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# ICSI GUIDELINE ANSWERS



Padhai Kar Befikar

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# GUIDELINE ANSWERS

## PROFESSIONAL PROGRAMME

Syllabus 2017

*Padhai Kar Befikar*

DECEMBER 2024

### MODULE 3



**THE INSTITUTE OF  
Company Secretaries of India**

**भारतीय कम्पनी सचिव संस्थान**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**

Statutory body under an Act of Parliament

(Under the jurisdiction of Ministry of Corporate Affairs)

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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.

*Padhai Kar Befikar*

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:

<b>CS Examinations</b>	<b>Applicability of Amendments to Laws</b>
December Session	upto 31 May of that Calendar year
June Session	upto 30 November of previous Calendar Year

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# CORPORATE FUNDING AND LISTINGS IN STOCK EXCHANGES

## MODULE 3 PAPER 7

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer All Questions.

### PART-A

#### Question 1

(a) Maxima Limited proposes to issue a 5 crore specified securities offered @ ₹ 400 per share. The total specified securities offered, also include offer made to :

- Qualified Institutional Buyers (QIBs)–3 crore specified securities
- Retail Individual Investors (RII) – 50 lakh specified securities.

Considering the above facts, comment on :

- (i) How many specified securities can Mr. X (a retail investor) apply in the net offer category?
- (ii) What is the maximum number of specified securities which non-institutional investors can apply in the said issue ?

(5 marks)

(b) ABC Ltd. is considering a right issue by issuing one equity share against two existing equity shares to raise funds for financing a new project requiring ₹ 10 crore. The floatation cost will be 15% of funds raised. The company currently has equity share capital of ₹ 2 crore divided into shares of ₹ 10 each fully paid and the current market price of its share is ₹ 250. The offer price for right has been fixed at ₹ 100 per share.

- (i) Calculate the fair value of a right and number of right shares that will be issued.
- (ii) Will the amount raised be sufficient for the new project ? Explain.

(c) Ms. Roopa Engineer who graduated recently has a good knowledge of financial market. She planned some experiment under regulatory environment to start a Fin Tech startup. Can she do this experiment ? Explain with respect to the framework for Regulatory Sandbox as issued by SEBI.

(5 marks)

#### Answer 1(a)

- (i) As per Regulation 2(1)(z)(vv) of SEBI (Issue of Capital and Disclosures) Requirements Regulations, 2018, 'retail individual shareholder' means a shareholder who applies or bids for specified securities for a value of not more than two lakhs rupees. Mr. X as an Retail Individual Investor (RII), can apply for specified securities for a value of up to ₹ 2 Lakhs in the category of RII which is 50 lakh specified securities in the given case.
- (ii) As per Regulation 47 of SEBI (Issue of Capital and Disclosures Requirements) Regulations, 2018 a person shall not make an application in the net offer category for a number of specified

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securities that exceeds the total number of specified securities offered to the public. However, the maximum application by non-institutional investors shall not exceed total number of specified securities offered in the issue less total number of specified securities offered in the issue to qualified institutional buyers.

Accordingly, the maximum number of specified securities which a non-institutional investor can apply are:

Securities offered in the issue	5 crore
Less: Securities offered to QIB	3 crore
Net available to non-institutional investors	2 crore

Thus, the number of specified securities which non-institutional investors can apply shall not exceed 2 crore.

**Answer 1(b)**

$$(i) \text{ Fair Value of a right} = \frac{\text{Market price} - \text{offer price}}{\text{Original holding} + \text{Rights}}$$

$$= \frac{\text{₹ } 250 - \text{₹ } 100}{2 + 1} = 150/3 = \text{₹ } 50 \text{ per share}$$

**Alternate answer**

$$\text{Value of Right} = [\text{Number of Rights Shares} / \text{Total shares (Old + New Holdings)}] \times [(\text{Market Value} - \text{Right issue price})]$$

$$= (1/3) \times (\text{₹ } 250 - \text{₹ } 100) = \text{₹ } 50 \text{ per share}$$

**Number of right shares to be issued:**

Equity capital of the company is ₹ 2 crore of ₹ 10 each fully paid (i.e. 20 lakh shares).

Since the ratio of rights issue is given (1:2), it means the number of shares to be issued on rights issue is fixed. Also, the offer price is fixed at ₹ 100.

Therefore, 10 lakh shares will be issued (of ₹10 each) at ₹100.

$$(ii) \text{ Fund raised from right issue} = \text{Number of right shares} \times \text{offer price}$$

$$= 10,00,000 \times \text{₹ } 100 = \text{₹ } 10 \text{ crore}$$

Since the company requires ₹10 crore for financing a new project, the amount raised will be sufficient.

**Answer 1(c)**

Ms. Roopa Engineer can conduct her financial market experiment under SEBI's regulatory environment provided it involves innovative technology or processes related to the securities market, complying eligibility criteria and application is evaluated and approved by SEBI.

The entities registered by SEBI under the regulatory sandbox, shall be granted certain facilities and flexibilities to experiment with financial technologies (Fintech) solution in a live environment and on limited set of real customers for limited time frame. These features shall be fortified with necessary safeguard for investor protection and risk mitigation.

SEBI believes that encouraging adoption and usage of Fintech can act as an instrument to further develop and maintain an efficient, fair and transparent securities market ecosystem. The framework for 'Regulatory Sandbox' as issued by SEBI provides for the following aspects:

- Applicability
- Eligibility criteria of project
- Application and approval process
- Evaluation criteria
- Regularly exemption
- Submission of test related information and report
- Obligation of the applicant towards the user
- Extending or exiting the Sandbox
- Revocation of the approval, and
- Regulatory sandbox application form.

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

### Question 2

- (a) The Real Estate Investment Trust (REIT) is an investment vehicle that invests in rent yielding completed real estate properties which has the potential to transform the Indian real estate sector. What are the eligibility criteria to sponsor a REIT ?
- (b) SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2023 introduced "Minimum Unitholding Requirement" for sponsors and sponsor groups of REIT. Explain the revised regulations.
- (c) (i) What do you understand by "social impact fund" and "social units" under SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2022 ?
- (ii) Briefly explain the provisions of Regulation 10 and Regulation 16 as per the amendment.
- (5 marks each)

### Answer 2(a)

#### Eligibility Criteria to Sponsor a REIT

- (i) Each sponsor shall hold or propose to hold not less than 5% of the number of units of the REIT on post-initial offer basis. Further, each sponsor and sponsor group shall be clearly identified in the application of registration to SEBI and in the offer document/placement memorandum, as applicable.
- (ii) For each sponsor group not less than one person shall be identified as a sponsor.
- (iii) Out of the entities categorized as sponsor group, only the following entities may be considered:
- a) a person or entity who is directly or indirectly holding an interest or shareholding in any of the assets or SPVs or holding companies proposed to be transferred to the REIT.
  - b) a person or entity who is directly or indirectly holding units of the REIT on post-issue basis.
  - c) a person or entity whose experience is being utilized by the sponsor for meeting the eligibility conditions required under REIT regulations.

