipline / Disciplinary Committee, at any time, as the case may be.

3. The Board may examine the quality of the report and shall have powers to remove the Reviewer from the panel of Peer Reviewers, in case the quality of the review/report fails to match the desired standards.

4. Sitting members on the Council / Regional Council / Chapter Management Committee, and the members of the Peer Review Committee of the ICSI shall not act as Peer Reviewers till they demit their office.
5. The requirement of at least ten years' experience as a member does not necessarily entail his/her experience as a Practicing Company Secretary. Even a member who has earlier been in employment for a decade can seek empanelment as a Reviewer provided, he/she is holding a certificate of practice on the date of making the application for empanelment as reviewer.

**Answer 4(b)**

Precedence and Practices in context of Auditing implies that Auditor shall evaluate on the basis of general or on-going practices or procedures that whether the Records maintained, statements prepared in all material respects, in accordance with the requirements of the applicable laws, rules and regulations. This evaluation shall include consideration of the qualitative aspects of the Auditee's compliance practices, including indicators of possible bias in Management's judgements.

The Practices and precedence used by Auditor for forming the Audit opinion may be as per the historical perspective i.e., methods used hitherto or generally used methods or practices or procedures be implemented for framing the opinion. Like, one of the methods involves selecting a sample size of total work and activities of a firm for conducting the audit process, which simultaneously depends upon the firm's size, operation of work and no. of branches, etc., or another practice includes having an unbiased approach while conducting the audit process in order to frame the honest and unbiased opinion.

**Answer 4(c)**

**Autonomy:** This principle states that decision making should focus on allowing people to be autonomous; that is, to be able to make decisions that apply to their own workplace or lives. In other words, people should have control over their own selves as much as possible because they are the only people who completely understand their chosen type of work/life style. Each individual deserves respect because only he/she has had those exact life experiences and understands own emotions, motivations, and physical capabilities in an intimate manner. In essence, this ethical principle is an extension of the ethical principle of beneficence because a person who is independent usually prefers to have control over his own experiences in order to secure the lifestyle that lie/she enjoys.

**Answer 4(d)**

Penalty for insider trading Section 15G under SEBI Act, 1992: If any insider who,-

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or

(ii) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(iii) counsels, or procures for any other person to deal in any securities o1 anybody corporate on the basis of unpublished price-sensitive information, shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

In the instant case, as per (iii) above maximum penalty payable in this case will be three times the amount of profits made out of insider trading i.e., 3 times of INR 10 crore = INR 30 crore.

**Answer 4(e)**

The quantity, type and content of working papers vary with the circumstances, but they should be sufficient to show that the records agree or reconcile with the statements or other information reported on and that the applicable standards of field work have been observed. Working papers ordinarily should include documentation showing that-

- The work has been adequately planned and supervised, indicating observance of the first standard of field work.
- A sufficient understanding of internal control has been obtained to plan the audit and to determine the nature, timing and extent of tests to be performed.
- The audit evidence obtained, the auditing procedures applied and the testing performed have provided sufficient competent evidential matter to afford a reasonable basis for an opinion, indicating observance of the third standard of field work.

Working papers are the property of the auditor. The auditor's rights of ownership, however, are subject to ethical limitations relating to the confidential relationship with clients.

**Question 5**

(a) 24 Hours Market, a large retail company, due to the failure of its information technology systems experienced a significant data breach during the festival shopping season. Hackers gained access to the company's network through a third party BGHJ vendor and stole credit and debit card information of approximately 30 million customers, as well as personal information of up to 50 million customers. As a result, the company faced numerous lawsuits and settlements after the stated breach.

Identify the audit, which can minimize any risk of financial loss, disruption or damage to the reputation of the company that may arises from the failure of its information technology systems, citing the scope of audit and the security and control issues dealt in the audit.

*(5 marks)*

(b) XJK, a multinational technology company which primarily used to develop, manufacture, license, support, and sell computer software, consumer electronics, personal computers, and related services, was accused of anticompetitive behaviour, leading to a protracted legal battle. In the antitrust litigation, XJK was accused of monopolistic practices rather than investing resources in more efficient business practices. This case was dragged for years, consuming significant financial and human resources.

Explain the type of audit, which can be carried out so as to know whether proper operating standards and norms have been established for economical and efficient use of resources.

*(5 marks)*

(c) Explain the manner in which the Company should ensure timely and accurate disclosures on all material matters including the financial situation, performance, ownership, and governance of the company as per guiding principles of Good Corporate Conduct and Practices. Also indicate any two principles that the Board of the company should effectively ensure.

*(3+2=5 marks)*

**Answer 5(a)**

In the given case it is Cyber Audit. Cyber security is an attempt to minimise any risk of financial loss, disruption or damage to the reputation of an organization that may arises from the failure of its information technology systems. The objective of the cyber audit is to provide an assessment of the operating effectiveness of cyber security policies and procedures, identify, protect, detect, respond and recover processes and activities to the board. The Cyber audit program generally covers sub- processes such as asset management, awareness training, data security, resource planning, recover planning and communications, in order to identify internal control and regulatory deficiencies that could put the organization at risk.

The security and control issues which deals under cyber security audits includes:

1. Protection of sensitive data and intellectual property
2. Protection of networks to which multiple information resource are connected
3. Responsibility and accountability for the device and information contained in it.

The scope of Cyber audit includes:

1. Data security policies relating to the network, database and application in place.
2. Data loss prevention measures deployed.
3. Effective network access control implemented.
4. Detection/prevention system deployed.
5. Security control established (physical and logical).
6. Incident response program implemented.

**Answer 5(b)**

The internal audit can be carried out so as to know whether proper operating standards and norms have been established for measuring economical and efficient use of resources.

The internal auditors should be detailed enough to be identifiable with specific operating responsibilities and should be capable of being used by operating personnel for monitoring and evaluating their performance. The internal auditor should review the methods of establishing the operating standards and norms. He should carefully examine the assumptions made while setting the standards to ensure that they are appropriate and necessary. The variances should be examined to evaluate whether or not the standards and norms are practical. Where there is a wide divergence between actual performance and the corresponding standards, reasons may be looked into. The system of identification and analysis of deviations from standards should be examined. The internal auditor should examine whether analysis of variances is communicated to those concerned in time. He should also examine whether in communicating the variances serious matters are highlighted and whether exceptional variances are communicated more expeditiously than is done in the normal course. As a part of evaluating resources utilization, identifying the facilities which are under-utilized is an important function of the internal auditor. Such instances may consist of under-utilized machines, unoccupied storage space, huge cash or bank balances, idle man power etc. The internal auditor may also identity under-staffing and overstaffing in various areas as these prevent optimum use of resources.

While commenting on staffing, the internal auditor should pay special attention to non-productive work being performed. This would require an enquiry into the job descriptions of employees combined with an intelligent observation of the work being done. Finally, the internal auditor

should review all procedures with reference to their costs and benefits. One of the factors resulting in inefficiency is that in many cases procedures become hindrance to operations.

**Answer 5(c)**

The Company should ensure that timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company, in the following manner:

(i) Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

(ii) Channels for disseminating information shall provide for equal, timely and cost- efficient access to relevant information by users.

(iii) Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.

The Board of the company should effectively ensure -

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestments.
2. Monitoring the effectiveness of the Company's governance practices and making changes as needed.
3. Selecting, compensating, monitoring and, when necessary, replacing key managerial personnel and overseeing succession planning.
4. Aligning key managerial personnel and remuneration of board of directors with the longer-term interests of the Company and its shareholders.
5. Ensuring a transparent nomination process to the board of directors with the diversity of thought, experience, knowledge, perspective and gender in the board of directors.
6. Monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.
7. Ensuring the integrity of the Company's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
8. Overseeing the process of disclosure and communications.
9. Monitoring and reviewing board of director's evaluation framework.

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

**Question 6**

(a) Financial due diligence provides peace of mind to both corporate and financial buyers, by analysing and validating all the financial, commercial, operational and strategic assumptions being made and can further be extended to tax due diligence. Elucidate.

(a) The Auditors of a company, while performing the audit assignment access various confidential information of the company, required to maintain confidentiality of such information. Elucidate.

(b) The Registrar of Companies (ROC) and the Serious Fraud Investigation Office (SFIO) are empowered to file complaint before a Magistrate in the special court, if they are of an opinion that a particular company has been in default according to Companies Act, 2013 or is pursuing its activities violating the law of the land. They can file a complaint under section 190 of the Criminal Procedure Code, 1973 and treat it as per the prescribed provisions which are different in both the cases. Elucidate.

(*5 marks each*)

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

**Question 6A**

(*i*) The Board of Directors of SK Ltd. approved a merger with PJ Ltd. without conducting adequate due diligence. The Supreme Court held that the Board breached its fiduciary duty by approving the merger without sufficient information and understanding the terms of deal. The case highlights the importance of conducting comprehensive legal due diligence before approving significant transactions to protect shareholders' interests. In the above context explain legal due diligence.

(*5 marks*)

(ii) JK has been appointed as a reviewer to review the records of practice unit DL & Associates. JK was unaware of the approaches to be used in the review process of attestation services engagement records. Guide JK as a Practicing Company Secretary (PCS) for the approaches to be used for review of attestation service engagement records.

(*5 marks*)

(iii) ABC Ltd. a listed company incorporated under the Companies Act, 2013 has a net worth of INR 450 crore, turnover of INR 1,200 crore and net profit of INR 250 crore in the immediate preceding financial year. The net profits of the company in the last four preceding years have been INR 250 crore, INR 200 crore, INR 200 crore and INR 100 crore respectively. You as a PCS are asked by the Board of ABC Ltd. to prepare a note on the provisions indicating applicability of Corporate Social Responsibility (CSR) spending and to conclude whether CSR provisions are applicable in the instant case. Calculate the CSR spending, as applicable. Prepare the note.

(*5 marks*)

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

**Answer 6(a)**

One of the most important types of due diligence, is financial due diligence as it seeks to check whether the financials showcased in the Information Memorandum is correct or not. It also provides a deep understanding of all the company's financials, including but not restricted to audited financial statements for last three years, recent unaudited financial statements with comparable statements of last year, review of accounting policies, review of internal audit procedures, quality and sustainability of earnings and cash flow, condition and value of assets, potential liabilities, tax implications of deal structures, examination of information systems to establish the reliability of financial information, internal control systems etc.

The Financial Due diligence also review the company's projection and basis of such projections, capital expenditure plan, schedule of inventory, debtors and creditors, etc. Also, the process involves analysis of major top customer accounts, fixed and variable cost analysis, analysis on gross

margins, customers with high profit margins and their contract period, internal control procedures etc. It will also involve the type of the company's order book and sales pipeline to better build projections.

Financial due diligence provides peace of mind to both corporate and financial buyers by analysing and validating all the financial, commercial, operational and strategic assumptions being made.

The Financial Due Diligence can further extend to tax due diligence which covers the Diligence on various taxes the company is required to pay and which ensure that the proper calculation with no intention of under- reporting of taxes. Status of any tax related case running with the tax authorities.

The tax due diligence comprises an analysis of:

- tax compliance
- tax contingencies and aggressive positions
- transfer pricing
- identification of risk areas
- tax planning and opportunities

**Answer 6(b)**

Confidentiality: The Auditors of a company while performing the audit assignment access the various confidential information of the company and it is most required for the auditors to maintain the confidentiality of the auditee information.

The principle of confidentiality imposes an obligation on the auditor to refrain from:

| | |
|---|---|
| **Disclosing information** | Disclosing information acquired as a result of professional relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and |
| **Using information for personal advantage** | Using information acquired as a result of professional relationships to their personal advantage or the advantage of third parties |
| **Inadvertent disclosures** | An auditor should maintain confidentiality even in a social environment. The auditor should be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a relative. |
| **Information disclosed by a Prospective client** | An auditor should also maintain confidentiality of information disclosed by a prospective client or employer. |
| **Confidentiality within the firm** | An auditor should also consider the need to maintain confidentiality of information within the firm or employing organization. |
| **Control of Staff** | An auditor should take all reasonable steps to ensure that staff under the auditor's control and persons from whom advice and assistance is obtained respect the auditor's duty of confidentiality. |

Clause (I) of Part I of the Second Schedule to the Company Secretaries Act, 1980 provides that a Company Secretary in practice shall be deemed to be guilty of professional misconduct, if the member — "discloses information acquired in the course of professional engagement to any person other than the Auditee so engaging him, without the consent of the Auditee, or otherwise than as required by any law for the time being in force."

The word 'information' here implies any information which is not available in public domain. During the course of audit, Auditor receives, verifies and inspects various audit documents, evidence, representation etc. to form an opinion or to give a report. These may be confidential and privileged information that remain in possession of the Auditor and shall not be disclosed without the express authority of the Auditee.

Herein the term proper and specific authority implies the Appointing Authority or any other person or committee as may be entrusted by the Appointing Authority to look after the conduct of Audit. It is the inherent duty of the Auditor to maintain the confidentiality of any information about the Auditee or his business that came to his knowledge as a result of performing the audit work. However, if permitted by the Auditee, Auditor may disclose or share such information with any other person as may be specifically allowed by Auditee. Since there may be different types of Auditees, the authority to give such permission to the Auditor may be different in each case. For example, in case of a company, the Secretarial Auditor is appointed by the Board and therefore it may be authorised by the Board whether the Auditor can disclose any confidential information to anyone. In another case, it may be possible that the Board has authorised a director in this regard to give such authorities and permissions to the Auditor and therefore that director will become the specific authority. Likewise in case of an LLP, it may be a designated partner or any other person as may be authorised by the LLP in this regard.

An Auditor shall maintain confidentiality even in a social environment. The Auditor shall be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a relative or friends etc.

However, if the Auditor gives any reference of the audit evidence or documents while forming the opinion in the audit report, it will be deemed to be the disclosure of information under the legal obligation or in the performance of the duty.

If during the course of audit and forming opinion, the Auditor uses the decisions of the judicial authority, it will not be treated as use or sharing of confidential information.

The Auditor shall educate his employees, staff and other team members about the importance of the confidentiality of the information available to them during the course of audit. The Auditor shall ensure that reasonable procedures have been followed to maintain the confidentiality of the information. The Auditor shall also take a duly signed Non-Disclosure Agreement (NDA) from such personnel who may have access to such confidential information.

The Auditor shall also ensure that reasonable procedures and safeguards are being followed to prevent unauthorised access to such confidential information.

**Answer 6(c)**

The Registrar of Companies and the SFIO are empowered to file complaint before a Magistrate if they are of an opinion that a particular company has been in default according to Companies Act, 2013 or is pursuing its activities violating the law of the land. They can file a complaint under section 190 of the Criminal Procedure Code, 1973. But the difference lies in how the complaint is treated.

The SFIO has been empowered under the section 212 of the Companies Act to file a complaint. The complaint of SFIO is treated as police report under section 173 of the Criminal Procedure Code, 1973. Whereas, the complaint filed by the Registrar of Companies is not considered as a police report but a private complaint under section 190 of the Criminal Procedure Code, 1973. The complaint by the Registrar of Companies has to pass though the hurdle of pre-trial evidence on the same platform as that of the complaint of SFIO.

When a complaint is received by the Magistrate, the power to take cognizance on the basis of such complaint is under Section 190 of Criminal Procedure Code, 1973. However, further action on such complaint has to be taken under Sections 200-204 of Criminal Procedure Code, 1973.

Under Section 200 of the Criminal Procedure Code, 1973, the Magistrate has to record the statement of the complainant on oath, and also of other witnesses, if any. As the large number of complaints are filed by private individuals, many of which may be frivolous complaints. Therefore, it is considered necessary to verify the details of such complaints by examining the complainant on oath under Section 200 of Criminal Procedure Code, 1973. In certain "complaint" cases, action may have to be taken by the Magistrate under the provisions of Section 202 of Criminal Procedure Code, 1973, i.e., an inquiry by the Magistrate himself or an investigation by police, etc. After these steps, if the Magistrate does not find sufficient ground or finds no prima facie case to proceed further, he may dismiss the complaint under section 203 of Criminal Procedure Code, 1973; on the other hand, if he finds sufficient ground to proceed, he may issue process under Section 204 of Criminal Procedure Code, 1973.

The complaint filed by SFIO does not have to pass through the process of section 200 to 203 as mentioned above. After a complaint has been filed by the SFIO, it is treated as police report and it directly proceeds to Section 204 and the next stage of trial that is issuing of summons or warrants. Whereas the complaint filed by the Registrar of Complaints has to pass through the procedure mentioned under section 200 to 203 which causes a delay in the prosecution initiated by the Registrar of Companies.

| Complaint by ROC | Complaint by SFIO |
|---|---|
| Complaint of ROC is considered as a private complaint under section 190 of the Criminal Procedure Code, 1973 | Complaint of SFIO is treated as police report under section 173 of the Criminal Procedure Code, 1973 |
| Complaint by ROC has to pass through the process of section 200 to 203 of Criminal Procedure Code, 1973 | Complaint filed by SFIO does not have to pass through the process of section 200 to 203 of Criminal Procedure Code, 1973 |
| The procedure causes delay in the prosecution initiated by ROC | Directly proceeds to Section 204 and the next stage of trial that is issuing of summons or warrants |

***Or (Alternate Question to Q. No to 6)***

**Answer 6A(i)**

A legal due diligence covers the legal aspects of a business transaction, liabilities of the target company, potential legal pitfalls and other related issues. Legal due diligence covers intra-corporate and inter-corporate transactions.