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- (iv) The sponsor(s), on a collective basis, have a net worth of not less than ₹ 100 crore. However, each sponsor to have a net worth of not less than ₹ 20 crore.
- (v) The sponsor or its associate(s) has not less than five years' experience in development of real estate or fund management in the real estate industry; However, where the sponsor is a developer, at least two projects of the sponsor must have been completed.

### Answer 2(b)

#### Minimum Unitholding Requirement for sponsors and sponsor groups as per SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2023

The revised regulation mandates that sponsor(s) and sponsor group(s) collectively hold not less than:

- 15% of total units of REIT for three years from the date of listing of units in the initial offer. If it exceeds 15% by any sponsor or sponsor groups, it shall be held for a period of not less than one year from the date of listing of units issued in initial offer.
- 5% of total units of REIT from beginning on 4<sup>th</sup> year till the end of 5<sup>th</sup> year from the date of listing of the units issued in the initial offer.
- 3% of total units of REITs from beginning of 6<sup>th</sup> year till the end of 10<sup>th</sup> year from the date of listing of the units issued in the initial offer.
- 2% of total units of REITs from the beginning of 11<sup>th</sup> year till the end of 20<sup>th</sup> year from the date of listing of the units issued in the initial offer.
- 1% of total units of REIT after completion of 20<sup>th</sup> year from date of listing of units issued in the initial offer.

However, the maximum value of the units to be held by the sponsor(s) and sponsor group(s) for compliance shall not exceed ₹500 crore. The units required to be held as mentioned above shall be locked in and shall not be encumbered.

### Answer 2(c)

- (i) SEBI vide its SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2022 introduced the definition "social impact fund" and "social units". 'Social Impact Fund' means an Alternative Investment Fund which invest primarily in securities, units or partnership interest of social venture or securities of social enterprise and which satisfies the social performance norms laid down by the fund.

'Social units' mean unit issued by the social impact fund or scheme of social impact fund who have agreed to receive only social return and no financial returns against their contribution.

- (ii) **Regulation 10** of SEBI (Alternative Investment Funds) Regulations, 2012, deals with Investment in Alternative Investment Fund which provides that the Alternative Investment Fund may raise funds from any investor whether Indian, foreign or non-resident Indians by way of issue of units. However, a social impact fund or schemes of a social impact fund may also issue social units. Each scheme of the Alternative Investment Fund shall have corpus of at least ₹ 20 crore. Provided that each scheme of the social impact fund shall have a corpus of at least ₹ 5 crore. The Alternative Investment Fund shall not accept from an investor, an investment of value less than one crore rupees. Minimum value of Investment for employee or directors of the Alternative Investment Fund or employees or directors of the Manager shall be five lakh rupees. This condition is not applicable to accredited investor Provided further that in case of a social impact fund which invests only in securities of not for profit organizations registered or

listed on a social stock exchange, the minimum value of investment by an individual investor shall be two lakh rupees. [Proviso to 10(a) and 10(b), 10(c) was inserted vide SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2022].

**Regulation 16** of SEBI (Alternative Investment Funds) Regulations, 2012 deals with the conditions for Category I Alternative Investment Funds. Regulation 16 (4) (a) has been substituted vide SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2022 with the following, viz. (a) at least seventy-five percent of the investable funds shall be invested in unlisted securities or partnership interest of social ventures or in units of social ventures or in securities of social enterprises. Provided that an existing social impact fund may invest the remaining investable funds in securities of not-for-profit organizations registered or listed on a social stock exchange with the prior consent of at least 75% of the investors by value of their investment.

The amount of grant that may be accepted by the fund from any person shall not be less than ₹ 10 Lakh. Further, it was inserted that a social impact fund or schemes of a social impact fund launched exclusively for a not for profit organization registered or listed on a social stock exchange, shall be permitted to deploy or invest 100% of the investable funds in the securities of not for profit organizations registered or listed on a social stock exchange.

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

#### Question 2A

- (i) Distinguish between Letter of Credit and Bank Guarantee.

(5 marks)

- (ii) On the basis of the following information, calculate the operating cycle of Verna Trading Limited :

Inventory as on 1st April, 2023 - ₹ 6,00,000 and as on 31st March 2024- ₹ 4,00,000.

Book Debts as on 1st April, 2023 - ₹ 20,00,000 and as on 31st March, 2024 ₹ 24,00,000.

The sales and cost of goods sold for the year ended 31st March, 2024 are ₹ 2,00,00,000 and ₹ 1,50,00,000 respectively.

Of the total sales as above, cash sales were for ₹ 24,00,000 (one year may be taken as 360 days for calculation).

(5 marks)

- (iii) Being the Company Secretary of XYZ Ltd., you decided to issue sweat equity shares to its employees. The company's Board decides to move a special resolution in its forthcoming AGM. What are the details of information you would include in the explanatory statement to be sent to shareholders along with the general meeting notice?

(5 marks)

#### Answer 2A(i)

##### Letter of Credit (LC)

A letter of credit is a document from a bank that guarantees payment. A Letter of Credit is issued by a bank at the request of its customer (importer / buyer) in favour of the beneficiary (exporter / seller). It is an undertaking/ commitment by the bank, advising/ informing the beneficiary that the documents under a letter of credit would be honoured, if the beneficiary (exporter) submits all the required documents as per the terms and conditions of the letter of credit.



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- A letter of credit, sometimes referred to as a documentary credit, acts as a promissory note from a bank.
- It represents an obligation taken on by a bank to make a payment once certain criteria are met. Once these terms are completed and confirmed, the bank will transfer the funds.
- The letter of credit ensures the payment will be made as long as the services are performed.
- Letters of credit are especially important in international trade due to the distance involved and potentially differing laws in the countries of the businesses involved. In these transactions, it is not always possible for the parties to meet in person.
- The bank issuing the letter of credit holds payment on behalf of the buyer until it receives confirmation that the goods in the transaction have been shipped.
- Letters of credit are used mostly in international trade agreements; bank guarantees are often used in real estate contracts and infrastructure projects.

### Bank Guarantees

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

- Bank guarantees represent a more significant contractual obligation for banks than letters of credit do.
- A bank guarantee, like a letter of credit, guarantees a sum of money to a beneficiary; however, unlike a letter of credit, the sum is only paid if the opposing party does not fulfil the stipulated obligations under the contract. This can be used to essentially insure a buyer or seller from loss or damage due to non-performance by the other party in a contract.
- Bank guarantees insure both parties in a contractual agreement from credit risk. For instance, a construction company and its cement supplier may enter into a new contract to build a mall.
- Both parties may have to issue bank guarantees to prove their financial stance and capability. In a case where the supplier fails to deliver cement within a specified time, the construction company would notify the bank, which then pays the company the amount specified in the bank guarantee.

### Answer 2A (ii)

Calculation of Operating Cycle of Verna Trading Limited

₹ in Lakh

Operating Cycle =	Inventory period + Accounts receivable period.
Average Inventory =	(Opening Inventory + Closing Inventory)/2 (₹6,00,000/₹4,00,000)/2 = ₹5,00,000
Cost of Goods Sold =	₹ 1,50,00,000 (Given)

Inventory Period (A) =	$\frac{\text{Average Inventory}}{\text{Cost of Goods Sold}} \times 360$
	5,00,000 / 1,50,00,000 x 360 = 12 days
Credit sales =	Total Sales – Cash Sales
	₹ 2,00,00,000 - ₹ 24,00,000 = ₹ 1,76,00,000
Accounts Receivable Period =	$\frac{\text{Average Book Debts}}{\text{Total Credit Sales}} \times 360$
Average Book Debts =	(Opening Book Debts + Closing Book Debts)/2
	(₹ 20,00,000 + ₹ 24,00,000)/2 = ₹ 22,00,000
Account Receivable Period (B) =	(₹ 22,00,000 / ₹ 1,76,00,000) x 360 = 45 days.
Hence, working capital cycle (A+B) =	12+ 45 = 57 days

**Answer 2A(iii)**

Particulars to be included in the explanatory statement sent along with general meeting notice for passing the Special Resolution to issue sweat equity shares:

**a) As per SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021**

For the purpose of passing a special resolution under Section 54 (1) (a) of the Companies Act, 2013, the Board of Directors at the time of sending notice to the shareholders shall send additional information for approving the issuance of sweat equity, which shall, *inter-alia*, contain the following information:

- The total number of shares to be issued as sweat equity.
- The current market price of the shares of the company.
- The value of know-how or intellectual property rights or other value addition to be received from the employee or director along with the valuation report/basis of valuation.
- The names of the employees or directors or promoters to whom the sweat equity shares shall be issued and their relationship with the company.
- The consideration to be paid for the sweat equity shares.
- The price at which the sweat equity shares shall be issued.
- Ceiling on managerial remuneration, if any, which will be affected by issuance of such sweat equity.
- A statement to the effect that the company shall conform to the accounting policies as specified by SEBI.
- Diluted EPS pursuant to the issue of securities to be calculated in accordance with International Accounting Standards specified by the Central Government.

**b) As per Companies (Share Capital and Debentures) Rules, 2014**

The explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 of Companies Act, 2013 shall contain the following particulars, namely:-

- a) The date of the Board meeting at which the proposal for issue of sweat equity shares was approved;
- b) The reasons or justification for the issue;
- c) The class of shares under which sweat equity shares are intended to be issued;
- d) The total number of shares to be issued as sweat equity;
- e) The class or classes of directors or employees to whom such equity shares are to be issued;
- f) the principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation ;
- g) The time period of association of such person with the company;
- h) The names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;
- i) The price at which the sweat equity shares are proposed to be issued;
- j) The consideration including consideration other than cash, if any to be received for the sweat equity;
- k) The ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how it is proposed to be dealt with;
- l) A statement to the effect that the company shall conform to the applicable accounting standards; and
- m) Diluted Earning Per Share pursuant to the issue of sweat equity shares , calculated in accordance with the applicable accounting standards.

**Question 3**

- (a) The term "Angel Investor" originated in the Broadway theatrical world, where plays were often financed by wealthy individuals rather than formal lenders, and payments were due only when and if the production was a success. Angel investors and funds have become a major source of private funding in Indian business growth. What do you mean by Angel Funds ? Who are Angel Investors ?
- (b) SEBI (AIF) (Second Amendment) Regulations, 2023 introduced a new category of Alternative Investment Fund (AIF), viz. Corporate Debt Market Development Fund (CDMDF). Explain in brief the framework for CDMDF as prescribed by SEBI. Also state the conditions to be complied by CDMDF.
- (c) What are masala bonds ? What are the advantages of issuing masala bonds ? How do they differ from normal bonds ?

**Answer 3(a)**

As per Regulation 19A (1) of SEBI (Alternate Investment Fund) Regulations 2012, Angel Fund means a sub-category of Venture Capital Fund under Category I of Alternative Investment Fund that raises funds from angel investors and invests in accordance with the provisions of Chapter III-A of the AIF Regulations.

Angel fund invest in startups which are not promoted or supported by or related to Industrial Group whose group turnover exceeds ₹ 300 crores. Angel funds can accept investment from maximum 200 investors. The investment by an angel fund is in the range of ₹ 25 lakh to ₹ 10 crores. They are regulated by SEBI (Alternative Investment Fund) Regulations, 2012.

As per Regulation 19A (2) of SEBI (Alternate Investment Fund) Regulations 2012 'Angel Investor' means any person who proposes to invest in an angel fund and satisfies one of the following conditions, namely,

- (i) an individual investor who has net tangible assets of at least ₹ 2 crore excluding value of his principal residence, and who:
  - has early stage investment experience, or
  - has experience as a serial entrepreneur, or
  - is a senior management professional with at least ten years of experience.

Early-stage investment experience shall mean prior experience in investing in start-up or emerging or early-stage ventures and 'serial entrepreneur' shall mean a person who has promoted or co-promoted more than one start-up venture.