It includes preparation of regulatory checklists, meeting with personnel, independent check with regulatory authorities etc. apart front the verification of following document.

- Copy of Memorandum and Articles of Association
- Minutes of Board Meeting for the last three years
- Minutes of all meetings or actions of shareholders
- Copy of share certificates issued to Key Management Personnel

- Copy of all guarantees to which company is a party
- All material contracts
- Copies of all loan agreements, bank financing agreements, line of credit to which company is a party
- Status of the order. awards issued by the various regulators and courts
- Status of Pending litigations
- Competition Law due diligence

**Answer 6A(ii)**

The reviewer JK may adopt a compliance approach or a substantive approach or a combination of both in the review of attestation services engagement records.

**(a) Compliance approach - Attestation services engagements**

- The compliance approach is to assess whether proper control procedures have been established by the practice unit to ensure that attestation services are being performed in accordance with Technical Standards.
- Practice units should have procedures and documentation sufficient to cover each of the key areas. If Members in smaller practices find some of the documentation too elaborate for their clients and they tailor their attestation services documentation to suit their particular circumstances with justification for doing should be provided to the reviewer.
- If the size of the Practice Unit is small or medium (a matter left to the judgement of the Reviewer), the Compliance Approach may not be appropriate. In such a case, the Reviewer may choose the Substantive Approach for conduct of Review.

**(b) Substantive approach - Attestation services Engagements**

A substantive approach will be employed —

- if the reviewer chooses not to place reliance on the practice unit's general controls on attestation engagements or;
- is of the opinion that the standard of compliance is not satisfactory or;
- not appropriate in the case of a specific Practice Unit selected for Peer Review.

This approach requires a review of the attestation working papers in order to establish whether the attestation work has been carried out as per norms of Technical Standards.

**Answer 6A(iii)**

**Corporate Social Responsibility (CSR) Audit**

Corporate Social Responsibility (CSR) includes various social and environmentally responsible guidelines, essential for companies that want to maintain a strong connection to the marketplace. Corporate Social responsibility includes the way a company treats and proactively contributes to its community, promotes fair working conditions and a nondiscriminatory environment, conveys transparent and honest accounting reports, and generally earns a reputation of trust and integrity in the society where it serves.

CSR has become a mandatory part of many Companies vide introduction in Companies Act, 2013 and has changed the dynamics of CSR. An increased emphasis on governance, stricter monitoring

and reporting obligations requires companies to be more accountable, disciplined and strategic in their CSR approach.

**Applicability of Provisions:**

Section 135 of the Companies Act, 2013 provides that every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year shall:

- constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director;
    - In case, where a company is not required to appoint an independent director under sub-section 4 of section 149 of the Companies Act, 2013, the company shall have in its Corporate Social Responsibility Committee two or more directors.
- adopt a CSR Policy in order to develop a sustainable CSR road map to help determine both compliance and social relevance with the Act.
- spend, in every financial year, at least 2% of its average net profits made during the three immediately preceding financial years, or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its CSR policy.

**Applicability in present case:**

In the Instant case ABC Ltd. is required to spend CSR expenditure (because its turnover and net profits exceed the prescribed turnover of INR 1,000 crores and net profits of INR 5 crores), in immediately preceding financial year.

It has to spend at least 2% of its average net profits made during the three immediately preceding financial years, [i.e., 2% of INR [(250+200+200)/3] amounting to INR 4.33 crores to start with in pursuance of its CSR policy.

# CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION AND WINDING-UP

## MODULE 2 PAPER 5

***Time allowed : 3 hours*** ***Maximum marks : 100***

***NOTE :*** *Answer All Questions.*

## PART-I

### Question 1

(a) "Corporate Restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholders value. Elucidate the statement indicating need and scope of Corporate Restructuring.

(*5 marks*)

(b) Upon public announcement by an Acquirer, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 places certain obligations on the Target Company. Comment.

(*5 marks*)

(c) The projected Cash Flow of ABC Limited is as following :

| Year | Cash Flow | DCF@20% |
|---|---|---|
| 1 | 700000 | 0.833 |
| 2 | 900000 | 0.694 |
| 3 | 1100000 | 0.578 |
| 4 | 1300000 | 0.482 |
| 5 | 1500000 | 0.401 |

Assuming the Discount Rate for ABC Limited to be 20%. Terminal Value is estimated to be ₹ 1800000 and estimated year of exit is 5. Calculate the Total Present Value.

(*5 marks*)

(d) "Courts look into fair and reasonbleness of any scheme of Compromise or arrangement made in good faith and mere complaint of minority Oppression does not suffice". Justify the statement supported by judicial pronouncements.

(*5 marks*)

### Answer 1(a)

Corporate Restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value.

Need and Scope of Corporate Restructuring:

- To enhance shareholders value.
- Deploying surplus cash from one business to finance profitable growth in another.

- Exploiting inter-dependence among present or prospective businesses.
- Risk reduction.
- Development of core-competencies.
- To obtain tax advantages by merging a loss-making company with a profit-making company.
- Revolution in information technology has made it necessary for companies to adopt new changes for improving corporate performances.
- To become globally competitive.
- To increase the market share.
- Convertibility of rupee has attracted medium-sized companies to operate in the global markets.
- Competitive business necessitated to have sharp focus on core business activities, to gain synergy benefits, to minimize the operating costs, to maximize efficiency in operation and to tap the managerial skill to the best advantage of the firm.
- By diversification of business activities, the minimization of business risk is possible and it enables the firm to achieve at least the minimum targeted rate of return.
- With the integration of sick unit into the successful unit, the adjustment of unabsorbed depreciation and write off of accumulated loss is possible and thereby the successful unit can have strategic tax planning.

Restructuring aims at improving the competitive position of an individual business and maximizing its contribution to corporate objectives. It also aims at exploiting the strategic assets accumulated by a business i.e., monopolies, goodwill, exclusivity through licensing, etc. to enhance the competitiveness advantages. Thus, restructuring helps in bringing an edge over competitors. In highly competitive world, cost cutting and value addition are very important to get highlighted.

**Answer 1(b)**

As per the SEBI (SAST) Regulations, 2011, where an Acquirer (with PAC), crosses the threshold limits prescribed in the Takeover Regulations, it shall make Public Announcement for the purpose of Open Offer to the shareholders of the Target Company.

Obligations of the target company -

1. When a public announcement of an open offer for acquiring shares of a target company is made, the Board of Directors of the target company shall ensure that during the offer period, the business of the target company is conducted in the ordinary course consistent with past practice:
2. During offer period, (unless shareholders' special resolution by postal ballot) the Board of target company or its subsidiaries shall not:
   a) alienate any material assets whether by way of sale, lease, or otherwise or enter into any agreement therefore outside the ordinary course of business;
   b) effect any material borrowings outside the ordinary course of business;
   c) issue or allot any authorized but unissued securities entitling the holder to voting rights.
   d) implement any buy-back or effect any other change to capital structure of target company.

e) enter into, amend or terminate any material contracts to which the target company or any of its subsidiaries is a party, outside the ordinary course of business, whether such contract is with a related party, within the meaning of the term under applicable accounting principles, or with any other person; and

f) accelerate any contingent vesting of a right of any person to whom the target company or any of its subsidiaries may have an obligation, whether such obligation is to acquire shares of the target company by way of employee stock options or otherwise

3. In any general meeting of a subsidiary of the target company in respect of the matters referred to in the above point (2), the target company and its subsidiaries, if any, shall vote in a manner consistent with the special resolution passed by the shareholders of the target company.
4. Target Company is prohibited from fixing any record date for any corporate action on or after third working day prior to commencement of tendering period and until the expiry of the tendering period.
5. Target company shall furnish to the acquirer (within 2 working days from identified date), a list of shareholders as per the register of members of the target company containing names, addresses shareholding and folio number, but the acquirer shall reimburse reasonable costs payable by the target company to external agencies in order to furnish such information.
6. The Board of Directors of Target Company shall facilitate the acquirer in verification of shares tendered in acceptance of the open offer.
7. On receiving detailed public statement, the Board of Target Company shall constitute a Committee of Independent Directors to provide recommendations (with reasons) on the open offer. The Committee may seek external professional advice. The Committee shall provide written recommendations on the open offer to the shareholders of the Target Company Also, the recommendations shall be published in newspapers, and sent to stock exchange(s), Board and the Manager.
8. The Board of Directors of the target company shall make available to acquirers making competing offers, any information and co-operation provided to an acquirer who has made a competing offer.
9. Upon fulfilment by the acquirer, of the conditions required under applicable regulations, the board of directors of the target company shall without any delay register the transfer of shares acquired by the acquirer in physical form, whether under the agreement or from open market purchases, or pursuant to the open offer.

**Answer 1(c)**

**Step 1:**

| Year | Cash Flow | Discount Factor @ 20% | Present Value (PV) of Cash Flow (₹) |
|---|---|---|---|
| 1 | 700000 | 0.833 | 583100 |
| 2 | 900000 | 0.694 | 624600 |
| 3 | 1100000 | 0.578 | 635800 |
| 4 | 1300000 | 0.482 | 626600 |

| | | | |
|---|---|---|---|
| 5 | 1500000 | 0.401 | 601500 |
| | Sum of PV cash flows | | 3071600 |

**Step 2:**

PV Terminal Value in year of exit

(₹) 1800000* 0.401 =721800

**Step 3:**

Total Present Value of cash flow of ABC Limited= Sum of PV Cash Flows + PV Terminal Value

= 3071600 + 721800

= (₹) 3793400

**Answer 1(d)**

A scheme of compromise or arrangement, that leads to either amalgamation, merger or demerger needs to be fair and reasonable and made in good faith, is fit for sanction by the Tribunal.

It was held in the case of *Sussex Brick Co Ltd* that although it might be possible to find faults in a scheme that would not be sufficient ground to reject it. In order to merit rejection, a scheme must be obviously unfair, patently unfair, unfair to the meanest intelligence.

It cannot be said that no scheme can be effective to bind a dissenting shareholder unless it complies with the basic requirements to the extent of 100 per cent. It is consistent view of the Courts that no scheme can be said to be fool proof and it is possible to find faults in a particular scheme but that by itself is not enough to warrant a dismissal petition for sanction of the scheme.

In the case of *Re Kami Cement & Industrial Co Ltd,* it was held that if the Court is satisfied of the scheme is fair and reasonable and in the interest of the general body of shareholders, there could be no scope for any provision favouring dissentients. For such a provision is not a sine qua non to sanctioning a fair and reasonable scheme, unless any special case is made out which warrants the exercise of court's discretion in favour of the dissentients.

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

**Question 2**

(a) "Amount standing in the credit of the Escrow Account created pursuant to the Securities and Exchange Board of India (Substantial Acquisition and Takeover) Regulations, 2011 in case of an open offer, shall not be released in any circumstances". State the exceptions to the statement.

*(5 marks)*

(a) Soham Limited is proposing to purchase Aham Limited. Information available for both the companies are as follows :

| | **Soham Limited** | **Aham Limited** |
|---|---|---|
| Paid up share capital | 5,00,000 equity shares of ₹ 10 each | 2,50,000 equity shares of ₹ 10 each |

| | | |
|---|---|---|
| Market value per share | ₹ 40.00 per share | ₹ 30.00 per share |
| EPS | ₹ 5.00 per share | ₹ 4.00 per share |

Following two alternatives are being explored for exchange of shares :

(i) In proportion to the relative earnings per share of the two companies.

(ii) 1 share of Soham Limited for 2 shares of Aham Limited. Calculate :

(i) Earnings Per Share (EPS) after amalgmation under the above two options.

(ii) Impact of EPS for the shareholders of the two companies under both options.

(*5 marks*)

(c) A clean and clear drafting of the Petition is required to be subsmitted to the NCLT, which would make process easier. Elaborate the standard guidelines for presenting an application or petition before NCLT, prescribed in National Company Law Tribunal Rules, 2016 and Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

(*5 marks*)

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

**Question 2A**

(*i*) "A business valuation involves logical application/analysis of historical/future tangible and intangible attributes of business". Do you agree with this statement ? What are the aspects involved in the preliminary study of valuation ?

(*5 marks*)

(ii) Zen Limited is proposing to take over Ken Limited at an exchange ratio of 4 : 5.

Following information is available for the companies :

| | **Zen Limited** | **Ken Limited** |
|---|---|---|
| Profit before Tax (in crore) | 20 | 14 |
| No. of shares (in crore) | 30 | 20 |
| P/E Ratio | 12 | 10 |

Consider Corporate Tax @ 30%.

You are required to calculate :

(i) Market Value of both the companies

(ii) Value of original shareholders

(iii) Price per share after merger.

(*5 marks*)

(iii) A Ltd. was a listed company with Kanpur Stock Exchange but delisted in 2012. In the year 2017, the Board passed a resolution approving a scheme of arrangement and petitioned before the National Company Law Tribunal (NCLT). Subsequent to that, scheme was placed before the members. Two (2) shareholders holding 80% shares opposed the scheme. As a

Company Secretary, what would you advice to the Board next course of action(s) pursuant to the provisions of the Companies Act, 2013.

*(5 marks)*

**Answer 2(a)**

Securities and Exchange Board of India (Substantial Acquisition and Takeover) Regulations, 2011 (Takeover Regulations) obliges the Acquirer in case of open offer, to open an escrow account with a scheduled bank and deposit an amount equal to twenty-five per cent of the calculated consideration on the first five hundred crore rupees and on the balance consideration at ten per cent.

Such escrow account cannot be released except in the following manner:

1. The entire amount to the acquirer upon withdrawal of offer in terms of Regulation 23 of SAST Regulations as certified by the manager to the open offer.
2. An amount not exceeding ninety per cent to the special escrow account in terms of Regulation 21.
3. The balance (after transfer of cash to the special escrow account) to the acquirer but after thirty days after completion of payment to shareholders who have tendered their shares in acceptance of the open offer, as certified by the manager to the open offer as certified by the manager to the open offer.
4. The entire amount to acquirer on expiry of thirty days from the completion of payment of consideration to the shareholders who tendered for exchange of other secured instruments.
5. The entire amount to the manager to the open offer, in the event of forfeiture for non-fulfilment of any of the obligations under these regulations.

**Answer 2(b)**

Calculation of total earnings after merger:

| Particulars | Soham Limited | Aham Limited | Total |
|---|---|---|---|
| Outstanding shares | 5,00,000 | 2,50,000 | |
| EPS | 5 | 4 | |
| Total earnings | 25,00,000 | 10,00,000 | 35,00,000 |

(i) Calculation of EPS after amalgamation when exchange ratio is in proportion to the relative earnings per share of the two companies-

Total Number of shares after merger

= 5,00,000 + 2, 50,000 X 4/5

= 5,00,000 + 2,00,000

= 7,00,000

| | Soham Limited | Aham Limited |
|---|---|---|
| EPS before merger | 5 | 4 |

| | | |
|---|---|---|
| EPS after merger | 35,00,000/7,00,000 = 5 | EPS after merger * Exchange ratio on EPS basis = 5 * 4/5 = 4 |

Calculation of EPS when Exchange ratio is 1:2-

Total earnings after merger = Rs. 35,00,000

Total number of shares after merger = 5,00,000 + (2,50,000 * ½)

= 5,00,000 + 1,25,000

= 6,25,000

EPS after merger = 35,00,000 / 6,25,000

= Rs. 5.60

| | **Soham Limited** | **Aham Limited** |
|---|---|---|
| EPS before merger | 5 | 4 |
| EPS after merger | 35,00,000/6,25,000 = 5.60 | EPS after merger * Exchange ratio on Share basis = 5.60 * 1/2 = 2.80 |

(ii) Impact of merger for the shareholders of the two companies under both options:

Under first option, when share exchange ratio is in proportion to relative earnings per share of the two companies, pre and post-merger EPS of shareholders of both the companies remain same.

Impact on shareholders of Soham Limited:

| | |
|---|---|
| EPS before merger | 5 |
| EPS after merger | 5.60 |
| Increase in EPS | 0.60 |

Impact on shareholders of Aham Limited:

| | |
|---|---|
| EPS before merger | 4 |
| EPS after merger =5.60*1/2 | 2.8 |
| Decrease in EPS | 1.20 |

**Answer 2(c)**

Following are the standard guidelines for presenting an application or petition before NCLT prescribed in National Company Law Tribunal Rules, 2016 and Companies (Compromises, Arrangements and Amalgamations) Rules, 2016: -.

1. The petition/application being filed shall fall under the proper territorial jurisdiction of NCLT Bench.
2. The petition/application and all enclosures shall be legibly typewritten in English language. In case it is in some other Indian language, it shall be accompanied by a copy translated in English.

3. The petition/application/appeal/reply shall be printed in double line spacing on one side of the standard petition paper with an inner margin of about 4 cms width on top and with a right margin of 2.5cm left margin of 5 cm and duly paginated, indexed and stitched together in paper book form.
4. The petition/application shall be filed in prescribed form with stipulated fee in triplicate by duly authorized representative of the companies or by an advocate duly appointed in this behalf.
5. The petition shall also be accompanied by an index and memo of the parties.
6. The cause title of the petition/application shall be "Before the National Company Law Tribunal" and it shall also specify the Bench to which it is presented.
7. All the relevant provisions of the Companies Act, 2013/ NCLT Rules, 2016 shall be clearly mentioned in the petition/application.
8. The petition/application shall be divided into paragraphs and shall be numbered consecutively and each paragraph shall contain a separate fact or point.
9. The foot of petition/application shall have name and signature of the authorized representative.
10. The name of the petitioner/applicant along with complete address, viz, the name of the road street lane and municipal division or ward, municipal door and other number of the house, the name of the town or village; the post office; postal district and pin code shall be mentioned in the petition/application.
11. The fax number, mobile number, valid email addresses of the petitioner / applicant shall also be mentioned.
12. Every interlineation, eraser or correction or deletion in petition/application shall be initialled by the party or his authorized representative.
13. The affidavit verifying the petition in Form NCLT-6 shall be drawn on non-judicial /stamp paper of requisite value duly attested by Notary public/Oath Commissioner.
14. Full name, parentage, age, description of each party, date, address and in case a party sues or being sued in a representative character, has been set out in accordance to Rule 20(5) of the NCLT Rules, 2016.
15. Petition/application/ appeal reply has been drawn in the prescribed form i.e., Form No. NCLT.1 with stipulated fee given in the Schedule of these rules. The fee is to be paid by way of demand draft /PO drawn in favour of the "The Pay & Accounts Officer, Ministry of Corporate Affairs, New Delhi" or can be paid through online at nclt.gov.in.
16. The documents attached with petition/application shall be duly certified by the authorized representative or advocate filing the petition or application.
17. The annexure to the petition/application shall be serially numbered.
18. The *Vakalatnama* shall bear court fee stamp.
19. The documents with regard to shareholding/paid-up capital/latest balance sheet of the petitioner/applicant shall be attached.
20. Document other than in English language shall be duly translated and accordingly a translated copy duly certified shall be attached with petition/application.

***Or (Alternate Question to Q. No. 2)***

**Answer 2A(i)**

Yes, I do agree with the given statement. A business valuation involves analytical and logical application/analysis of historical/future tangible and intangible attributes of business.

- Valuation is a process to assess the worth of an enterprise or a business.
- In case of corporate restructuring through mergers, amalgamations, takeovers, etc., valuation assumed great importance due to determination of the transaction price.
- Valuation plays a vital role in deriving the share exchange (swap) ratio.
- Determining the value of company/business/share is a complicated, elaborative process.
- Valuation shall be exercised judiciously and diligently. However, it is a more a subjective than objective process, and depends on the skills and perceptions of the valuer/expert.
- It is an application of facts, figures, skills and insight of valuer. It is more an art than science.
- Business valuation involves analytical and logical application/analysis of past as well as future tangible and intangible aspects of business.

Preliminary study to valuation includes:

1. Purpose of valuation,
2. Goodwill/Brand name in the market,
3. Business environment of the entity to be valued,
4. Estimation/forecast of future cash flows as accurately as possible,
5. Is company listed on any stock exchange,
6. If listed, whether shares of the company are traded frequently?
7. The industry to which the concerned entity belongs to,
8. The industry P/E ratio, past and future growth rate,
9. Who are the competitors locally and globally?
10. Whether any similar valuation has been done recently?
11. The technology concerning the enterprise and its probability of obsolescence,
12. The accepted discounting rates,
13. Market capitalization aspects,
14. Identification of hidden liabilities through analysis of material contracts,
15. Last years audited balance sheets.

**Answer 2A(ii)**

| | Zen Limited | Ken Limited |
|---|---|---|
| Profit before Tax (`)(cr) | 20 | 14 |
| Tax @ 30% (`)(cr) | 6 | 4.2 |

| | | |
|---|---|---|
| Profit after Tax (`)(cr) | 14 | 9.8 |
| No. of shares(cr) | 30 | 20 |
| P/E ratio | 12 | 10 |

*(i) Market value of the companies*

Zen Ltd.= PAT* P/E = 14*12= ₹168 cr

Ken Ltd. = 9.8*10= ₹98 cr

*(ii) Value of original shareholders*

| | **Zen Limited** | **Ken Limited** |
|---|---|---|
| Market value of shares (`) (cr) | 168 | 98 |
| No. of shares (cr) | 30 | 20 |
| Price of share i.e. value of original shareholder | 168/30 = ` 5.6 | 98/20 =` 4.9 |

*(iii) No. of shares after merger*

| | **Zen Limited (cr)** | **Ken Limited (cr)** |
|---|---|---|
| No. of shares | 30 | 20 * 4 / 5 = 16 |

Price per share after merger

| | |
|---|---|
| Combined PAT of entity (₹) | 14+9.8=23.8 cr |
| No. of shares after merger | 30+16= 46 crores |
| PE ratio | 12 |
| Market value of combined entity | =23.8*12=` 285.6 cr |
| Price per share (after merger) | 285.6/46=`6.2087 |

**Answer 2A(iii)**

- As per section 230 of the Companies Act. 2013, an application shall be made to Tribunal for sanctioning a scheme of amalgamation.
- The Tribunal has the power to sanction the scheme u/s 231 of the Companies Act, subject to approval in the shareholders meeting(s) and creditors' meeting(s). The resolution shall be passed in the respective meeting through dual majority as given under section 230(6).
- As per section 230(6) of the Companies Act, 2013, compromise or arrangement would require approval by a majority of persons representing three fourths (75%) in value of the creditors, or class of creditors or members or class of members, as the case may be.
- Once the required approval is received in the members and creditors meeting, the scheme

of compromise or arrangement shall be sanctioned by the Tribunal. Once the scheme is approved by the Tribunal the same is binding on the company, all the creditors and members.

- In the given case, the proposed scheme was opposed by two shareholders holding 80% shares. Hence, it does not fulfil requirement of Section 230(6) and will not be approved by the Tribunal based upon the reports received from Scrutinizer and Chairman of the meeting.
- Moreover, it is given that A Ltd. was delisted in 2012 and hence it was not required to submit the scheme with SEBI, so observations, if any, from SEBI or stock exchanges were not required.
- The Board of A Ltd. may review the said scheme of arrangement and prepare a revised scheme of arrangement considering the observations of shareholders, if any, and present it for shareholder's approval.

**Question 3**

(a) Explain the term "relevant geographic market" and "relevant product market" in terms of the Competition Act, 2002.

*(3 marks)*

(b) "Stamp Duty is exempted when amalgamation is between Holding and Subsidiary Companies". Comment.

*(3 marks)*

(c) Internal accruals are an important source of funding mergers and takeovers. Comment on the statement with reference to issue of equity instruments with differential voting rights.

*(3 marks)*

(d) Mention anticipated benefits and challenges for business ventures involving Cross Border Mergers.

*(3 marks)*

(e) NCLT and NCLAT have opened a plethora of opportunities for Company Secretary in practice. Comment.

*(3 marks)*

**Answer 3(a)**

Section 2 (s) of the Competition Act, 2002 defines the term "relevant geographic market" to mean a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas.

Section 2 (t) of the Competition Act, 2002 defines the "relevant product market" to mean a market comprising all those products or services which are regarded interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.

Relevant market is the mix of relevant geographic market or relevant product market or both.

Competition (Amendment) Act, 2023 expands the definition of relevant product market to include the perspective of suppliers. As per revised definition "relevant product market" means a market comprising of all those products or services–

i) which are regarded as inter-changeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use; or

ii) the production or supply of, which are regarded as interchangeable or substitutable by the supplier, by reason of the ease of switching production between such products and services and marketing them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices.

**Answer 3(b)**

*Amalgamation between Holding and Subsidiary Companies-Exemption from payment of Stamp Duty*

The Central Government has exempted the payment of stamp duty on instrument evidencing transfer of property between companies limited by shares as defined in the Indian Companies Act, 1913, in a case:

i) where at least 90 percent of the issued share capital of the transferee company is in the beneficial ownership of the transferor company, or

ii) where the transfer takes place between a parent company and a subsidiary company one of which is the beneficial owner of not less than 90 percent of the issued share capital of the other, or

iii) where the transfer takes place between two subsidiary companies each of which having not less than 90 percent of the share capital is in the beneficial ownership of a common parent company:

Provided that in each case a certificate is obtained by the parties from the officer appointed in this behalf by the local Government concerned that the conditions above prescribed are fulfilled.

Therefore, if property is transferred by way of order of the High Court in respect of the Scheme of Arrangement/Amalgamation between companies which fulfil any of the above mentioned three conditions, then no stamp duty would be levied provided a certificate certifying the relation between companies is obtained from the officer appointed in this behalf by the local Government (generally this officer is the Registrar of Companies).

A circular was issued in the year 1937 vide which exemption was granted on payment of Stamp Duty when there is an amalgamation/merger between holding and subsidiary company. Delhi High Court in the case of *Delhi Towers Ltd. Vs. GNCT of Delhi* made reference to this circular.

However, stamp duty being a state subject, the above would only be applicable in those States where the State Government follows the above stated notification of the Central Government otherwise stamp duty would be applicable irrespective of the relations mentioned in the said notification.

**Answer 3(c)**

Mergers and takeovers involve payment of consideration for acquiring the properties/shares of the target company. The consideration depends on the target company valuation.

- Funding mergers and takeovers imply the modes of raising finance to service the corporate restructuring strategy
- Funds may be raised through internal sources such as Equity capital Preference Capital, accumulated reserves and profits.
- As per the Companies Act, 2013, an Indian company is permitted issue equity instruments with differential rights as to dividend and or voting Companies may issue non-voting shares
- Such issue gives companies an additional source of fund without dividend cost and without

the obligation to repay, as these are other forms of the equity capital. Generally, promoters prefer such securities since there is no loss of control.

*A company limited by shares may issue equity shares with differential rights subject to the following conditions:*

1. There must be an authority in the Articles of Association of the company,
2. Obtain shareholders' approval through ordinary resolution in general meeting. Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot.
3. The equity capital with differential rights shall not exceed 74% of the total voting power,

   No default in filing annual accounts and annual returns for three years; immediately preceding the financial year in which it is decided to issue such shares;
4. No subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend
5. The company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund of the Central Government. Provided that a company may issue equity shares with differential rights upon expiry of five years from the end of the financial Year in which such default was made good.
6. The company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.
7. A company shall not convert its existing equity share capital with normal voting rights into equity shares with differential voting rights and vice versa.

**Answer 3(d)**

The trend of cross border mergers increased recently. Cross border mergers have opened up vistas of opportunities. It enables an Indian company to utilise sophisticated levels of technical know-how offered by the foreign collaborator whereas enables the latter to utilise the large market and resources of India.

*The benefits anticipated are:*

- Expansion of markets
- Geographic and industrial diversification
- Technology transfer
- Avoiding entry barriers
- Industry consolidation
- Tax planning and benefits

- Foreign exchange earnings
- Accelerating growth
- Utilisation of material and labour at lower costs
- Increased customers base
- Competitive advantage.

*And Challenges are -*

- the risks regarding Tax implications
- Regulatory Landscape and
- Political scenario is to be tackled with confidence.
- Technological difference
- Strategic issues
- Overpayment in the deal
- Failure to integrate
- HR challenges.
- Legal issues in different countries
- Accounting challenges

**Answer 3(e)**

Establishment of NCLT and NCLAT have created plenty of opportunities for Practicing Company Secretaries. Company Secretaries are authorized to appear before the NCLT/NCLAT. Following are the areas of activities for Company Secretary in Practice:

1. Merger/Amalgamation/Compromise - A whole new area of practice opened up for Company Secretary in Practice with respect to advising and assisting corporate sector on merger, amalgamation, demerger, reverse merger, compromise and arrangements. The role of CS starts from the conceptual to implementation level. Company Secretaries in Practice will be able to render services in preparing schemes, appearing before NCLT/NCLAT for approval of schemes and post-merger formalities.
2. Revival of Companies - Where a Registrar of Companies (ROC) have struck off the name of a company u/s 248, a practicing company secretary may assist in revival of such company.
3. Winding up - National Company Law Tribunal has also been empowered to pass an order for winding up of a company. Therefore, Practicing Company Secretaries may represent the winding-up case before the Tribunal. Now Practicing Company Secretaries have been permitted to act as Liquidator in case of winding-up by the Tribunal.
4. Reduction of Capital-As per Section 66 of the Companies Act, 2013, subject to confirmation by the Tribunal, a company limited by shares or a company limited by guarantee and having a share capital can reduce its share capital. Practicing Company Secretaries will be able to represent cases of reduction of capital before the Tribunal.
5. Oppression and mismanagement- Sections 241 and 244 of the Companies Act, 2013 deals with the cases of Oppression and Mismanagement. Section 241 deals with making an application to Tribunal for relief in cases of Oppression, etc. and section 244 describes the Right to apply under section 241.

6. Insolvency and Bankruptcy cases- Insolvency practice is a new field of activity for professionals while improving the quality of intervention at all levels during rehabilitation/winding-up liquidation proceedings. Law has recognized the Insolvency Practitioners as Administrators, Liquidators, Turn around Specialists Valuers, etc. Greater responsibility and authority have been given to Insolvency Practitioners under the supervision of the Tribunal to maximize resource use and application of skills.
7. Company Secretary in Practice as Member of NCLT- A Practicing Company Secretary can be appointed as a Technical Member of NCLT, provided he has 15 years working experience as secretary in whole-time practice.

## PART-II

**Question 4**

(a) Committee of Creditors of ABC Limited undergoing CIRP have approved a Resolution Plan with 75% vote. The Resolution Plan has been presented to NCLT for its approval thereof. However, an Operational Creditor (OC) raised objection that provision for repayment of Financial Creditor under resolution plan has ignored the interests of OCs and thus not viable.

In the light of judicial pronouncement/(s), discuss whether NCLT can disapprove a Resolution Plan on grounds of lack of viability and question the commercial wisdom of the Committee of Creditors.

(*5 marks*)

(b) Mr. X, is a Director and holds 15 percent shares in HRK Limited and 1 percent equity share in ABC Limited, and his father, Mr. Y holds 3 percent equity shares in ABC Limited, subsequently insolvency proceedings are instituted against HRK Limited which owes a debt of Rs. 75 lacs to ABC Limited.

Discuss whether ABC Limited is a "related party" as per The Insolvency and Bankruptcy Code, 2016 ?

(*5 marks*)

(c) Explain the provisions pertaining to termination of pre-packaged insolvency resolution process.

(*5 marks*)

(d) "Corporate Insolvency Resolution Process (CIRP) shall be mandatorily completed within 330 days". Comment.

(*5 marks*)

**Answer 4(a)**

Hon'ble Apex Court in the case of *Committee of Creditors of Essar Steel India Limited* vs. *Satish Kumar Gupta & ors,* while upholding the constitutional validity of the Code made, inter alia, important ruling with regard to the role of the Committee of Creditor in the CIR process. It had emphasized the primacy of the commercial wisdom of the committee of Creditors in the resolution process as to whether to rehabilitate the corporate debtor or not by accepting a particular resolution plan. It also states that prior to approving the resolution plan, the Committee is required to assess the "feasibility and viability" of the resolution plan, which takes into account" all the aspects of the resolution plan, including the manner of distribution of funds among various class of creditors." In this regard, the Committee is free to negotiate with the resolution applicant by suggesting modifications in the commercial proposal on a case-to-case basis.

Further, in the case of Kalparaj *Dharamshi and another vs Kotak Investment Advisors Ltd and another,* the Supreme Court observed that the evaluation of proposals to keep the entity as a going concern, including decisions about the sale of business or units, restructuring of debt, etc., are required to be taken by the Committee of the Financial Creditors. The Apex Court further observed that it has been provided, that the choice of the solution to keep the entity as a going concern will be voted upon by the Committee and there are no constraints on the proposals that the resolution professional can present to the Committee. It was held that the NCLT or the NCLAT cannot interfere with the commercial wisdom of the Committee of Creditors, except within the limited scope under Sections 30 and 31 of the Code. It was further held that the commercial wisdom of the Committee has been given paramount status without any judicial intervention for ensuring completion of the stated processes within the timelines prescribed by the Code. The Court further held that there is an intrinsic assumption that financial creditors are fully informed about the viability of the corporate debtor and feasibility of the proposed resolution plan.

They act on the basis of thorough examination of the proposed resolution plan and assessment made by their team of experts. It was further held that the opinion expressed by the Committee after due deliberations in the meetings through voting, as per voting shares, is a collective business decision.

In view of the above, NCLT cannot reject a Resolution Plan on the basis of viability thus questioning the commercial wisdom of the Committee of Creditors as long as the Resolution Plan is within the scope of section30 and 31 of the Insolvency & Bankruptcy Code.