- (ii) a body corporate with a net worth of at least ₹ 10 crore; or
- (iii) an Alternative Investment Fund registered under SEBI AIF Regulations or a Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

### Answer 3(b)

SEBI introduced Corporate Debt Market Development Fund (CDMDF) vide SEBI (AIF) (Second Amendment) Regulations, 2023, is a new category of AIF in which investments shall be made in accordance with Chapter II C of these Regulations. It acts as a Backstop Facility for purchase of investment grade corporate debt securities to instill confidence amongst the participants in the Corporate Debt Market during times of stress and to generally enhance secondary market liquidity by creating a permanent institutional framework for activation in times of market stress.

The fund shall deal only in following securities during normal times:

- Low duration Government Securities
- Treasury bills
- Tri-party Repo on G-sec
- Guaranteed corporate bond repo with maturity not exceeding 7 days.

### Registration of CDMDF

CDMDF shall be structured as a trust and its establishment requires the execution of a registered deed in accordance with the provisions of Indian Registration Act of 1908. The CDMDF shall operate as a close ended fund, meaning that it has a pre-determined duration of 15 years, from the date of initial closing. COMDF are made available for investment to asset Management Companies (AMCs) and specified debt-oriented schemes of mutual funds.

The SEBI vide circular dated July 27, 2023 prescribed the framework for Corporate Debt Market Development Fund (CDMDF) which states that CDMDF shall comply with the Guarantee Scheme for Corporate Debt (GSCD) as notified by Ministry of Finance vide notification no. G.S.R. 559(E) dated July 26, 2023, which includes the Framework for Corporate Debt Market Development Fund. In addition to the scheme, CDMDF shall comply with the conditions as mentioned in the circular.

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- Investment Conditions: During periods of market dislocation, the Corporate Debt Market Development Funds shall purchase corporate debt securities from the specified debt-oriented schemes of mutual funds which meet the following eligibility criteria:
  - a) corporate debt securities shall be listed and have an investment grade rating;
  - b) the residual maturity of such securities shall not exceed five years on the date of purchase;
  - c) securities where there is no material possibility of default or adverse credit news or views.
- Disclosure Norms: The portfolio of the CDMDf will be made available to the unitholders on a fortnightly basis. Additionally, the net asset value (NAV) of the CDMDf will be disclosed to the unitholders on a daily basis. These regular disclosures ensure transparency and provide timely information to the unitholders regarding the fund's holdings and NAV.
- Compliance with governance mechanism: The CDMDf will select and appoint a trustee company. The appointment of both the board of directors of the trustee company and the manager of the CDMDf necessitates prior approval from SEBI.

The trustee company is authorized to engage solely in activities where it acts as the trustee of the CDMDf, unless prior written consent is obtained from SEBI. In terms of composition, two-thirds of the members on the board of the trustee company must be independent directors who do not have any affiliation with the sponsor or manager.

The appointment of any individual as a director of the trustee company is subject to the prior approval of SEBI. Furthermore, an audit committee must be established within the trustee company to oversee and assess compliance with the provisions outlined in the placement memorandum.

### Answer 3(c)

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

The advantage of issuing masala bonds is that the company does not have to worry about the depreciation in the rupee in comparison to the other bonds/ instruments that are denominated in foreign currencies. This is normally a big worry for corporates while raising money in the overseas markets. If the rupee weakens at the time of the redemption of the bonds, the company will have to pay more rupees to repay the dollars. Many companies which had raised funds via the Foreign Currency Convertible Bonds in 2007 found themselves in a great difficulty, as the rupee had depreciated very sharply during the global financial crisis. In order to compensate the risk of currency depreciation, the buyer of the Masala Bond will get a higher coupon rate and therefore earns a higher yield.

The masala bonds were reckoned under both corporate debt and external commercial borrowings for Foreign Portfolio investment. The Reserve Bank of India recently amended the Regulations and currently treats Masala Bonds under the ECB category only, where a borrower just needs to seek the RBI's approval to sell those securities.

### Normal Bonds vis-s-vis Masala Bonds:

As against Normal Bonds, Masala Bonds are considered a safer way of raising funds from international investors by Indian Corporates as they are rupee denominated bonds. Whereas the investor gets the benefit of a slightly high rate of interest as against normal bonds, issuer enjoys safety in terms of decrement in the rupee value against foreign currencies.

**Question 4**

- (a) Who is an Anchor Investor in the context of Infrastructure Investment Trusts (InvIT) ? How can Anchor Investors participate in the public issue of units of InvITs ?
- (b) Pinnacle Ltd made a public issue in the month of March, 2023 of non-convertible debentures having face value of ₹ 1000 and carrying a coupon rate 9% per annum payable annually. The terms of the issue mentioned that these are secured debentures and carry call and put option. In the month of January, 2024, one of the Investors approached the Company with a request to exercise his put option.

Being the Company Secretary of Pinnacle Ltd., examine whether the right of the investor can be exercised in light of Regulation 15 of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

- (c) Several approvals are required for Issuance of ADRs/GDRs. Prepare the list of such approvals.
- (d) What are the pre-requisites for initial offer of units by an Infrastructure Investment Trust (InvIT)? Is there a mandatory listing requirement under the InvIT Regulations ?
- (e) What is Green Shoe Option in IPO ?

(3 marks each)

**Answer 4(a)**

In the context of Infrastructure Investment Trusts (InvITs), 'Anchor Investor' means a qualified institutional buyer who makes an application for a value of at least ₹ 10 crore in a public issue on the SEBI main board made through the book building process or makes an application for a value of at least ₹ 2 crore for an issue made in accordance with SEBI (ICDR) Regulations, 2018.

**Participation by Anchor Investors in the public issue of units of InvITs**

- A strategic investor may participate in an offer as an anchor investor.
- The investment manager, on behalf of the InvIT, may allocate up to 60% of the portion available to institutional investors to anchor investors.
- The anchor investors will have to make an application of a value of at least INR 100 million in the public issue.
- Allocation to anchor investor shall be on a discretionary basis, and subject to the minimum of two investors for allocations of up to INR 2.5 billion and minimum five investors for allocations exceeding INR 2.5 billion.
- The bidding for anchor investor before the issue opening date and the allocation must be completed on the same day.
- The number of units allocated and the allocation price must be disclosed on the websites of the stock exchange(s), sponsor(s), investment manager and merchant banker(s) before opening of the issue.
- The anchor investor shall have to bring in the deficit between the cut-off price and the allocation price, if any.
- The lock-in period shall be thirty days for anchor investors other than a strategic investor. However, lock-in should be one year for strategic investors investing as anchor investors,
- Neither the merchant bankers nor any person related to the merchant bankers in the concerned public issue can apply under the anchor investor category, except mutual funds, insurance companies and pension funds.