**Answer 4(b)**

According to section 5(24) of the Insolvency & Bankruptcy Code, a "related party", in relation to a corporate debtor, means

a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;

b) key managerial personnel of the corporate debtor or a relative of key managerial personnel of the corporate debtor;

c) a limited liability partnership or a partnership firm in which a director, partner, or manager of the corporate debtor or his relative is a partner,

d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent. of its share capital;

e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent. of its paid-up share capital;

f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

g) any limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;

i) a body corporate which is a holding, subsidiary or an associate company of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;

j) any person who controls more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement,

k) any person in whom the corporate debtor controls more than twenty per cent. of voting rights on account of ownership or a voting agreement;

l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor,

m) any person who is associated with the corporate debtor on account of-

i) participation in policy making processes of the corporate debtor; or

ii) having more than two directors in common between the corporate debtor and such person; or

iii) interchange of managerial personnel between the corporate debtor and such person; or

iv) provision of essential technical information to, or from, the corporate debtor

Explanation to section 5(24A) of the Insolvency & Bankruptcy Code provides

(a) "relative", with reference to any person, means anyone who is related to another, in the following manner, namely: - (iv) father,

In light of definition of relative and clause (e) above, ABC Limited is a "related party" of HRK Limited as Mr. X is a director in HRK Limited and Mr. X together with Mr. Y (father) holds more than 2 percent of the equity share capital of ABC Limited.

**Answer 4(c)**

Section 54N of the Insolvency & Bankruptcy Code dealing with termination of pre-packaged insolvency resolution process. It provides that:

1. Where the resolution professional files an application with the Adjudicating Authority, -

   a) under the proviso to sub-section (12) of section 54K; or

   b) under sub-section (3) of section 54D,

   the Adjudicating Authority shall, within thirty days of the date of such application, by an order, -

   i) terminate the pre-packaged insolvency resolution process; and

   ii) provide for the manner of continuation of proceedings initiated for avoidance of transactions under Chapter III or proceedings initiated under section 66 and section 67A, if any.

2. Where the resolution professional, at any time after the pre-packaged insolvency commencement date, but before the approval of resolution plan under sub-section (4) or sub-section (12), as the case may be, of section 54K, intimates the Adjudicating Authority of the decision of the committee of creditors, approved by a vote of not less than sixty-six per cent of the voting shares, to terminate the pre-packaged insolvency resolution process, the Adjudicating Authority shall pass an order under sub-section (1).

3. Where the Adjudicating Authority passes an order under sub-section (1), the corporate debtor shall bear the pre-packaged insolvency resolution process costs, if any.

4. Notwithstanding anything to the contrary contained in this section, where the Adjudicating Authority has passed an order under sub-section (2) of section 54J and the prepackaged

insolvency resolution process is required to be terminated under sub-section (1), the Adjudicating Authority shall pass an order –

(a) of liquidation in respect of the corporate debtor as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1) of section 33; and

(b) declare that the pre-packaged insolvency resolution process costs, if any, shall be included as part of the liquidation costs for the purposes of liquidation of the corporate debtor.

**Answer 4(d)**

The preamble to the Insolvency and Bankruptcy Code, 2016 (IBC) gives a thrust to provide an effective legal framework for timely resolution of insolvency and bankruptcy. Hence, Section 12 of IBC lays down a time limit for completion of insolvency resolution process.

As per Section 12 (1) of IBC, normally any insolvency resolution process needs to be completed within one hundred and eighty days from the date of commencement of Corporate Insolvency Resolution Process (CIRP)

However, as expected no one and even legislation can bind the time. Keeping this in view Section 12 (2) of IBC enables the resolution professional can seek extension after obtaining instructions by a resolution passed at a meeting of the Committee of Creditors by a vote of sixty-six per cent of the voting share.

Section 12 (3) of IBC enables the Adjudicating Authority to consider such application to grant extension of CIRP duration for further maximum ninety days. It is provided that any extension of the period of corporate insolvency resolution process under this section shall not be granted more than once.

It is further provided that the CIRP shall mandatorily be completed within three hundred and thirty days from the insolvency commencement date, including any extension of the period of corporate insolvency resolution process granted under this section and the time taken in legal proceedings in relation to such resolution process of the corporate debtor.

Though, the word 'mandatorily' has been struck down by the Court in the decision in Committee of Creditors of Essar Steel India Limited, Supreme Court has only balanced the interest of all concerned, by permitting an enlargement of the time, only in those cases, where the delay occurs not on account of the fault of the players concerned and it is based on the principle of *actus curiae neminem gravabit*, which means that the act of Court shall prejudice no one. The Court has not undermined the timeline fixed by the Legislature and, in fact, it has underlined the importance of conforming to the time limit. Speed, indeed, continues to be of the essence of the Code.

**Question 5**

(a) Extreme Finance Limited wants to take possession of immovable property belonging to Amar pursuant to an order of Debt Recovery Tribunal (DRT). Discuss whether it can take assistance from the Chief Metropolitan Magistrate or the District Magistrate under SARFAESI Act, 2002 to take possession of secured assets and procedure therefor.

(b) State the situations under which the Adjudicating Authority can order liquidation of a corporate person in terms of Insolvency & Bankruptcy Code, 2016 (IBC)

(c) "Though the procedure to be followed for voluntary liquidation proceedings under Chapter III is largely similar to the procedure to be followed for insolvent liquidation under Chapter III of the Code yet there are marked differences". Point out some differences between two.

(d) "Section 29A was introduced in the Insolvency and Bankruptcy Code, 2016 to prevent certain persons from applying as resolution applicant." Comment.

(e) The liquidator is equipped with the powers to take possession of assets of the Corporate Debtor under liquidation forming part of liquidation estate yet some Assets need to be excluded". Elucidate.

*(3 marks each)*

**Answer 5(a)**

The main purpose of SARFAESI Act, 2002 is to enable and empower the secured creditors to take possession of their securities and to deal with them, without the intervention of Court.

- The secured creditors may also authorize any securitization or reconstruction company to acquire financial assets of any bank or financial institution.
- Section 14 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 provides for assistance for taking possession of secured asset from the Chief Metropolitan Magistrate or the District Magistrate.
- The Chief Metropolitan Magistrate or the District Magistrate is empowered to facilitate taking possession of secured asset. The possession of secured asset may be for sale or transferring the asset for recovery of funds.
- For the purpose of taking possession or control of secured assets, the secured creditor may make a written application to the Magistrate (within jurisdiction).
- Such application shall be supported by an affidavit with details such as total financial assistance provided, amount due, nature of security interest existing, proof of default, status of NPA, copy of notice sent to the defaulting party etc.
- On receiving such application & affidavit, the Magistrate shall pass necessary orders (in 30 days) for taking possession of such asset and related documents. Due to any reasons duly written, such order cannot be passed within 30 days, the same may be sent within 60 days.
- The Magistrate may authorize any subordinate officer to take possession of the secured assets and forward the same to the secured creditor.
- The Magistrate is empowered to use force, in case of any wrongful resistance. Any action or order of the Magistrate is not questionable in any court or before any authority.

**Answer 5(b)**

The Adjudicating Authority, in exercise of powers may order for liquidation of the Corporate Debtor. However, keeping in view liquidation is the last resort because revival is the priority for the economy.

Section 33 of the Insolvency and Bankruptcy Code, 2016 provides that the Adjudicating Authority shall pass an order requiring the corporate debtor to be liquidated if:

1) No resolution plan is received under section 30(6) 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 or the fast-track corporate insolvency resolution process under section 56;
2) the resolution plan under section 31 is rejected by the Adjudicating Authority for non-compliance of the requirements specified therein;
3) 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;

4) Where the resolution plan approved by the Adjudicating Authority under section 31 or under sub-section (1) of section 54L, is contravened by the concerned corporate debtor, any person other than the corporate debtor, whose interests are prejudicially affected by such contravention, makes an application to the Adjudicating Authority for a liquidation order and such a contravention is determined by the Adjudicating Authority.

**Answer 5(c)**

Section 59 (6) of the Insolvency and Bankruptcy Code, 2016 provides that the provisions of sections 35 to 53 of Chapter III and Chapter VII shall apply to voluntary liquidation proceedings for corporate persons with such modifications as may be necessary.

Though the procedure to be followed for voluntary liquidation proceedings under Chapter V is largely similar to the procedure to be followed for insolvent liquidation under Chapter III of Part II of the Code yet there are marked differences:

1. Section 59 of the Code provides that a corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of Chapter V of the Code whereas Liquidation is ordered under section 33 of the Code by the Adjudicating Authority in case of corporate debtors who have committed default and whose Corporate Insolvency Resolution Process fails.
2. Declaration of solvency and liquidation not intended to defraud any person shall be given by the majority of directors in case of voluntary liquidation whereas Liquidation is ordered in case of corporate debtor which has committed default of threshold limit.
3. Date of passing of special resolution of the members of the corporate debtor approving voluntary liquidation shall be deemed to be the date of commencement of voluntary liquidation whereas the date on which the Adjudicating Authority passes an order of liquidation under section 33 shall be deemed to be the date of commencement of Liquidation.
4. Liquidator is appointed by the Adjudicating Authority for liquidation under section 33 of the Code while Liquidator is appointed by the corporate debtor in case of voluntary liquidation under section 59 of the Code.
5. The Adjudicating Authority gives order under section 33 and then Liquidation commences while in case of Voluntary Liquidation, the liquidator shall make an application to the Adjudicating Authority for the dissolution of such corporate person after the affairs of the corporate person have been completely wound up, and its assets completely liquidated,

**Answer 5(d)**

The Insolvency and Bankruptcy Code, 2016 was created to benefit the Financial and Operational Creditors, through the insolvency resolution process. However, it was observed that existing promoters of the Corporate Debtor were directly or indirectly acquiring stake in their own assets through the resolution plan, at a big discount.

Hence, through the resolution process, the existing promoters were regaining control over their assets (directly or indirectly) after a huge hair-cut (discount) from lenders. In other words, re-purchase the same assets at a much lower cost and getting a back-door entry into their company.

To plug this loophole, the IBC was amended though the ordinance of the President of India. The amendment inserted section 29A, which provides for persons ineligible to be a Resolution Applicant.

The newly added section 29A declares certain persons ineligible to be a resolution applicant and prohibits such persons from submitting a resolution plan.

As per Section 29A of the Insolvency and Bankruptcy Code, 2016 following persons are not eligible to submit a resolution plan -

(a) applicant is an undischarged insolvent,

(b) wilful defaulters (as defined by RBI and Banking Regulation Act, 1949),

(c) persons whose accounts are classified as NPA for one year or more and are unable to settle their overdue amount (incl. interest), at the time of submission of the resolution plan,

(d) persons convicted for any offence punishable with imprisonment for two years or more (for offences of XII Schedule) or for seven years or more (under any other law) and a period of two years has not been expired from the date of his release from imprisonment

(e) persons disqualified to act as director under the Companies Act, 2013,

(f) persons prohibited by SEBI, from trading in securities or accessing the securities market,

(g) person who has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction (PUFE) has taken place and in respect of which an order has been made by the Adjudicating Authority under this Code except when such PUFE transactions has taken place prior to acquisition of such corporate debtor by resolution applicant and resolution applicant has not contributed in those transactions.

(h) persons who have executed any guarantee to a creditor for the corporate debtor w.r.t. which CIRP application initiated by such creditor has been admitted by the Adjudicating Authority and such guarantee has been invoked by the creditor and remains unpaid in full or part

(i) persons disqualified by any law of other country, for the conditions mentioned in (a) to (h),

(j) has connected person not eligible under clauses mentioned in (a) to (i).

**Answer 5(e)**

Section 36 (3) of the Insolvency and Bankruptcy Code, 2016 (IBC) specifies the assets of the Corporate Debtor that should be taken into custody as Liquidation Estate.

a) In a similar way, Section 36 (4) of IBC illustrates the following assets which shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation assets owned by a third party which are in possession of the corporate debtor, including-

   i) assets held in trust for any third party;

   ii) bailment contracts;

   iii) all sums due to any workmen or employee from the provident fund, the pension fund and the gratuity fund;

   iv) other contractual arrangements which do not stipulate transfer of title but only use of the assets; and

   v) such other assets as may be notified by the Central Government in consultation with any financial sector regulator.

b) assets in security collateral held by financial services providers and are subject to netting and set-off in multi-lateral trading or clearing transactions;

c) personal assets of any shareholder or partner of a corporate debtor as the case may be provided such assets are not held on account of avoidance transactions that may be avoided under this Chapter;

d) assets of any Indian or foreign subsidiary of the corporate debtor; or

e) any other assets as may be specified by the Board, including assets which could be subject to set-off on account of mutual dealings between the corporate debtor and any creditor.

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

**Question 6**

(a) The Resolution Professional of Arc Private Limited has to issue notice of meeting of Committee of Creditors. Specify :

- Category of persons entitled to receive notice of the meeting.
- Category of persons not entitled to vote at the meeting.

(b) Under section 80 of Insolvency and Bankruptcy Code, 2016, a person unable to pay a "Qualifying Debt" can apply for "fresh start process" subject to fulfillment of certain conditions. What do you mean by "Qualifying Debt" and "Excluded Debt" under IBC, 2016 ?

(c) "Any modification suggested by creditors need consent of the debtor in respect of Repayment plan in case of individual or firm solvency." Comment briefly on the statement narrating the provisions in respect of conductings meetings and rights of secured creditors to attend ?

*(5 marks each)*

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

**Question 6A**

(i) Enumerate the measures under Regulation 37 of CIRP that can be provided under a Resolution Plan for maximization of value of assets of the Corporate Debtor. Can a Resolution Plan envisage corporate restructuring of the Corporate Debtor under Corporate Insolvency Resolution Process (CIRP) ?

*(5 marks)*

(ii) Of late, Insolvency and Bankruptcy Code, 2016 has provisions to tackle the issue of Cross Border Insolvency. Justify the statement with any recent case law.

*(5 marks)*

(iii) Who can be an Interim Resolution Professional (IRP), a Resolution Professional (RP), a Liquidator or a Voluntary Liquidator under Insolvency and Bankruptcy Code, 2016 ? Briefly enumerate eligibility conditions.

*(5 marks)*

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

**Answer 6(a)**

Section 24 of the Insolvency and Bankruptcy Code, 2016 (IBC) lays down the procedure for conducting the meetings of the Committee of Creditors (COC).

The resolution professional shall give notice of each meeting of the committee of creditors to:

a) members of committee of creditors, including the authorised representatives referred to in sub sections (6) and (6A) of section 21 and sub-section (5),

b) members of the suspended Board of Directors or the partners of the corporate persons, as the case may be,

c) operational creditors or their representatives if the amount of their aggregate dues is not less than ten percent of the debt [Section 24(3)].

The directors, partners and one representative of operational creditors, as referred to in sub-section (3), may attend the meetings of committee of creditors, but shall not have any right to vote in such meetings. The absence of any such director, partner or representative of operational creditors, as the case may be, shall not invalidate proceedings of such meeting.

Section 21of the Code states that the committee of creditors shall comprise all financial creditors of the corporate debtor. It is provided that a financial creditor or the authorised representative of the financial creditor referred to in sub-section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors

**Answer 6(b)**

A debtor may either personally or through a Resolution Professional may apply for "fresh start process" only on fulfilling specified conditions. Section 80 of the Insolvency and Bankruptcy Code, 2016 states that a debtor who is unable to pay his debt, if conditions are fulfilled, shall be entitled to make an application for a fresh start for discharge of his qualifying debt.

"Qualifying Debt" means amount due, which includes interest or any other sum due in respect of the amounts owed under any contract, by the debtor for a liquidated sum either immediately or at certain future time but does 'not' include:

1. An excluded debt;
2. A debt to the extent it is secured;
3. Any debt which has been incurred three months prior to the date of the application for fresh start process.

"Excluded debt" means-

1. Liability to pay fine imposed by a court or tribunal;
2. Liability to pay damages for negligence, nuisance or breach of a statutory, contractual or other legal obligation;
3. Liability to pay maintenance to any person under any law for the time being in force;
4. Liability in relation to a student loan; and
5. Any other debt as may be prescribed.

**Answer 6(c)**

Part III of the Insolvency and Bankruptcy Code, 2016 (IBC) provides separate insolvency resolution process for individuals/partnership firms.

- Application to Debt Recovery Tribunal (DRT) for initiating Insolvency Resolution Process may be made by a creditor or the debtor (individual or firm) who has committed default. Such application may be made either personally or through a resolution professional.
- The Debtor shall prepare a Repayment Plan, in consultation with the Resolution Professional.

The Repayment plan consists of justification for preparation of repayment plan and reasons on the basis of which the creditors may agree upon the plan.

- It shall be noted that the creditors are not involved in the preparation of the repayment plan. However, creditors have the right to approve, reject or modify the repayment plan.
- The Resolution Professional shall verify the repayment plan for its validity and legal compliance. Further, the Resolution Professional may summon a meeting of creditors to consider the plan.
- Where creditors' meeting is needed, the Resolution Professional shall consider the convenience of creditors in fixing the date and venue of the meeting of the creditors (not less than 14 days and not more than 28 days from the date of submission of report).
- The Resolution Professional shall conduct the meeting of creditors. In the meeting, the creditors may decide to approve, modify or reject the repayment plan. Where modifications are suggested by the creditors, the Resolution Professional shall ensure that consent of the debtor is obtained for each modification.
- A creditor shall be entitled to vote at every meeting of the creditors in respect of the repayment plan as per the voting share assigned to him. A creditor shall not be entitled to vote in respect of a debt for an indeterminate amount.
- However, a creditor shall not be entitled to vote in a meeting of the creditors if he-
  - is not a creditor mentioned in the list of creditors; or
  - is an associate (i.e., related party) of the debtor.

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

**Answer 6A(i)**

The Insolvency and Bankruptcy Board of India (IBBI) framed IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP) to regulate insolvency resolution process. Corporate Restructuring process may be governed by the Regulation 37 of the CIRP Regulations. Measures, which the resolution plan may provide, for insolvency resolution of the corporate debtor for maximization of value of its assets including but not limited to the following:

(a) transfer of all or part of the assets of the corporate debtor to one or more persons;

(b) sale of all or part of the assets whether subject to any security interest or not;

(ba) restructuring of the corporate debtor, by way of merger, amalgamation and demerger;

(c) the substantial acquisition of shares of the corporate debtor, or the merger or consolidation of the corporate debtor with one or more persons;

(ca) cancellation or delisting of any shares of the corporate debtor, if applicable;

(d) satisfaction or modification of any security interest

(e) curing or waiving of any breach of the terms of any debt due from the corporate debtor;

(f) reduction in the amount payable to the creditors;

(g) extension of a maturity date or a change in interest rate or other terms of a debt due from the corporate debtor;

(h) amendment of the constitutional documents of the corporate debtor;

(i) issuance of securities of the corporate debtor, for cash, property, securities, or in exchange for claims or interests, or other appropriate purpose;

(j) change in portfolio of goods or services produced or rendered by the corporate debtor,

(k) change in technology used by the corporate debtor; and

(l) obtaining necessary approvals from the Central and State Governments and other authorities.

Regulation 37 of the CIRP Regulations was amended and clauses (ba), and (ca) were inserted facilitating corporate restructuring such as merger, demerger or amalgamation of the Corporate Debtor and cancellation or delisting of any shares, if applicable.

Section 5(26) of the Code defines "resolution plan" which means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II. It is provided in the Explanation to the definition that for removal of doubts, it is hereby clarified that a resolution plan may include provisions for the restructuring of the corporate debtor, including by way of merger

Therefore, a resolution plan can include corporate restructuring of the corporate debtor as part of the corporate insolvency resolution process.

**Answer 6A(ii)**

Insolvency & Bankruptcy Code, 2016 (IBC) has enabling provisions to consider the cases of Cross Border insolvency matters involving corporate persons in India and their counter parts in any foreign nation.

Sections 234 and 235 of IBC make provisions to deal with cross border insolvencies. Section 234 of IBC empowers the Central Government to enter into agreements with other countries to deal with or resolve situations pertaining cross border insolvency. The current cross border insolvency framework in India is dependent on India entering bilateral agreements with other countries which is a long-drawn process requiring time consuming negotiations.

Section 235 requires Adjudicating Authority to file Letter of request to court or authority of a country of competent for cross border insolvency as follows:

(1) 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.

(2) 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.

*Jet Airways (India) Ltd Vs State Bank of India & anr* is the first case touching the realm of cross border insolvency. In the instant case, Jet Airways (India) Ltd was subjected to parallel insolvency proceedings in India as well as in Netherlands.

**Answer 6A(iii)**

Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016 makes provisions for the examination and registration of Insolvency Professionals who can be appointed

as an Interim Resolution Professional (IRP), Resolution Professional (RP), Liquidator or Voluntary Liquidator under relevant regulations.

According to Regulation 4 of the IBBI (Insolvency Professionals) Regulations, 2016, no individual shall be eligible to be registered as an insolvency professional if he -

a) is a minor;

b) is not a person resident in India;

c) does not have the qualification and experience specified in regulations 5 or 9 of the IBBI (Insolvency Professionals) Regulations, 2016, as the case may be;

d) has been convicted by any competent court for an offence punishable with imprisonment for a term exceeding six months or for an offence involving moral turpitude, and a period of five years has not elapsed from the date of expiry of the sentence. Provided that, if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;

e) he is an undischarged insolvent, or has applied to be adjudicated as an insolvent;

f) he has been declared to be of unsound mind; or

g) he is not a fit and proper person.

Explanation: For determining whether an individual is fit and proper under these Regulations, the Board may take account of any consideration as it deems fit, including but not limited to the following criteria-

i) integrity, reputation and character;

ii) absence of convictions and restraint order; and

iii) competence, including financial solvency and net worth.

No insolvency professional entity, recognised by the Board under regulation 13 shall be eligible to be registered as an insolvency professional, if the entity and/or any of its partner or director, as the case may be, is not fit and proper person.

# RESOLUTION OF CORPORATE DISPUTES, NON-COMPLIANCES & REMEDIES

## Module 2 PAPER 6

***Time allowed : 3 hours*** ***Maximum marks : 100***

***NOTE :*** *Answer All Questions.*

### Question 1

(a) Helpway, was an NGO supporting various causes including the legal support, needed by any deprived. Kechar, was an engineering drop out, who was very skilled in developing applications ('app'). He developed an app for the NGO to gather information about poor kids, aged people, etc., who may need help and support, however he was not able to host it on playstore, for downloading by public. The NGO alleged that Hyper Ltd. (a leading brand) is using a barrage of anti-competitive restraints and abuse of dominant practices in markets for distribution of apps to users of smartphones, tablets and processing of consumers' payments for digital content used within mobile apps ('in-app content'). The NGO averred that Hyper Ltd. imposes unreasonable and unlawful restraints on app developers from reaching users of its mobile devices unless they go through the 'App Store' which was stated to be controlled by it. Further, Hyper Ltd requires app developers who wish to sell digital in-app content to their consumers to use its in-app payment solution i.e. In-App Purchase (IAP) which carries a 20 per cent commission which is 10 times higher as compared to open market rates. NGO alleged that such restrictive practice and charge of exorbitant price amounts to abuse of dominant position in the Competition Act. NGO further asserted that, Hyper Ltd. enjoys a dominant position in the market for non-licensable mobile OS for smart mobile devices as well as in the relevant market for app store in India.

Hyper Ltd's App Store was the only approved App Store for iOS devices. App developers have no other alternative except Hyper Ltd's App Store through which they could reach users of iOS. Thus, it was stated to have a monopoly in the iOS app distribution market. NGO had alleged that Hyper Ltd prevents iOS users from downloading app stores or apps directly from websites; pre-installs its own App Store on every iOS device it sells; disables iOS users' ability to remove the App Store from their devices; and conditions all app developers' access to iOS on the developers' agreement to distribute their apps solely through the App Store and not to distribute third-party app stores.

In the light of judicial pronouncement, comment if the appeal of NGO would be allowed before Competition Commission of India (CCI).

(*5 marks*)

(b) The Assessing Officer received a tip-off about certain transactions happening in a famous café named, The Friends Joint, which could probably lead to some evidences he was looking for. This café was within the Assessing Officers jurisdiction and he found it little weird, that the café is open between 1 AM to 1 PM. He went to the café at night 12.30 PM for a survey, as he was expecting to collect information which may be useful in assessment under the Income-tax Act, 1961. He inspected the books of accounts and other documents and retained them in his custody for 12 days, after recording the reasons in writing. Meanwhile, the owner of the Café contended that, the Assessing Officer's action of entering the Café is not as per the Income-tax Act 1961. Is his contention valid ?

(*5 marks*)

(c) SEBI investigated the activities of Kamalai, an individual stock trader. During the investigation, it was found that Kamalai was putting orders, ahead of orders placed by Pointed Ltd. Vimalai, was the portfolio manager of Pointed Ltd., who also happens to be a cousin of Kamalai and Tharen. It was alleged that Vimalai provided information to Kamalai and Tharen regarding forthcoming trading activity of the Pointed Ltd. These trades were executed using the telephone number registered in the name of Tharen, at the common residential address of Vimalai and Tharen. Taking advantage of the information received from Vimalai, Kamalai had indulged in trading before the Pointed Ltd and consequently squared off the position when the order of Pointed Ltd were placed in the market. It was estimated that Kamalai earned a total profit of ` 1.5 crores from the alleged trades. Despite the evidence on record, Kamalai pleaded that it was a coincidence. With reference to a judicial pronouncement, comment if SEBI's action is justified.

(*5 marks*)

(d) Kimona Luxury Private Ltd, is a company dealing in trading of luxury lifestyle products like writing instruments, expensive watches, high end leather products, tech products like headphones and other accessories having 10 boutique stores in high end luxury malls and five start hotels across the country. As a policy, the Company ensures compliance with all the applicable regulatory and legal requirements. To be customer friendly and increase sales, Nainaj, a sales associate in one of the stores, regularly accepted payment in cash from customers and swiped his own credit card against purchase, to record the payment against such purchase. With this practice, he was able to get credit period of 45 days on swiped transaction and get instant cash for his personal use. This unethical practice was unnoticed until the Bank's credit risk team blocked all the credit card swiping machines installed at the stores due to a suspicious transaction of high value. Over and above, Nainaj used to exchange cash collected from customer with fake notes and deposit them with Company's banker, so that gradually fake notes come into circulation. One of the customers recorded this on his mobile phone, shared it on the social media and it went viral within a very short span of time. The Company ordered a forensic audit to examine the details of such transactions. Meanwhile, the matter also received attention from Central Government, and the Central Bureau of Investigation (CBI) was asked to investigate the fraud. Can CBI investigate such matters ? Comment.

(*5 marks*)

**Answer 1(a)**

The facts of the given situation are similar to the matter of *Together We Fight Society v. Apple Inc.* decided by the Competition Commission of India.

In the instant case, the informant (an NGO called 'Together We Fight Society') alleged that Apple uses a barrage of anti-competitive restraints and abuse of dominant practices in markets for distribution of applications ('apps') to users of smartphones, tablets and processing of consumers' payments for digital content used within iOS mobile apps ('in-app content').

The Informant averred that Apple imposes unreasonable and unlawful restraints on app developers from reaching users of its mobile devices (e.g., iPhone and iPad) unless they go through the 'App Store' which was stated to be controlled by Apple.

Further, Apple requires app developers who wish to sell digital in-app content to their consumers to use Apple's in-app payment solution i.e. In-App Purchase (IAP) which carries a 30 per cent commission which is 10 times higher than as compared to open market rates.

The informant alleged that such restrictive practice and charge of exorbitant price amounts to abuse of dominant position under section 4 of the Act.

The Informant further asserted that Apple enjoys a dominant position in the market for non-licensable mobile OS for smart mobile devices as well as in the relevant market for app store for Apple smart mobile OS in India.

Apple's App Store was the only approved App store for iOS devices. App developers have no other alternative except Apple's App Store through which they could reach users of iOS. Thus, Apple was stated to have a monopoly in the iOS app distribution market.

The informant had alleged that Apple prevents iOS users from downloading app stores or apps directly from websites; pre-installs its own App Store on every iOS device it sells; disables iOS users' ability to remove the App Store from their devices; and conditions all app developers' access to iOS on the developers' agreement to distribute their apps solely through the App Store and not to distribute third-party app stores.

The Competition Commission of India observed that in a relevant market i.e., market for app stores for iOS in India, Apple's App Store is only means for developers to distribute their apps to consumers using Apple's smart mobile devices running on Apple's smart mobile operating system iOS, Apple holds a monopoly position in relevant market.

The Commission prima facie viewed that Apple has violated the provisions of section 4(2)(a), 4(2)(b), 4(2)(c), 4(2)(d) and 4(2)(e) of the Act, and therefore, it warrants detailed investigation. Accordingly, CCI directed the Director-General to cause an investigation to be made into the matter under the provisions of section 26(1).

In view of above, it may be said that the appeal of NGO can be allowed before the Competition Commission of India.

**Answer 1(b)**

According to Section 133A(2) of the Income-tax Act, 1961, an income-tax authority may enter any place of business or profession referred to in section 133A(1) only during the hours at which such place is open for the conduct of business or profession and, in the case of any other place, only after sunrise and before sunset.

According to Section 133A(2A), without prejudice to the provisions of section 133A(1), an income-tax authority acting under this sub-section may for the purpose of verifying that tax has been deducted or collected at source in accordance with the provisions under sub-heading B of Chapter XVII or under sub-heading BB of Chapter XVII, as the case may be, enter, after sunrise and before sunset, any office, or any other place where business or profession is carried on, within the limits of the area assigned to him, or any place in respect of which he is authorized for the purposes of this section by such income-tax authority who is assigned the area within which such place is situated, where books of account or documents are kept and require the deductor or the collector or any other person who may at that time and place be attending in any manner to such work, –

1. to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place, and
2. to furnish such information as he may require in relation to such matter.

As per Sec 133A(3)(ia), an income tax authority acting under this Section may impound and retain in his custody for such period, not exceeding 15 days, as he thinks fit any books of account or other documents inspected by him without obtaining the approval of the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General or the Principal Commissioner or the Commissioner or the Principal Director or the Director therefor, as the case may be,

In view of the above, it can be said that the Assessing Officer's action in entering the café at 12:30 PM i.e., during the hours when the café was open for business and inspecting and then impounding books of account and documents inspected by him and also retaining them in his custody for 12 days is in order. Therefore, the contention of the owner of the café that "Assessing Officer's action of entering the café is not as per the Income-tax Act, 1961" is not valid.

***Alternate Answer to above paragraph***

In view of the above, it can be said that the Assessing Officer's action in entering the café at 12:30 Night i.e., before the hours when the café was open for business and inspecting and then impounding books of account and documents inspected by him was not correct.

**Answer 1(c)**

The facts of the given situation is similar to the case of *Securities and Exchange Board of India (Appellant) v. Shri Kanaiyalal Baldevbhai Patel (Respondent)* dated 20th September, 2017 decided by the Supreme Court of India.

This case revolves round the legality of non-intermediary front running' in security market under the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (FUTP 2003).

**Facts of the case:** SEBI investigated into the activities of Shri Kanaiyalal Baldevbhai Patel [herein after 'KB' for brevity] an individual trader. During the investigation, it was found that KB was putting orders ahead of orders placed by Passport India Investment (Mauritius) Ltd. [herein after 'PII' for brevity]. One Dipak Patel, was the portfolio manager of PII, who also happens to be a cousin of KB and one Shri Anandkumar Baldevbhai Patel [herein after 'AB' for brevity]. It was alleged that Dipak Patel provided information to KB and AB regarding forthcoming trading activity of the PII. It is to be noted that trades were executed using the telephone number registered in the name of AB at the common residential address of KB and AB. Taking advantage of the information received from Dipak Patel, KB had indulged in trading before the PII and consequently squared off the position when the order of PII were placed in the market. It was estimated that the KB earned a total profit of Rs. 1,56,32,364.01/- from the alleged trades.

**Decision:** The object and purpose of FUTP 2003 is to curb "market manipulations". Market manipulation is normally regarded as an "unwarranted" interference in the operation of ordinary market forces of supply and demand and thus undermines the "integrity" and efficiency of the market.

The law of confidentiality has a bearing on this case instant. "Confidential information acquired or compiled by a corporation in the course and conduct of its business is a species of property to which the corporation has the exclusive right and benefit, and which a court of equity will protect through the injunctive process or other appropriate remedy." The information of possible trades that the company is going to undertake is the confidential information of the company concerned, which it has absolute liberty to deal with. Therefore, a person conveying confidential information to another person (tippee) breaches his duty prescribed by law and if the recipient of such information knows of the breach and trades, and there is an inducement to bring about an inequitable result, then the recipient tippee may be said to have committed the fraud.

In order to establish charges against tippee, under regulations 3 (a), (b), (c) and (d) and 4 (1) of FUTP 2003, one needs to prove that a person who had provided the tip was under a duty to keep the non-public information under confidence, further such breach of duty was known to the tippee and he still trades thereby defrauding the person, whose orders were front-runner, by inducing him to deal at the price he did.

In view of the above case, it can be said that concerned parties to the transaction were involved in an apparent fraudulent practice violating market integrity. The parting of information with regard to an imminent bulk purchase and the subsequent transaction thereto are so intrinsically connected that no other conclusion but one of joint liability of both the initiator of the fraudulent practice and the other party who had knowingly aided in the same is possible. SEBI may accordingly take action against the parties to the transaction.

**Answer 1(d)**

Central Bureau of Investigation (CBI) has grown into a multidisciplinary investigation agency over a period of time. Today it has the following three divisions for investigation of crime:

**Anti-Corruption Division:** For investigation of cases under the Prevention of Corruption Act, 1988 against Public officials and the employees of Central Government, Public Sector Undertakings, Corporations or Bodies owned or controlled by the Government of India - it is the largest division having presence almost in all the States of India.

**Economic Offence Division:** For investigation of major financial scams and serious economic frauds, including crimes relating to Fake Indian Currency Notes, Bank Frauds and Cyber Crime.

This wing cover fraud, forgery and counterfeiting, offences against the legislation governing cheques, forgery or use of credit cards, undeclared employment and offences against companies (such as misuse of company assets).

**Special Crimes Division:** For investigation of serious, sensational and organized crime under the Indian Penal Code, 1860 and other laws on the requests of State Governments or on the orders of the Supreme Court and High Courts.