**Answer 4(b)**

As per Regulation 15 (1) of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, an issuer making the issuance of non-convertible securities shall:

- (i) have the right to recall such securities prior to the maturity date (call option)
- (ii) shall have right to provide such right of redemption of debt securities prior to the maturity date (put option) to all the investor or only to retail investor.

Regulation 15 (5) of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 provides that no such right will be exercisable before the expiry of one year from the date of issue of such non-convertible securities.

In the present case, the investor approached the company with a request to exercise his put option after 8 months from the date of the issue, hence his request will be rejected.

**Answer 4(c)**

Several approvals are required for Issuance of ADRs/ GDRs. A list of such approvals are as under:

- Approval of Board of Directors
- Approval of Shareholders
- Approval of Ministry of Finance 'In-Principle and Final'
- In-Principle consent of stock exchange for listing of underlying shares
- In-Principle consent of Financial Institutions

**Answer 4(d)**

**Pre-requisites for initial offer of units by an Infrastructure Investment Trust (InvIT):**

- The InvIT is registered with SEBI
- The value of InvIT assets is not less than ₹ 500 crore. Such value shall mean the value of the specific portion of the holding of InvIT in the underlying assets or holdco or SPVs;
- The offer size is not less than ₹ 250 crore.

As per Regulation 16 of SEBI (Infrastructure Investment Trust) Regulations, 2014, it is mandatory for units of all InvITs to be listed on a recognized stock exchange having nationwide trading terminals, whether publicly issued or privately placed. However, this provision shall not be applicable if the initial offer does not satisfy minimum subscription amount or the minimum number of subscribers as per Regulation 14 of InvIT Regulations. The listing of the units shall be in accordance with the listing agreement entered into between the InvIT and the designated stock exchanges.

With respect to listing of privately placed units, its units shall be mandatorily listed on the designated stock exchange(s) within thirty working days from the date of allotment. With respect to listing of publicly offered units, its units shall be mandatorily listed on the designated stock exchange(s) within twelve working days from the date of closure of the initial public offer.

**Answer 4(e)**

Green Shoe Option means an option of allotting equity shares in excess of the equity shares offered in the public issue as a post-listing price stabilizing mechanism in accordance with the provisions of SEBI (ICDR) Regulations, 2018. There is a provision in an Initial Public Offering (IPO) underwriting agreement that grants the underwriter the right to sell more shares than originally planned, if the demand for a security issued proves higher than expected. It is also called an over-allotment option.



According to SEBI, Green Shoe Option is a price stabilizing mechanism in which shares are issued more than the issue size, i.e. a maximum of 15%. It is a mechanism to stabilize the issue price post listing.

## PART-B

### Question 5

- (a) Explain the provisions of SEBI (LODR) Regulations, 2015 related to role and responsibilities of Nomination and Remuneration Committee, its chairperson, composition, number of meetings to be held in a year and its quorum. (5 marks)
- (b) List the annual compliance calendar for listed SME entities as per SEBI Listing Regulations, 2015. (5 marks)
- (c) You are the Company Secretary of XYZ Ltd, which has recently listed on Bombay and National Stock Exchanges. The CEO of the company is eager to know the applicability of various corporate governance provisions as per SEBI (LODR) Regulations, 2015. In this context, explain the provisions applicable to the following aspects :
- (i) Maximum age of non-executive directors
  - (ii) Minimum number of directors' requirements
  - (iii) Number of Meetings of the Board and its periodicity and
  - (iv) Quorum of the board meeting. (5 marks)
- (d) Prepare a checklist of documents required for granting approval under SEBI (LODR) Regulations, 2015, for companies proposing to issue GDRs/ADRs/FCCBs.

### Answer 5(a)

#### Role and Responsibilities of Nomination & Remuneration Committee

Regulation 19 of SEBI (LODR) Regulations, 2015 provides that the role of Nomination and Remuneration Committee is specified in Part D of Schedule II, which include the following:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the board of directors a policy relating to, the remuneration of the directors, key managerial personnel and other employees.
2. For every appointment of an independent director, the Nomination and Remuneration Committee shall evaluate the balance of skills, knowledge and experience on the Board and on the basis of such evaluation, prepare a description of the role and capabilities required of an independent director. The person recommended to the Board for appointment as an independent director shall have the capabilities identified in such description.
3. Formulation of criteria for evaluation of performance of independent directors and the board of directors;
4. Devising a policy on diversity of board of directors;
5. Identifying persons who are qualified to become directors and who may be appointed in

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senior management in accordance with the criteria laid down, and recommend to the board of directors their appointment and removal.

6. Whether to extend or continue the term of appointment of the independent director, on the basis of the report of performance evaluation of independent directors.
7. Recommend to the board, all remuneration, in whatever form, payable to senior management.

**Composition:** The committee shall comprise of at least three directors and all of them shall be non-executive directors. At least two-thirds of these directors shall be independent directors.

The Chairperson shall be an independent director. However, the chairperson of the listed entity, whether executive or non- executive, may be appointed as a member of the Committee and shall not chair such Committee. The Chairperson of the committee may be present at the annual general meeting, to answer the shareholders' queries; however, it shall be up to the chairperson to decide who shall answer the queries.

**Meeting:** The committee shall meet at least once in a year.

**Quorum:** The quorum for a meeting of the nomination and remuneration committee shall be either two members or one third of the members of the committee, whichever is greater, including at least one independent director in attendance.

#### Answer 5(b)

Compliance requirements for listed SME enterprises under annual compliance calendar:

Regulation/Title	Particulars/Timelines
Regulation 7 (3) Compliance Certificate	The listed entity shall submit a compliance certificate to the exchange, duly signed by both the compliance officer of the listed entity and the authorised representative of the share transfer agent <b>within 30 days from the end of the financial year</b> certifying that all activities in relation to share transfer facility of the listed entity are maintained either in house or by Registrar to an issue and share transfer agent registered with the SEBI.
Regulation 33(3) Annual Financial results	The listed entity shall submit annual audited standalone financial results <b>within 60 days from the end of the financial year along</b> with audit report and Statement on Impact of Audit Qualifications applicable only for audit report with modified opinion, to the stock exchange .
Regulation 34 Annual Report	The listed entity shall submit to the stock exchange and publish on its website the annual report along with the Notice of the Annual General Meeting <b>not later than the day commencement of dispatch to its shareholders</b>
Regulation 40(9) Certificate	The listed entity shall ensure that the share transfer agent and/or the in-house share transfer facility, as the case may be, produces a certificate from a practising company secretary <b>within 30 days from the end of the financial year</b> 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

Regulation/Title	Particulars/Timelines
Initial Disclosure Requirements for Large Entities	Within 30 days from the beginning of the financial year
Annual Disclosure Requirements for Large Entities	Within 45 days from the end of the financial year

**Answer 5(c)**

With reference to corporate governance provisions under SEBI (LODR) Regulations, 2015, the following conditions apply to a listed company:

## (i) Maximum age of non-executive directors:

No listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of 75 years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

## (ii) Minimum Number of Directors' Requirement:

The board of directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors.