The laws under which CBI can investigate Crime are notified by the Central Government under section 3 of the Delhi Special Police Establishment Act, 1946(DPSE Act). According to Section 3, the Central Government may, by notification in the official gazette, specify the offences or classes of offences which are to be investigated by the Delhi Special Police Establishment.

According to section 2 of the DSPE Act, CBI can *suo-moto* take up investigation of offences notified in section 3 only in Delhi or other Union Territories. However, as per Sec 5 & 6 of the said DPSE Act, for taking up investigation by CBI in the boundaries of a State requires prior consent of that State.

As per section 5(1), the Central Government may by order extend to any area including Railway areas in a State, not being a Union territory the powers and jurisdiction of members of the Delhi Special Police Establishment for the investigation of any offences or classes of offences specified in a notification under section 3.

Further as per section 6, nothing contained in section 5 shall be deemed to enable any member of the Delhi Special Police Establishment to exercise powers and jurisdiction in any area in a State, not being a Union territory or railway area, without the consent of the Government of that State.

As the crime transaction of accepting cash from customer and swiping personal credit card instead in the company system and exchanging collected cash with fake notes and putting same in banking circulation, the matter is major financial scam, it can be investigated by Economic Offence Division of CBI, provided that the crime took place either in Delhi or any other Union Territory, or if the crime took place in any State, the consent of the State Government of that state has been obtained.

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

**Question 2**

(a) Joint Commissioner of Goods and Services Tax based on the returns filed by Bhojraj, a taxable person is of the opinion that he has suppressed some transactions relating to goods/services and also claimed input tax credit in excess of his entitlement under the Goods and Services Tax Act. He issued a letter authorizing the GST Officer to inspect Bhojraj's premises. Bhojraj did not allow the GST officer to enter his place of business, as he claimed that authorization is faulty and it is not tenable u/s 67 (1) of the Central Goods and Services Tax Act, 2017 . In the background of CGST Act, examine the validity of Bhojraj's action.

(*4 marks*)

(b) Swayam and Shubham are two directors of Shuyam Medical Consultancy Private Ltd., Hyderabad. Swayam was authorized by Board of directors to prepare and file returns, reports and other related information and documents to Registrar of Companies (RoC) within due date on behalf of the Company. While preparing returns, he did not mention the fact that the Company also had export income which formed part of revenue and filed the return. Subsequently, RoC found that a material fact is omitted in the information provided in the return. Upon probing, RoC came to know that, Swayam intentionally omitted to mention those facts in the return filed. Explain the consequences of Swayam's action under Companies Act, 2013.

(*4 marks*)

(c) Ruhi, Managing Director of Forever Sisters Private Ltd, was the founder of the Company along with her sister and few other friends. The Company was doing well initially, they had raised few rounds of funding from angel investors. After couple of years, Ruhi, was inflating the revenue to honour her commitment to the investors and this continued for more than one year. The investors had a suspicion about the Company's operation and an external audit was conducted, wherein the fraud committed by Ruhi was identified. The investors filed a case against Ruhi for the fraud perpetrated by her. After going through legal challenges for six months, Ruhi wants to settle the case through mediation or conciliation. Referring to the provisions of Companies (Mediation and Conciliation) Rules, 2016, evaluate whether Ruhi will be able to get the case settled through mediation or conciliation.

(*4 marks*)

(d) Prem, the CEO of Pranan Cements Ltd., a cement manufacturing company was allotted an Audi car during the tenure of his employment. He had retired on 31st January, 2023. As per the terms of his employment, he was required to return the car within three months of his ceasing to be in employment i.e., 30th April, 2023. He used his good offices to seek one-year time to return the car to the Company. The Company secretary of the Company was informed about this by one of the Directors. Advise the Company about the actions it can take in such situation.

(*4 marks*)

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

**Question 2A**

(*i*) Snowcap Ltd is aggrieved by an order of National Company Law Appellate Tribunal (NCLAT). On 'question of law', the Company wants to file an appeal against the order and approaches you, a Practising Company Secretary.

Advise the Company :

(a) On the possibility of filing appeal on the basis of question of law

(b) As to where that appeal can be filed and

(c) Limitation period of the appeal against the order.

(*4 marks*)

(ii) Due to some untoward circumstances, Varenya Ltd could not hold Annual General Meeting (AGM) within due date. Audited Financial Statements along with Auditors' Report were not placed at the meeting and later Company failed to file with the Registrar, the Annual Return and copies of Financial Statements within the specified period following AGM. Directors of the Company contended that these are series of offences, but they should be combined into one single offence as they are linked to each other and have continuity of action. With reference to a judicial pronouncement, evaluate whether the contention of the Directors of the Company is appropriate.

(*4 marks*)

(iii) Varah was a Director on the Board of Karunya Jewellers Ltd. The Company was planning to appoint two other directors, one independent director and another executive director. After due procedures, the new directors were appointed and they were familiarized with the operations of the Company. In one of the conversations with a friend, Varah was saying the kind of power, Directors wield in the functioning of the company puts them in a position, where it is not difficult for them to bend the rules and due to this, it is quite possible that they may be involved in fraudulent activities. His friend asked him, if he was upto doing some fraud in Karunya Jewellers Ltd, for which Varah laughed and said I am not doing anything like that, but even if I do it will make other directors liable especially non-executive and independent directors. In the background of Companies Act, 2013, comment whether Varah's perspective is appropriate.

(*4 marks*)

(iv) Namar was appointed as Director (Engineering) in BHAL Ltd. Though he was from engineering background, he had a liking to understand the legal aspects. He had read well about the procedures but required some clarity. In one of the conversations, he asked Company Secretary to brief him about criminal courts in India and their powers. He also asked how Section 435 of Companies Act, 2013 deviates itself from CrPC in Indian Legal System. Prepare a note in this regard.

(*4 marks*)

**Answer 2(a)**

According to Section 67(1) of the Central Goods and Services Tax Act, 2017(CGST Act) where the proper officer, not below the rank of Joint Commissioner, has reason to believe that –

(a) a taxable person has suppressed any transaction relating to supply of goods or services or both or the stock of goods in hand, or has claimed input tax credit in excess of his entitlement under this Act or has indulged in contravention of any of the provisions of this Act or the rules made thereunder to evade tax under this Act; or

(b) any person engaged in the business of transporting goods or an owner or operator of a warehouse or a godown or any other place is keeping goods which have escaped payment of tax or has kept his accounts or goods in such a manner as is likely to cause evasion of tax payable under this Act,

he may authorise in writing any other officer of central tax to inspect any places of business of the taxable person or the persons engaged in the business of transporting goods or the owner or the operator of warehouse or godown or any other place.

In view of the above said provision of CGST Act, it can be said that the action of Bhojraj is not valid as Joint Commissioner has authority to authorise in writing any other officer of central tax to inspect any places of business of the taxable person under Section 67 (1) of the CGST Act, 2017.

**Answer 2(b)**

According to section 448 of the Companies Act, 2013(the Act), save as otherwise provided in this Act, if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—

(a) which is false in any material particulars, knowing it to be false; or

(b) which omits any material fact, knowing it to be material,

he shall be liable under section 447.

Section 447 of the Act provides the provisions relating to Punishment for fraud. As per section 447, 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 involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower 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.

Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

In view of the above said provisions, it can be said that Swayam's action of omitting material facts comes under section 448 and is liable for being punished in accordance with section 447 of the Act.

**Answer 2(c)**

Rule 30 of the Companies (Mediation and Conciliation) Rules, 2016 provides the provision relating to Matters that are not to be referred to the mediation or conciliation.

As per rule 30, the following matters shall not be referred to mediation or conciliation, namely:

(a) the matters relating to proceedings in respect of inspection or investigation under Chapter XIV of the Act; or the matters which relate to defaults or offences for which applications for compounding have been made by one or more parties.

(b) cases involving serious and specific allegations of fraud, fabrication of documents forgery, impersonation, coercion etc.

(c) cases involving prosecution for criminal and non-compoundable offences.

(d) cases which involve public interest or interest of numerous persons who are not parties before the Central Government or the Tribunal or the Appellate Tribunal as the case may be.

In view of the above said rule, it can be said that Ruhi will not be able to get the case settled through Mediation or Conciliation as the investors have filed a case for the fraud against her. Cases involving serious and specific allegations of fraud, fabrication of documents forgery, impersonation, coercion etc. cannot be referred to mediation or conciliation, as per Rule 30 of the Companies (Mediation and Conciliation) Rules, 2016.

**Answer 2(d)**

Section 452 of the Companies Act, 2013 provides the provision relating to Punishment for wrongful withholding of property. It states that:

(1) If any officer or employee of a company—

(a) wrongfully obtains possession of any property, including cash of the company; or

(b) having any such property including cash in his possession, wrongfully withholds it or knowingly applies it for the purposes other than those expressed or directed in the articles and authorised by this Act,

he shall, on the complaint of the company or of any member or creditor or contributory thereof, be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

(2) The Court trying an offence under sub-section (1) may also order such officer or employee to deliver up or refund, within a time to be fixed by it, any such property or cash wrongfully obtained or wrongfully withheld or knowingly misapplied, the benefits that have been derived from such property or cash or in default, to undergo imprisonment for a term which may extend to two years.

Provided that the imprisonment of such officer or employee, as the case may be, shall not be ordered for wrongful possession or withholding of a dwelling unit, if the court is satisfied that the company has not paid to that officer or employee, as the case may be, any amount relating to-

(a) provident fund, pension fund, gratuity fund or any other fund for the welfare of its officers or employees, maintained by the company;

(b) compensation or liability for compensation under the Workmen's Compensation Act, 1923 in respect of death or disablement.

Unless the company decides to grant an extension of time to Prem for return of the car, the Company can file a complaint before the appropriate court under section 452(1) of the Companies Act, 2013 against Prem.

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

**Answer 2A(i)**

According to section 423 of the Companies Act, 2013, any person aggrieved by any order of the National Company Law Appellate Tribunal (NCLAT) may file an appeal to the Supreme Court within sixty days from the date of receipt of the order of the NCLAT to him on any question of law arising out of such order:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

(a) Snowcap Ltd. can file appeal against the order of NCLAT on the basis of question of law.

(b) The appeal can be filed to the Supreme Court.

(c) The appeal can filed within 60 days from the date of receipt of the order. However, the Supreme Court may allow another 60 days in terms of the proviso to section 423.

**Answer 2A(ii)**

Section 220 of the Code of Criminal Procedure, 1973(CrPC) provides the provisions relating to single trial for more than one offence. If, in one series of acts so connected together as to form the same transaction, more offences than one are committed by the same person, he may be charged with, and tried at one trial, for every offence. Section 220 (1) of CrPC could be used when different offences committed by a single person or same persons and the trial could be a combined and held as a single trial.

The Calcutta High Court in Madan Gopal Dey and Anor. v. State and Anor. held that if several offences are committed in the course of the same transaction, section 235 of CrPC would authorize their joinder for the purpose of a single trial. Continuity of action, therefore, seems to be very important test in the matter.

The substance of charges framed is that they failed to hold AGM and that they had failed to place the Audited Financial Statements at the meeting and they had further failed to file with the Registrar the annual return and copies of Financial Statements within the specified periods following the annual general meeting. The requirement of the law in these regards fall into a pattern and the action that is to be satisfy those requirements carries a sense of continuity in the matter of the administration of the company. The defaults and omissions in the present cases constitute a series of acts which are so connected as to form the same transaction and as such whatever offences might have been committed in the course of that transaction are liable to be joined together under section 235 of CrPC for the purpose of single trial.

Hence, it can be said that offences committed by Varenya Limited can be clubbed in single trial. However, they cannot be treated as a single offence, as section 220 provides for a single trail and not for combining of offences.

**Answer 2A(iii)**

Directors are expected to perform in the best interest of the company. However, the kind of power they wield in the functioning of the company puts them in a position where it is not difficult for them to bend the rules and due to this, it is quite possible that they may be involved in fraudulent activities.

Executive directors can usually be caught in the net of suspicion of fraud, since they are hands on involved in the day to day operations of the company and are aware of where there are loopholes in the systems prevalent within the company. However, the non- executive or the independent directors cannot escape responsibility simply by virtue of their position. Section 2(60) of the Companies Act, 2013 (the Act) implicates 'every director' in respect of a contravention of the provisions of the Act who consented to the fraud or is aware of the contravention can become covered within the term 'officer who is in default'.

The method of awareness is also provided for this must be either by participating in the board proceedings without objecting to the same or even by virtue of receipt of proceedings of the board. 'Proceedings of the board' normally be understood to mean the minutes. However, this includes board papers also.

Further, section 149(12) of the Act provides for liability of non-executive and independent directors. It provides as below:

"(12) Notwithstanding anything contained in this Act,–

(i) an independent director; &

(ii) a non-executive director not being promoter or key managerial personnel,

shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently."

Similar provisions are contained in section 27(2) of the SEBI Act, 1992 and regulation 25(5) of SEBI (LODR) Regulations, 2015. Ministry of Corporate Affairs have also from time to time issued circulars to emphasize that non-executive directors and Independent Directors should not be prosecuted unless there's adequate proof that they had knowledge through Board process or that the acts of omission or commission were committed by the company with their consent, connivance or negligence. There is no bar on commencement of prosecution or any other legal proceedings against such directors, they can however be exonerated by the concerned authorities / courts if their bona-fides are proved.

Thus, non-executive and independent directors can be held liable only in those cases which had occurred with their knowledge, attributable through Board processes, AND with their consent or connivance / where they did not act diligently.

Resignation may seem to be the immediate recourse to a non-executive director, but that does not absolve someone from liability, since the *proviso* to section 168(2) of the Companies Act, 2013 clearly provides that the director who has resigned shall be liable even after his resignation, for the offences which occurred during his tenure.

Here's where the attendance registers, board papers and minutes which you thought were mundane, suddenly become relevant. Attendance at the board meeting promptly brings a director within the 'awareness' purview just discussed above. A recording of who attended the meeting, where they did not participate in the discussion and voting and where they dissented is very relevant to affixing liability.

Secretarial Standard on Meetings of the Board of Directors (SS - 1) requires that the draft minutes need to be circulated to all the members of the board of directors, not only those who attended the meeting. Thus, the proceedings of the Board can be available even to those who did not attend the meeting and they can therefore be considered to be aware of a contravention.

Hence, it can be concluded that fraud by one director makes liable every such other director, including non-executive or Independent director, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance; as provided under the definition of "officer who is in default" under Sec 2(60) of the Companies Act, 2013.

**Answer 2A(iv)**

Courts of Magistrates are the basic Courts for conducting trial of criminal offences. In Metropolitan Cities such as Mumbai, Kolkata and Chennai, respectively the capitals of the States of Maharashtra, West Bengal and Tamil Nadu, have special category of Magistrates called Presidency Magistrates / Chief Metropolitan Magistrates.

The following are the powers of Criminal Courts [Section 28 and 29 of Code of Criminal Procedure, 1972(CrPC)]:

| Name of the Court | Power |
|---|---|
| High Court | To award any sentence as authorized by law |
| Sessions Judge / Additional Sessions Judge | To award any sentence authorized by law. Sentence of death shall be subject to confirmation by High Court. |
| Assistant Sessions Judge | To award any sentence authorised by law except a sentence of death or of imprisonment for life or of imprisonment for a term exceeding ten years. |
| Chief Judicial / Chief Metropolitan Magistrate | To award any sentence authorised by law except a sentence of death or of imprisonment for life or of imprisonment for a term exceeding seven years |
| Judicial Magistrates of Class I / Metropolitan Magistrates/ Sub- divisional Judicial Magistrates | To award imprisonment up to 3 years or fine up to INR 10,000/-, or both. |

Deviating from the CrPC, it has been stated that notwithstanding anything contained in CrPC all offences specified under section 435(1) of the Companies Act, 2013 shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned.

A Special Court shall consist of—

(a) a single judge holding office as Session Judge or Additional Session Judge, in case of offences punishable under this Act with imprisonment of two years or more; and

(b) a Metropolitan Magistrate or a Judicial Magistrate of the First Class, in the case of other offences,

who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

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

**Question 3**

(a) Explain whether the following offences under the Companies Act, 2013 are compoundable, if yes, by whom ?

(i) Fraudulently issuing of duplicate share certificate by a company;

(ii) Disobeys the direction issued by the Registrar or Inspector under Companies Act ;

(iii) Company Secretary in practice certifies the Annual return otherwise than in conformity with the requirements of Section 92 or the Rules made thereunder;

(iv) Functioning as a Director after vacation of office.

(*4 marks*)

(b) Amin, Director of Tituto Ltd was penalized by Regional Director (RD) for an offence committed by him under the Companies Act, 2013. There were proceedings before the penalty was

levied on Amin. However, Amin had not learnt his lessons, and he ended up committing the same offence again. This time the matter was again noticed and it went to the RD. The concerned RD penalized him again, but Amin challenged the decision of RD stating that he cannot be penalized for the same offence. In the background of provisions relating to adjudication of penalties, comment whether Amin's contention is correct.