The top 1000 and 2000 entities shall be determined on the basis of market capitalisation as at the end of the immediate previous financial year.

## (iii) Meetings of Board and its periodicity:

The board shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.

## (iv) Quorum of the Board Meeting:

But in case of the top 1000 listed entities with effect from April 1, 2019 and of the top 2000 listed entities with effect from April 1, 2020 quorum shall be one third of its total strength or three directors, whichever is higher, including at least one independent director, as per SEBI (LODR) Regulations, 2015.

For a listed entity, one independent director should be present at the Meeting to form a quorum.

**Answer 5(d)**

Documents required for granting approval under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015, for companies proposing to come out with issue of GDRs/ADRs/FCCB are as under:

1. Certified true copy of the resolution passed by the board approving the issue;
2. Copy of meeting notice sent to shareholders;
3. Certified true copy of the resolution passed by the shareholders' meeting approving the issue;
4. Draft offer circular for the issue;
5. Confirmation by the MD and /or company secretary;
6. Processing fee.

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

**Question 6**

- (a) Discuss the process of listing of GDRs on the Euro MTF.
- (b) Neel Pharma Ltd. successfully completed its initial public offer (IPO). List the documents to be submitted on T + 2 days for listing of IPO with Stock Exchanges.
- (c) Write a brief note on NASDAQ.
- (d) Explain briefly the due diligence procedure that a merchant banker is expected to carry out during an IPO.

(5 marks each)

**Answer 6(a)**

**Listing of GDRs on the Euro MTF** will require submission of a prospectus to Luxembourg Stock Exchange (LuxSE). Once your prospectus has been reviewed and approved, your GDR will be listed and admitted to trading.

- **Choose a listing agent:** It is not mandatory to appoint a listing agent. Either the issuer itself or a Company acting on its behalf can submit request for approval.
- **Listing requirement:** In order to list on the Euro MTF, a security must fulfil the following criteria, among other things:
  - Minimum Capital of ₹10,00,000 or equivalent value in other currencies
  - Minimum public free float of 25%
  - Securities should be eligible for clearing and settlement
  - Securities should be freely negotiable and fungible
- **Listing Process:**

*File a prospectus:* To begin the listing process, the following documents to be sent on LuxSE

- A copy of your prospectus
- Application form
- Undertaking letter
- Article of association
- Existing agreement /Conventions
- The last three annual financial reports (if published)

*Prospectus review:* A first set of comments on a complete draft prospectus will be sent to you within a maximum period of three business days from the date of receipt of the filed application.

Additional comments following submission of an updated draft prospectus will be provided within a maximum of two business days after submission.

*Final submission:* Listing can take place after receipt of the following items:

1. Final version of the prospectus
2. First listing price

- **Fees:** All fees are paid to LuxSE and priced in euros.
- **Continuing Obligations:** After listing and admission to trading, issuers must fulfil specific reporting obligations. E.g. issuers must file information and scheduled corporate events with LuxSE.
- **LEI code:** The LuxSE is obliged to collect a 'Legal Entity Identifier' or LEI Code from any issuer operating on its regulated market and on Multilateral Trading Facility (Euro MTF) & communicate it to the relevant supervisory authorities.

#### Answer 6(b)

Documents to be submitted to stock exchanges by the company prior to listing under T+2 days category (i.e. within 2 working days from the closure of the issue)

- All due diligence certificates with SEBI by Merchant banker(s).
- Observation Letter issued by SEBI pursuant to filing of draft offer document.
- List of authorized signatories along with their specimen signatures.
- Confirmation from Lead Managers that devolvement notices have been sent to underwriters (applicable if the issue has devolved).
- Certificate from the Book Running Lead Manager(s) that the issue has received minimum subscription as specified under Regulation 45 (1) of SEBI (ICDR) Regulations, 2018.
- Confirmation from the company regarding the email ID for Investor Grievances as per Regulation 46 of SEBI (LODR), Regulations, 2015.
- Copies of all advertisements published in connection with the issue up to T+1 stage.
- Confirmation from the company stating that they have obtained authentication for SCORES from SEBI as per Regulation 13 of SEBI (LODR) Regulations, 2015.

#### Answer 6(c)

**NASDAQ** began primarily as a U.S. based equities exchange. Today, NASDAQ is recognized around the globe as a diversified worldwide financial technology, trading and information services provider to the capital markets, with more than 3,500 colleagues serving businesses and investors from over 50 offices in 26 countries across six continents and in every capital market.

There are three distinct markets within NASDAQ: the NASDAQ Global Market (NGM), the newly created NASDAQ Global Select Market (NGSM) and the NASDAQ Capital Market (NCM).

- The NGSM mandates the highest initial listing requirements of any market in the world, while its maintenance requirements are identical to those of the NGM. It is a mark of achievement and stature for qualified companies.
- The NGM, in turn, has more stringent quantitative listing and maintenance requirements than does the NCM. It lists companies with an overall global leadership and international reach with their products or services.
- NASDAQ Capital Markets are focused on its core purpose for those companies listed.

The quantitative listing and maintenance criteria applicable to non-Canadian foreign private issuers for the NGM, NGSM and NCM are identical to those of US domestic and Canadian issuers. Foreign Private Issuers (FPI) (including Canadian issuers) may, however, elect to follow home country practice in lieu of compliance with the NASDAQ corporate governance requirements.

**Answer 6(d)**

Due Diligence Procedure by a merchant banker during an IPO

- (i) Carry out the procedures to demonstrate that it had no reasonable ground to believe and did not believe that there were material misstatements or omissions in the Offer Documents which could have had an impact on an investment decision;
- (ii) Have detailed discussions with the management and key customers, suppliers (where practicable) and the Issuer's auditors with respect to the business and associated risks and financial reporting statements;
- (iii) Identify procedures such that disclosures in the Offer Document that are material to an investment decision are backed by appropriate documentation, such as corporate and secretarial records or certificates of the Issuer or third parties and independent third-party reports; and
- (iv) inform the Issuer that it may be required to provide documents that have been reviewed for an Issue, post completion of the Issue in instances of receipt of clarifications or questions from SEBI or other regulatory agencies or other persons.