(4 *marks*)

(c) Jeyan, filed an application before Usurla Ltd, for transmission of equity shares held by his father. Jeyan provided the documents requested by the Company for transmitting the shares in the name of his deceased father to himself and his sister Jaya. He received a communication from the Company that the process of transmission has been completed. However, he noticed that his name was not included as 'member' despite providing all the documentation. He filed a petition against the Company for omitting his name from Register of Members 'without sufficient cause'. Discuss and interpret the words 'without sufficient cause' in the background of judicial pronouncements.

(4 *marks*)

(d) Suraj, a public servant was accused of neither depositing nor making entries of Stationery and other inventory required for official purpose. He was in charge of the store in the concerned department at the time of commission of offence. He was accused of committing criminal breach of trust. Can Suraj be held liable for committing criminal breach of trust ? Comment.

(4 *marks*)

***OR (Alternate question to Q. No. 3)***

**Question 3A**

Write short notes on the following :

(i) Shareholder activism

(ii) Whistle blowing and Operational reporting system

(iii) Legal compliance programs

(iv) D & O Insurance for Non-Profit Organisations.

(4 *marks each*)

**Answer 3(a)**

**(i) Fraudulently issuing of duplicate share certificate by a company**

According to section 46(5) of the Companies Act, 2013, if a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447.

According to section 447 of the Act, 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 involving an amount of at least ten lakh rupees or one per cent. of the turnover of the company, whichever is lower 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.

Provided further that where the fraud involves an amount less than ten lakh rupees or one per cent. of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to five years or with fine which may extend to fifty lakh rupees or with both.

In view of the above, it can be said that Offence is compoundable if comes under the purview of 2nd proviso of section 447. The offence can be compounded by National Company Law Tribunal. In any other situation, offences are not compoundable.

**(ii) Disobeys the direction issued by the Registrar or Inspector under Companies Act**

According to section 207(4)(i) of the Companies Act, 2013, if any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

In view of the above provision, it can be said that the offence is non-compoundable.

**(iii) Company Secretary in practice certifies the Annual return otherwise than in Conformity with the requirements of section 92 or the rules made thereunder**

According to section 92(6), if a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be liable to a penalty of two lakh rupees.

In view of the above, the offence is Non-compoundable.

*Alternate answer to above paragraph*

In view of the above, it can be said that the offence is non-compoundable but comes under the purview of Adjudication under section 454 of the Companies Act, 2013.

**(iv) Functioning as a Director after vacation of Office**

According to section 167(2), if a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in subsection (1), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

In view of the above, it can be said that the offence is Compoundable and powers vested with Regional Director or any other officer authorised by Central Government. However, National Company Law Tribunal can also compound this offence.

**Answer 3(b)**

According to rule 3 of the Adjudication of Penalties Rules, 2014, the Central Government may appoint as many officers of the Central Government not below the rank of Registrar, as adjudicating officers for adjudging penalty under the provisions of Companies Act, 2013.

Under Rule 3(2), the adjudicating officer before adjudging penalty, shall issue a written notice in the specified manner, to the company, the officer who is in default or any other person, as the case

may be, to show cause, within such period as may be specified in the notice (not being less than 15 days and more than 30 days from the date of service thereon), why the penalty should not be imposed on it or him.

Every notice issued under rule 3(2), shall clearly indicate the nature of non-compliance or default under the Act alleged to have been committed or made by such company, officer in default, or any other person, as the case may be and also draw attention to the relevant penal provisions of the Companies Act, 2013(the Act) and the maximum penalty which can be imposed on the company, and each of the officers in default or the other person.

The adjudicating officer, after giving the opportunity of being heard, as provided under Rule 3, to such company, officer in default, or any other person, as the case may be may, pass such orders in accordance with Rule 3(7) of the Adjudication of Penalties Rules, 2014 read with Sec 454A.

**PENALTIES FOR REPEATED DEFAULT [SECTION 454A OF THE COMPANIES ACT, 2013]**

Where a company or an officer of a company or any other person having already been subjected to penalty for default under any provisions of this Act, again commits such default within a period of three years from the date of order imposing such penalty passed by the adjudicating officer or the Regional Director, as the case may be, it or he shall be liable for the second or subsequent defaults for an amount equal to twice the amount of penalty provided for such default under the relevant provisions of this Act.

In view of the above provisions, Amin's contention is wrong and the RD can levy penalty for the repeated offence, as there is no such protection available to an offender under the Companies Act, 2013.

## Answer 3(c)

The facts of the given situation are similar to the case of in *Chotoo Sud v. Bhagwan Finance Corpn. (P.) Ltd. [2006] 66 SCL 223 (CLB - KOL.)*. The relevant discussion of this case is as under:

> "Section 111 of the Companies Act, 1956 Transfer of shares - Power to refuse registration and appeal against refusal - Whether a petition under Section 111(4) can be filed by an aggrieved person or company or any member so long as he establishes that name of any person is entered or omitted from Register of Members 'without sufficient cause' - Held, yes"

**Meaning of sufficient cause**

What is without sufficient cause? There are several decisions explaining what sufficient cause is. Some of the decisions are as under:

(a) In Benarsi Das Saraf v. Dalmia Dadri Cement Ltd. AIR 1959 Punj. 232, the words 'sufficient cause' has been considered in detail. Reference was also made to the observations of Lord Cairns, LJ extracted above.

The Court said: "22. The word 'sufficient' means, 'adequate', 'enough', 'as much as may be necessary to answer the purpose intended'. It embraces no more than, that which provides a plentitude which, when done, suffices to accomplish the purpose intended in the light of existing circumstances and when viewed from reasonable standard of practical and cautious men." (p. 235)

(b) In Indian Chemical Products Ltd. v. State of Orissa AIR 1967 SC 253, in paragraph 9, their Lordships said thus:

"(9) The power under article 11 to refuse registration of the transfer is a discretionary power. The directors must exercise this power reasonably and in good faith. The Court can control their discretion if they act capriciously or in bad faith. " (p. 256)

(c) In Smt. Mallina Bharathi Rao v. Gowthami Solvent Oils Ltd [2001] 31 SCL 60 (CLB – CHENNAI), it was held that:

"Whether since company had not only authorised a director to sign transfer instrument on behalf of petitioner but effected transfer without share certificates, entire process of transfer was in violation of mandatory provisions of Section 108 and as such omission of petitioner's name from Register of Members was without sufficient cause - Held, yes - Whether transfer of shares being in contravention of mandatory provisions of Section 108 and consequent omission of petitioner's name being without sufficient cause, company should restore her name on Register of Members in respect of her shares and rectify register accordingly - Held, yes"

(d) In Asha Purandare v. Integrated Controls (P.) Ltd. [2002] 39 SCL 970 (CLB – MUM.), that:

Whether minor typographical omission can be said to be sufficient cause for refusal by company to register transfer of shares in name of petitioners - Held, no"

(e) It was held in Gulshan Mahindru v. Reliance Industries Ltd. [2014] 47 taxmann.com 186 (CLB - Mumbai) that:

Reason attributed by a company for refusal of transmission of shares and rectification of register of members that company had already transferred duplicate shares to its registered owners and shares had been dematerialized, cannot be said to be a sufficient and cogent reason as contemplated under Section 111A.

**Answer 3(d)**

**Criminal breach of trust by public servant, or by banker, merchant or agent (Section 409 of the Indian Penal Code)**

Whoever, being in any manner entrusted with property, or with any dominion over property in his capacity of a public servant or in the way of his business as a banker, merchant, factor, broker, attorney or agent, commits criminal breach of trust in respect of that property, shall be punished with imprisonment for life, or with imprisonment of either description for a term which may extend to ten years, and shall also be liable to fine.

The acts of criminal breach of trust done by strangers is treated less harshly than acts of criminal breach of trust on part of the persons who enjoy special trust and also in a position to be privy to a lot of information or authority or on account of the status enjoyed by them, say as in the case of a public servant. In respect of public servants a much more stringent punishment of life imprisonment or imprisonment up to 10 years with fine is provided. This is because of special status and the trust which a public servant enjoys in the eyes of the public as a representative of the government or government owned enterprises.

The persons having a fiduciary relationship between them have a greater responsibility for honesty as they have more control over the property entrusted to them due to their special relationship. Under this section the punishment is severe and the persons of fiduciary relationship have been classified as public servants, bankers, factors, brokers, attorneys and agents.

In view of the above, Suraj can be held Liable for criminal breach of trust.

***OR (Alternate question to Q. No. 3)***

**Answer 3A(i)**

Shareholder activism is strengthened due to recent changes in Corporate Laws including the Company Act, 2013. These laws empowered the minority shareholders, which in turn, have

protected them and empowered them to present their viewpoints to the Board of Directors and more actively protect their interest.

The following factors have played a pivotal role in fostering shareholder activism in India:

- **Electronic Voting:** With the dawn of electronic age, where the distances around the world have been compressed by the use of internet, the Companies Act, 2013 has acknowledged the need to bring the advantage of technology to voting system of companies in order to enable the shareholders to be active in the decision making of the company.
- **SEBI Regulations:** Regulation 44 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, provides that the listed entity shall provide the facility of remote e-voting to its shareholders, in respect of all shareholders, resolutions. Further the listed entity shall submit to the stock exchange, within 2(two) working days of conclusion of its General Meeting the details regarding the voting results in the prescribed format.
- **Approval of Related Party Transaction by Shareholders:** A company shall enter into any contract or arrangement with a related party subject to the prescribed conditions, which inter alia requires that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a resolution of Shareholders.

***Alternate answer 3A(i)***

Shareholder activism is a phenomenon which has been gaining prevalence not only in India but the world over. It refers to a concept within corporate governance, where the shareholders of a company become more proactively involved in the functioning and management of the company that they have made investments in. It is a form of activism in which shareholders use equity stakes in a corporation to put pressure on its management. For instance, shareholder activists may prompt businesses with surplus profit to boost dividend dispersal among investors. The other financial reasons for activism may include cost-cutting, corporate restructuring, executive appointment, remuneration, etc. Besides seeking to change corporate financial policies, shareholders may also appeal to the corporation to look into its social performance like environmental reporting, discrimination, etc.

The Companies Act, 2013 ("Act"), through sections 241 to 246, provides a robust legal framework for the protection of minority shareholders against oppression and mismanagement.

**Benefits of Shareholder Activism**

One of the primary benefits of shareholder activism is that it encourages companies to be more accountable to their shareholders. This approach compels companies to be more transparent in their operations, which can lead to better decision-making and ultimately, better returns for shareholders.

Constant monitoring by the shareholders keeps the management on its toes and ensures the optimal utilization of the company's resources through methodical governance.

As a result, the company's performance improves, thereby improving its profitability and enhancing its shareholder value in the long run. Hence, both for the company and its shareholders stand to benefit from shareholder activism.

Moreover, this phenomenon also aids in resolving leadership-shareholder problems to foster a trustworthy and prosperous business environment. Consequently, the corporation's market position alleviates augmenting its prospects further.

**Risks of Shareholder Activism**

One of the main risks associated with shareholder activism is the potential for conflict between the activist and the company's management. Activists may push for changes that the management is not willing to make, which can lead to a breakdown in communication and a loss of trust. Additionally, shareholder activism can be expensive and time-consuming, which can divert resources away from other investments.

**Different Perspectives on Shareholder Activism**

There are different perspectives on the role of shareholder activism in corporate governance. Some investors believe that activism is necessary to hold companies accountable, while others argue that it can be disruptive and counterproductive. Some companies view shareholder activism as a threat to their autonomy, while others see it as an opportunity to engage with their shareholders and improve their operations.

Shareholder activism can be a powerful tool for investors who are seeking to influence the decision-making process of the companies in which they hold stakes. While there are risks associated with this approach, the benefits can be significant if done correctly. Investors who are considering engaging in shareholder activism should carefully weigh the potential benefits and risks before making any decisions.

## Answer 3A(ii)

**Whistle blowing**

That an established vigil mechanism and its reporting methods finds a specific mention in the provisions of section 177(9) of the Companies Act, 2013 and that the LODR requires listed entities to devise effective whistle blower mechanism, reflects on how necessary the lawmakers think these systems are. It is so important that the Act expressly requires that whistle blowers be provided direct access to the Chairman of the Audit Committee and for adequate safeguards to avoid victimisation of the whistle blowers. The ineffective protection mechanisms for whistle blowers might result in creating an atmosphere of fear for whistle blowers. However, it still does not stop some crusaders from going ahead and blowing off the lid of corruption. The stronger the protection to the whistle blowers, more can be the chances of early fraud detections.

**Operational reporting system**

A reporting system that is operational and effective can be helpful in reducing fraud in companies. Employees should be aware of the reporting system if they need to report any kind of suspicious activity. A reporting system that keeps the person reporting the fraud anonymous might be more fruitful as it will keep the identity of the employee private while reporting his/her colleague. To make this system more beneficial, the employees should be encouraged and ensured that they won't land in trouble if they report anything that sparks doubt in their head.

## Answer 3A(iii)

**Legal Compliance Programs**

Senior management should provide the board or committee with an appropriate review of the company's legal compliance programs and how they are designed to address the company's risk profile and detect and prevent wrongdoing. While compliance programs will need to be tailored to the specific company's needs, there are a number of principles to consider in reviewing a program. A compliance program should be designed by persons with relevant expertise and will typically include interactive training as well as written materials. Compliance policies should be reviewed periodically to assess their effectiveness and to make any necessary changes. Policies

and procedures should fit with business realities. A rulebook that looks good on paper but is not followed will end up hurting rather than helping. There should be consistency in enforcing stated policies through appropriate disciplinary measures. Finally, there should be clear reporting systems in place both at the employee level and at the management level so that employees understand when and to whom they should report suspected violations and so that management understands the board's or committee's informational needs for its oversight purposes. A company may choose to appoint a chief compliance officer and/or constitute a compliance committee to administer the compliance program, including facilitating employee education and issuing periodic reminders. If there is a specific area of compliance that is critical to the company's business, the company may consider developing a separate compliance apparatus devoted to that area.

**Answer 3A(iv)**

**D & O Insurance for Non-Profit Organisations**

Large numbers of directors and officers for non-profit organizations lack experience. Often times, they also lack sufficient knowledge of their legal duties and responsibilities regarding the non-profit they serve. Directors and officers of non-profit organizations who do have knowledge or experience sometimes take advantage of the less formal approach of non-profits and fail to take the same business approaches to decision-making as they would when working for a for-profit corporation.

It is critical for non-profit board directors and officers of all types and sizes of non-profit organizations to understand that not all of their actions are fully protected by the law. Non-profit boards that fail to protect their organizations with a D&O insurance policy, may find that the cost of just one claim is far larger than the cost of any insurance premiums they would have paid, if they had purchased a D&O insurance policy.

D&O insurance will not prevent claims from occurring; however, it does mitigate the high costs associated with defending claims. Lawsuits and potential claims may originate with vendors, donors, competitors, employees, government regulators or others.

According to Massnonprofit.org, D&O insurance protects against, "Any actual or alleged act or omission, error, misstatement, misleading statement, neglect or breach of duty by an insured person in the discharge of his/her duties." It also covers personnel issues, including discrimination, wrongful termination, harassment, failure to provide services and mismanaging assets.

D&O insurance policies are common and necessary to cover the actions and decisions of board directors and officers. D&O insurance policies offer coverage for defence costs, settlements, judgments arising from lawsuits and wrongful allegations brought against the non-profit organisations.

The cost of D&O insurance policies is determined by many factors, including the potential degree of risk and the size of the non-profit organisation. Boards may also reduce some of the costs of the policy by working with insurance companies to mitigate certain risks. Boards that have clearly written policies for hiring, firing and other issues will be viewed as less risky by insurance companies. Lower risk factors typically equate to lower insurance premiums.

Board directors should take care to understand their D&O insurance policies. Specifically, they need to be familiar with policy wording for directors and officers, as well as any additions, conditions and exclusions listed within the policy wording.

Non-profits organisations may consider inviting an insurance professional to make a presentation to the board on D&O insurance as part of board development.

In summary, regardless of the organization's size and board experience, all non-profit organizations need to purchase D&O insurance protection. In addition to a D&O insurance policy, all non-profit

boards should develop an effective risk management plan to protect individual directors, protect the organization and prevent claims against the D&O insurance policy.

**Question 4**

(a) 'Public prosecutors are to be independent, unbiased and impartial while conducting prosecution.' Explain the distinction between Public Prosecutors and Company Prosecutors.

(b) 'Minor defects in order or judgement will not rescue a prosecution which is *void ab initio*.' Explain.

(c) 'Class action suit is a new mechanism in India to claim the loss caused to the specified stakeholders of the Company, not only from the Company but also from other entities.' Explicate.

(d) 'No warrant can be issued for recovery of fines.' Elucidate.

(*4 marks each*)

**Answer 4(a)**

Criminal cases are prosecuted by the State representing the public and the society. Public prosecutors carry out the prosecution in such cases. The role of a prosecutor lies in placing before the Court all the material and evidences, whether it helps the accused or otherwise.