It must be clearly understood that due diligence is the backbone of any primary market offering. The risk that the Merchant Banker runs for any lapse in conducting due diligence is not restricted only to any regulatory action but extends to reputational risk with the investors & Issuers.

Though Merchant Bankers are supposed to carry out diligence and comply with all the requirements of applicable regulations, the Company and the Management is responsible for the contents of offer document and have to declare and certify that all the information in the offer document is true and fair. Offer document being a legal document defined under the Companies Act as well as applicable regulations, responsibility of the management is final.

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

**Question 6A**

- (i) Every website of a listed company must contain statutory disclosures in terms of listing regulations. In this context, mention various management policies which should be disseminated through the Company's website.  
(5 marks)
- (ii) Yeswanth Ltd is a listed company having all committees constituted in compliance with listing regulations. Its Audit committee has 5 directors, out of which four directors are independent. At a meeting of the Audit Committee, 2 directors were present (one non-executive and one independent). Is the meeting valid? Can the company appoint its executive chairman (of the Board) who is a Chartered Accountant as Chairman of Audit committee also? Explain with reference to the relevant provisions.  
(5 marks)
- (iii) What is the role of SCORES platform in Investor Grievance Redressal Mechanism of a listed company?  
(5 marks)
- (iv) Explain the term Catalist with reference to Singapore Exchange Ltd. (SGX). How does the Catalist listing process differ from Mainboard listing process at SGX?  
(5 marks)

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**Answer 6A(i)**

Listed Companies shall disclose certain management policies on the website of the Company such as:

- Code of conduct for Board of Directors & Senior Management personnel;
- Code of conduct for Prevention of Insider Trading;
- Code of practices & procedures for fair disclosures of unpublished price sensitive information;
- Familiarization programme for Independent Directors;
- Vigil Mechanism/Whistle Blower Policy;
- Policy related to disclosure of material events to the stock exchanges (Materiality Policy);
- Policy on dealing with Related Party Transactions;
- Policy on determining 'Material' subsidiaries;
- Risk Management Policy;
- Archival Policy;
- Policy for determination of materiality of events or information;
- Internal Financial Control;
- Dividend Distribution Policy listed entities based on market capitalization;
- Policy against sexual harassment.

**Answer 6A(ii)**

Regulation 18(2) (b) of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 provides that the quorum for audit committee meeting shall either be two members or one third of the members of the audit committee, whichever is greater, with at least two independent directors. Therefore, the aforesaid meeting is invalid, as only one Independent Director was present at the meeting of the Audit Committee.

Regulation 18(1) (d) of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 provides that the chairperson of the audit committee shall be an independent director and he/she shall be present at Annual general meeting to answer shareholder queries.

Hence, Chairman of the Company's Board who is also a Chartered Accountant cannot be appointed as Chairman of the Audit Committee.

**Answer 6A(iii)**

SCORES is an online grievance redressal facilitation platform provided by SEBI wherein investors in securities market can lodge their complaints through web URL and an App. Every listed company must have in place Investor Redressal Mechanism to address grievances of any shareholders. All listed companies must register themselves on SEBI Complaints Redressal System (SCORES) platform. The SCORES strengthens the investor complaint redress mechanism in the securities market by the following ways:

- (i) Reduced and uniform timelines for redressal of investor complaints across the Securities Market i.e. 21 Calendar days from date of receipt of complaint.
- (ii) Auto-routing of complaints to the concerned regulated entity so as to eliminate time lapses, if any, in the flow of complaints.



- (iii) Monitoring of the timely redressal of the investors' complaints by the 'Designated Bodies'.
- (iv) Providing two levels of review: First review by the 'Designated Body' if the investor is dissatisfied with the resolution provided by the concerned regulated entity. Second review by SEBI if the investor is still dissatisfied after the first review.
- (v) Auto-escalation of complaint to the next level in case of non-adherence to the prescribed timelines by the regulated entity or the Designated Body as the case may be.
- (vi) Integration with KYC Registration Agency database for easy registration of the investor on to SCORES.

#### Answer 6A(iv)

Unlike issuers listed on SGX's Main Board, Catalist companies are directly supervised by their sponsors. Sponsors are qualified professional companies experienced in corporate finance and compliance advisory work. They are authorised and regulated by SGX through strict admission criteria and continuing obligations. However, SGX continues to regulate issuers through its rules for admission and continuing obligation. It also retains the power to discipline them when there is a rule breach.

There are two Listing processes at SGX:

- **Mainboard Listing Process:** caters to the needs of established enterprises. Companies seeking a listing on the Mainboard must meet the entry criteria, which includes minimum profit and/or market capitalisation levels. Mainboard-listed companies enjoy the prestige of an established market place and access to the widest range of institutional and retail investors.
- **Catalist Listing Process:** caters to the needs of fast growing enterprises. Companies seeking a primary listing on the Catalist must be brought to list by authorised Sponsors via an initial public offering (IPO) and reverse take-over.

\*\*\*

*Padhai Kar Befikar*

Lecture Kart

## MULTIDISCIPLINARY CASE STUDIES

### MODULE 3 PAPER 8

*Time allowed : 3 hours*

*Maximum marks : 100*

*NOTE : Answer All Questions.*

#### Question 1

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

Param, an IIT graduate was inclined towards teaching and he was well known for his subject knowledge and teaching techniques across Chennai. Few of his friends suggested that he should now look at expansion and cash on his reputation of a subject knowledge expert with innovative teaching methodologies. This led to development of his brand 'Quiklearn', which was owned by Quiklearn Private Ltd., a start-up company, which Param had initially incorporated.

Param with his skillset and business sense developed the Company's operations, with its presence across USA and Canada. The Company quickly grew into one of the world's largest Edtech companies and one of the top five most-valued start-ups in India.

Its flagship product, 'Quiklearn' the Learning App, was launched in India in 2013 and reached more than 90 million registered students around the world, with 7.5 million annual paying subscribers. The Company also launched in India, an early Learn App to offer personalized, interactive programs for young learners.