In *S Thamizharasan v. The State of Tamil Nadu*, the Madras High Court held that –

> "the Office of the Public Prosecutor is a very responsible office and he has an important role to play in the Criminal Justice Delivery System. Public prosecutors are to be independent, unbiased and impartial while conducting prosecution. The Public Prosecutor is not a Police Prosecutor in the sense that he is not a mouthpiece of the Police, for he is not an Advocate engaged by the State to conduct its prosecutions. Therefore, the Prosecutors cannot be allowed to be controlled either administratively or in any other mode by the Police Department." It was further held that "as held repeatedly by the Hon'ble Supreme Court and various High Courts that there should be complete separation of Public Prosecutors, Additional Public Prosecutors, Special Public Prosecutors and Assistant Public Prosecutors from the control or supervision in any form by the Police, as otherwise, such control or supervision would only invade into the independence of the institution of Prosecutors, which would only bring harm to the Criminal Justice Delivery System".

As held by Supreme Court in *Balwant Singh and Ors. v. State of Bihar*, Criminal Procedure Code is the only matter of the Public Prosecutor and he has to guide himself with reference to Criminal Procedure Code only.

When a Registrar or any other person duly authorized/ entitled, to file a complaint for any offence under the erstwhile Companies Act, 1956 files a complaint, the prosecution is conducted in the trial Court by a special category of officers called Company Prosecutors. The company prosecutors have all the powers and privileges of public prosecutors appointed by State Government under section 24 of the Criminal Procedure Code, 1973.

Also, under the provisions of Section 443 of the *Companies Act, 2013* it has been provided that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Central Government may appoint generally, or for any case, or in any case, or for any specified class of cases in any local area, one or more persons, as company prosecutors for the conduct of prosecutions arising out of this act and the persons so appointed as company prosecutors shall have all the powers and privileges conferred by the Code on Public Prosecutors appointed under section 24 of the Code.

**Answer 4(b)**

Where there is any error, omission or irregularity in the complaint, summons, warrant, proclamation, order, judgement or other proceedings in a trial or in commencing a prosecution, it will not affect any finding, sentence or order passed by a Court of competent jurisdiction. The above protection has been enshrined in section 465 of the Code of Criminal Procedure, 1973 (CrPC).

As held by many High Courts, if there is any defect in compliance of the requirements of section 251 of CrPC, such as a mere omission to state the particulars of an offence to an accused, such defect cannot be construed to be fatal to the case and it is not an illegality to vitiate the trial, provided no prejudice can be shown to have been caused to the accused. Such defect may be mere omission or irregularity curable under section 465 of CrPC. However, it should be mentioned that the above protection will not rescue a prosecution which is *void ab initio*.

**Answer 4(c)**

A Class Action Suit is a new mechanism to claim the loss caused to the specified stakeholders of the company not only from the company but also from other entities. Various persons / entities against whom such actions can be taken are:

- A company or its director for any fraudulent, unlawful or wrongful act or omission.
- An auditor including audit firm of a company for any improper or misleading statement of particulars made in the audit report or for any unlawful or fraudulent conduct.
- An expert of advisor or consultant for an incorrect or misleading statement made to the company.

It is pertinent to note that the definition of the expert is wide under the Companies Act, 2013 which includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force. However, the advisors or consultants are not provided, thus the definitions of the same will be derived from judicial precedence and use of the same in common parlance.

**Answer 4(d)**

As per section 421 of the Code of Criminal Procedure, 1973 (CrPC), where an offender has been sentenced to pay a fine, the Court has the authority to issue a warrant for the levy of the amount by attachment and of any movable properly belonging to the offender and further can issue a warrant to the Collector of the District authorizing him to realize the amount as arrears of land revenue or movable or immovable property or both of the defaulter.

It is possible to invoke the inherent powers of the High Court under section 482 of CrPC for recalling a warrant also. The Orissa High Court in *Hrushikesh Panda v. State of Orissa and Ors. [1997] 89 Comp Cas 613 (Ori)*, setting aside a non-bailable warrant of arrest as well as a distress warrant issued against the petitioner in order to realise a fine levied on the company of which he was the Managing Director, held that the fine has been imposed on the company and it is the liability of the company to pay the same. The High Court further held that the liability of the company is distinct from the liability of its managing director. Once it is concluded that the company has its own liability, the realization of fine has to be made from the company. The mode for realisation is provided under section 421 of CrPC.

The High Court further held that legal dues of a company could be realized only by attaching the assets of the company and not by putting the managing director or any of the directors in prison. It is to be kept in mind that the company is the offender or the defaulter. The issuances of a non-

bailable warrant or distress warrant against the managing director or director to realize the same is not permissible.

Dismissing a petition under section 482 of CrPC seeking to recall warrants issued against the petitioner for alleged cheating of the public by accepting and failing to repay deposits, the Hon'ble Madras High Court in S. Shreenivasa Rao alias S.S.Rao v. Inspector of Police [2002] 109 Comp Cas 406 (Mad) held as follows:

*"Where the petitioner was arraigned as a party to criminal conspiracy and cheating, it was immaterial whether the petitioner was a director of that Company or its group companies in as much as such criminal conspiracy could be hatched even by any person who need not necessarily be a director of the Company or its group of companies as there were materials available to show that the funds of the Company and its group companies were diverted to another Company of which the petitioner was admittedly a director. Therefore, it would not be proper for the Court to lift the corporate veil and to analyse the contentions of the petitioner in a petition under Section 482. "*

However, the Hon'ble High Court gave liberty to the petitioner to move the Court of additional Chief Metropolitan Magistrate to recall the warrant invoking section 70(2) of CrPC.

**Question 5**

(a) Niruthan and Vanithan, were two close friends and IITians. They had founded a company together called Valuin Technologies Private Ltd, which was a start-up. The Company started to grow in terms of its service offerings and so did its value. It also got some institutional investors who were planning to invest in the Company. For the purposes of due-diligence, the investors appointed KnowY Consultants LLP. The Consultants reviewed the documentation and other aspects and carried out a detailed due-diligence. During their review, it was noticed the Company had not made certain filings in a timely manner and missed filing few documents with the Registrar. The Senior Manager of KnowY, a close friend of Niruthan, informed him about the non-compliances and suggested that, these should be rectified at the earliest. Niruthan reached out to Kanak, a Senior Company Secretary for his inputs on this matter. Kanak suggested that, compounding of offences would be appropriate at this juncture to ensure we correct the non-compliances. However, Niruthan, was apprehensive as compounding would indicate that they are guilty. Kanak explained to him that, compounding is an admission of guilt either voluntarily or on receipt of notice of default or initiation of prosecution. Thus, it can be said that Compounding is essentially a compromise or arrangement between the administrator of the enactment and person committing an offence. In this background, prepare a detailed note, explaining the need for compounding, key benefits of compounding and the process for compounding an offence.

(8 *marks*)

(b) Prethona Financial Services Ltd., was a company providing financial services, and had offices located across all the major cities in India. Considering the nature of the industry it was functioning, the Company required funds to expand its operations to the Tier II and Tier III cities in India. The management was evaluating various options to raise funds including public offer of its securities. They appointed consultants to support them in this process. After due deliberations, the Company finalized that it would go for IPO in next two years and the finance team was asked to do the ground work for the same. As a part of preparatory activities, they also appointed Rakshak on the Board of the Company as a Director, who was on board of many global corporates. In one of the meetings with the management and the consultants, Rakshak recommended that the board needs to design a risk management system which is critical for its risk oversight. In this context, he requested the consultants to do a detailed study of corporate governance issues and risk management intricacies in financial

institutions. You are part of the consultant team, and the manager asks you to prepare a detailed note on common risk management issues in relation to corporate governance in financial institutions and review mechanisms which are necessary for the Board of Directors.

*(8 marks)*

**Answer 5(a)**

Compounding of an offence is an opportunity given in the Corporate laws, to the Companies or any of its Officers, to make good the non-compliance committed by them. The legislative construct is expected to provide for the guiding legal provisions and also allow a scope to rectify mistakes if any, committed inadvertently. Accordingly, it was considered necessary (also by the Rajinder Sachar Committee) that there is greater need of flexibility in the administration of the Corporate Laws, particularly its penal provisions not only because large number of defaults are of technical nature but also because they arise out of ignorance of the lengthy and bewildering complexity of the legal provisions. Therefore, the concept of compounding of offences was incorporated in the law as a measure to avoid the long-drawn process of prosecution, which would save both cost and time in exchange of payment of a penalty.

Compounding is not defined in Companies Act or FEMA or SEBI laws. On perusal of various legal provisions relating compounding, it can be noted that compounding is an admission of guilt either voluntarily or on receipt of notice of default or initiation of prosecution. The defaulters agree to pay penalty which may be ordered by the Compounding authority to be paid.

As per the Black's Law Dictionary, to "Compound" means "to settle a matter by a money payment, in lieu of other liability." As per this definition Compounding is akin to a Settlement Mechanism, a settlement by paying the penalty in lieu of facing the prosecution for the offence committed.

Compounding is essentially a compromise or arrangement between administrator of the enactment and person committing an offence.

**Benefits of Compounding**

- Buy peace of mind.
- Generally, compounding amount is not be treated as fine.
- Speedy disposal of offences and justice
- Judiciary can devote more time and concentrate on serious cases
- No need to appear before prosecution authorities. It provides comfort to individuals and corporates and persons connected with it.
- Amount paid as compounding fee under law for can be claimed as a tax deduction under the Income Tax Act while a penalty paid for contravention is not eligible for deduction

**Procedure for Compounding**

(a) **Board Meeting:** Call for a board meeting to decide on compounding as per the CA, 2013.

(b) **Quantification of Fine:** Arrive at the amount of the fine involved as per the relevant section(s)

(c) **Resolutions:** Hold the Board Meeting and pass resolution(s) to compound and provide for preparation and providing necessary authorization for compounding.

(d) **Application:** Every application for the compounding of an offence shall be made to the Registrar who shall forward the same, together with his comments thereon, to the Tribunal or the Regional Director or any officer authorized by the Central Government, as the case maybe. The filing with Registrar of Companies (ROC) is done in the e-from GNL-1 prescribed

for this purpose. Also deliver sufficient number of hard copies of the compounding application to ROC for him to forward it to Regional Director (RD)/Tribunal (NCLT) based on the quantum of fee involved.

(e) **Personal Hearing:** There will be a personal hearing before the Regional Director or Tribunal which will decide the amount to be paid for compounding.

(f) **Order:** Get the order passed by the RD/ NCLT and pay the amount stipulated within the time fixed.

(g) **Filing**: File Order of RD/NCLT with ROC in form INC-28 and ROC will take note of the same.

**Answer 5(b)**

Several large companies and financial institutions worldwide no longer exist or have been taken over precisely because they neglected the basic rules of risk management and control. Some common risk management problems in relation to corporate governance that appeared in many financial institutions before and during the crisis according to the OECD (2009) was because:

- Risks were frequently not linked to strategy which is a key issue to ensuring that risk management has a focus on the business context;
- Risk definitions are often poorly expressed. Better risk definitions (context, event, consequence) are contrary to a lot of current thinking in risk management which has shorten risk descriptions to the smallest number of words possible;
- Organizations weren't always in a position to develop intelligent responses to risks;
- Boards didn't take stakeholders and guardians into account in detailing responses to risk;
- Important parts of the value chain were outsourced to others.

To accomplish all these, certain review mechanisms are necessary on the part of the board, which have been detailed in COSO's 2010 progress report; the board must, *inter alia*, review:

- The company's procedures for (a) identifying when risks arise and (b) the actions to be taken if material risks arise;
- The quality and types of risk-related information provided to the board;
- Management's implementation of the company's risk policies and procedures and their communication across the firm;
- The company's risk management functions;
- Reports from internal and external experts, such as auditors, legal counsel and analysts, to ensure that appropriate risks are being considered;
- Whether the board members primarily tasked with risk oversight have the necessary experience, knowledge and expertize to oversee the company's risk management matters, and provide directors risk education as necessary;
- The qualifications and backgrounds of risk management personnel and policies applicable to the risk management personnel, to access whether they are appropriate in their positions while giving consideration to the companies size and scope of operations.

**Question 6**

(a) An investigation has been initiated against Terla Mart Private Ltd under section 210 of the Companies Act, 2013. Mohana, the Managing Director of Company, was of the view that the Company has not committed any default or offence, hence no documents need to be

furnished for inspection. She also refused to produce books of accounts before the inspector and did not obey the direction issued by the inspector. She discussed the matter with her friend Suhana, a Company Secretary, who informed her that she would have to face penal consequences for refusing to furnish the books of accounts to the inspector. Explain the penal provisions, which Mohana may have to face under the Companies Act, 2013.

(4 *marks*)

(b) Meroz is accused for certain violations under SEBI Act, 1992. While prosecution is in progress, SEBI observed that she has been co-operating in the inquiry and has made full and true disclosure of facts in respect of the alleged violations. Convinced by her behavior and approach, Board recommends Central Government to grant her immunity from prosecution for any offence. In this background, answer the following :

- Can Board make such recommendation to Central Government ?
- Is such recommendation binding on Central Government ?
- What if after getting immunity from prosecution for such offence, Central Government came to know that true disclosure made by her to Board were actually false disclosure ?

(4 *marks*)

(c) Apramey is a qualified Company Secretary and is employed in SEBI as rank of a Division Chief . While conducting an enquiry, he noticed that IIL Ltd, a stock broking firm had failed to issue contract notes in the form and manner specified by the stock exchanges of which it is a member and also charges an amount of brokerage which is in excess of the brokerage specified in the regulations.

SEBI asked Apramey to issue notice to IIL Ltd. for penalties. Briefly explain the penalty which can be levied on IIL Ltd. and the factors to be considered while adjudging quantum of penalty.

(4 *marks*)

(d) Meharban was involved in developing an online betting app. He was also actively involved in other activities like online cricket betting and gambling activities, in relation to which he committed acts which constitutes money-laundering. Rafi, his close aid and confidante worked closely with Meharban and was aware that the funds he used for the purposes of betting was not legal. Rafi had a fight with Meharban on some trivial issue, for which he was so angry, that he went and informed about his activities by way of anonymous letters to various regulators. Upon receipt of information, the Directors authorised under Section 17 of Prevention of Money Laundering Act, 2002 went to conduct search and seizure procedure in Meharban's premises, under the Act. Meharban contended that the Directors authorised, did not have the jurisdiction to conduct search. Is Meharban's contention justified ?

(4 *marks*)

**Answer 6(a)**

As per section 217(6) of the Companies Act, 2013,

(i) If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

(ii) If a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company.

Further According to section 217(8) of the Act, if any person fails without reasonable cause or refuses–

(a) to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty under section 217(1) or section 217(2) to produce;

(b) to furnish any information which is his duty under section 217(2) to furnish;

(c) to appear before the inspector personally when required to do so under section 217(4) or to answer any question which is put to him by the inspector in pursuance of that sub-section; or

(d) to sign the notes of any examination referred to in section 217(7),

he shall be punishable with imprisonment for a term which may extend to six months and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, and also with a further fine which may extend to two thousand rupees for every day after the first during which the failure or refusal continues.

Mohana may have to face the abovementioned consequences.

**Answer 6(b)**

Section 24B of the Securities and Exchange Board of India Act, 1992 (SEBI Act)

(1) The Central Government may, on recommendation by the Board (SEBI), if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation:

Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:

Provided further that recommendation of the SEBI under this sub-section shall not be binding upon the Central Government.

(2) An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

In view of the above, it can be said that:

(i) Yes, Board can recommend Central Government to grant Meroz immunity from prosecution initiated for violations under the SEBI Act, 1992.

(ii) No, recommendation of the SEBI under this section 24B shall not be binding upon the Central Government.

(iii) If Central Government is satisfied that Meroz in the course of the proceedings had given false evidence, immunity granted may be withdrawn at any time by the Central Government and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under SEBI Act to which such person would have been liable, had not such immunity been granted.

**Answer 6(c)**

According to section 15F of the Securities and Exchange Board of India Act, 1992, if any person, who is registered as a stock broker under this Act:

(a) fails to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees for which the contract note was required to be issued by that broker;

(b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;

(c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

According to section 15J, while adjudging quantum of penalty under 15-I or section 11 or section 11B, the Board(SEBI) or the adjudicating officer shall have due regard to the following factors, namely :

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

**Answer 6(d)**

Section 17 of the Prevention of Money-laundering Act, 2002(PMLA, 2002) provides the provisions relating to Search and seizure. It states that:

(1) Where the Director or any other officer not below the rank of Deputy Director authorised by him for the purposes of this section, on the basis of information in his possession, has reason to believe (the reason for such belief to be recorded in writing) that any person—

(i) has committed any act which constitutes money-laundering, or

(ii) is in possession of any proceeds of crime involved in money-laundering, or

(iii) is in possession of any records relating to money-laundering, or

(iv) is in possession of any property related to crime,

then, subject to the rules made in this behalf, he may authorise any officer subordinate to him to—

(a) enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such records or proceeds of crime are kept;

(b) break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by clause (a) where the keys thereof are not available;

(c) seize any record or property found as a result of such search;

(d) place marks of identification on such record or property, if required or make or cause to be made extracts or copies therefrom;

(e) make a note or an inventory of such record or property;

(f) examine on oath any person, who is found to be in possession or control of any record or property, in respect of all matters relevant for the purposes of any investigation under this Act.

In view of the above, it can be said that the contention of Meharban is not justified, since the search and seizure at his premises was conducted by Directors duly authorized under Sec 17 of the PMLA, 2002.