"Quiklearn" has head count of more than 10,000, people working across the globe including a content and research team of 2500 plus people who are highly qualified educators and learning science wizards, who developed the curriculum after conducting extensive research.

Due to its innovative approach in education sector, it has won several accolades and awards. Quiklearn began as an offline coaching centre and gained popularity through engaging and personalised learning methods. Eventually, it ventured into the online space with a mobile app. The Company's success was majorly attributed to effective marketing by celebrities, focus on technology, and strategic acquisitions.

The Company's early expansion could be attributed to its adaptive learning technology and engaging teaching methods, which resonated with a growing market of tech-savvy students. Quiklearn managed to secure significant investments from prominent investors, strategic investors, venture capitalist, enabling its expansion and aggressive marketing campaigns. Its strategy mainly involved rapid expansion through acquisitions and heavy investments in marketing. As a result, Quiklearn quickly became a household name in the Indian education sector, boasting millions of users and a valuation of billions of dollars. The Company was at its peak during the COVID pandemic, as 'virtual classes' were a preferred mode of learning by students. However, once things normalised the Company's operations were hit, as students returned to offline classes thereby questioning the further scalability and revenue model.

Despite its soaring success, Quiklearn's journey was blemished by instances of corporate governance failures, stymied by opaque accountability and transparency in the Company's financial reporting. Multiple media reports emerged that Quiklearn indulged in unethical accounting practices, such as, inflating its operational revenue to attract more investments and such fraudulent activities, which eroded the trust of investors and raised serious concerns about the Company's integrity.

Quiklearn faced allegations of mishandling users sensitive information, breaching privacy regulations and engaging in aggressive data mining practices. These disclosures not only damaged the Company's reputation but also elicited legal action and regulatory scrutiny. The absence of data protection measures and transparency further exposed the weak corporate governance structure within the organization. Company also faced allegation of adopting illicit sales and loss of trust.

The Statutory auditors of the Company resigned on the ground that start-up had not provided its financials over a year. Besides, three independent directors representing investors and lenders also resigned from their positions. The Company was subject to many lawsuits both in India and US, by investors. It failed to honour the financial covenants, and interestingly, Quiklearn filed counter lawsuits against the creditors and lenders. There has been a considerable number of dismissals and the prevalence of utter-chaos in the corporate governance mechanism, which rocked the corporate world.

Quiklearn's crisis has cautioned various investors and venture capital firms. Corporate governance collapses like Quiklearn's are disseminating quivers through the South Asian nation's fledgling start-up economy. The fiasco at Quiklearn has forced the complete business ecosystem to think about what could be wrong in every portfolio company, as most of the venture capital firms finances several firms.

On the financial front, Quiklearn's agony seems to exacerbate as settling of the ongoing dispute over its \$2.2 billion term loan, as it may prove to be more expensive for the Company.

The distressed Edtech major may have to cough up an additional \$50-60 million to service the increased interest rate it has offered to finalize the new terms of the disputed term loan. Quiklearn has been negotiating to freeze new terms for the loan with its lenders, which has been a sore point for the Edtech firm for the past few months. The financial capacity of Quiklearn to pay the interest on these loans is now questionable. Quiklearn has been working to secure new funds but its myriad troubles related to new acquisition as well as statements from investors on corporate governance issues have affected the process.

Another major development, that may be attributed to the stressed Quiklearn's business conditions, is decline in swapping of equity holdings by minority shareholders of Aventurome Educational Services Limited (AESL) with Quiklearn Private Ltd., resulting from a merger deal.

The impact on the operations of Quiklearn's from this calamity have been severe. Amid continuous cost-cutting exercises, Quiklearn has shuttered some of its offices in Hyderabad, Gurugram and Bengaluru, with multiple rounds of layoffs impacting occupancy. It has been consolidating its real estate spaces in tune with layoffs and has even defaulted in provident fund pay-outs.

Governance issues and start-up policy also impacted the Company. At this juncture, it is essential to comprehend the governance issues plaguing the start-ups in India. These issues, if not addressed, may engender failure of other start-ups too like Quiklearn. With considerable capital inflows and rapid increase of start-up ventures across sectors, India's start-up ecosystem has become highly competitive. This can influence some founders/promoters to overlook governance aspects. Also, first-time founders may not have the required expertise on corporate governance. Moreover, some of the promoters do not lay due emphasis on governance, as they might be of the view that it results into escalation of operational costs. In certain cases, founders/promoters may engage in questionable acts due to a lack of ethical standards or a general disregard for the law. Venture capitalist induced drive for fast growth is a major reason for the rise in corporate mis-governance cases in the start-up ecosystem. The pressure to grow at all costs, forces the start-ups to abandon the systems and processes they may have set up for governance. Firm valuations have started exceeding fundamental values. People have started to give more importance to company's valuation, than business processes. VCs and founders have overestimated the size of total

addressable market in India and exaggerated the India opportunity to their investors. No doubt, India being an emerging economy, its market is also thriving, but it is yet to gain the desired level which can foster merger and acquisitions of start-ups.

The saga of governance gaps does not end with Quiklearn, there have been numerous instances of corporate mis-governance. This largely coincided with lowering of private-capital flow into the Indian start-up milieu, as global financial market sentiments have mellowed down over the last one year.

The case of Quiklearn is an exemplar of governance collapse. 'The Company went on expanding its wings but amidst this, they failed to diagnose the fault lines that further resulted into a catastrophe. From the aforesaid facts, it may be stated that the Company was highly leveraged, as it took huge loans and servicing the debt became a nightmare. Further, the half-baked merger deal may not assist them to scale the desired heights due to unwillingness of the minority shareholders of AESL for swapping of equity holdings. A substantial amount of purchase consideration was paid by Quiklearn in this merger deal and subsequently the deal entered into rough weather thereby jeopardising the fortunes of the Company. The management of the Company failed to conduct an intensive study of the pros and cons of the merger deal, the basis/methods of determining the purchase consideration, valuation approaches applied for valuing AESL, probable legal hassles that may arise from the merger, especially from minority shareholders, probable synergistic impact of the merger and so on and so forth. Hence, it may be opined that there was lack of due diligence on the part of Quiklearn's management before going ahead with the merger. The corporate restructuring initiative of Quiklearn went wrong and instead of creating business opportunities, it created more issues for it.

The management of the Company tried various measures and strategies, generally espoused universally, to revive the Company, which includes, crisis stabilisation, conserving cash flow, sale of non-core current assets or disposal of surplus plant and machinery, improving debtor collection and stretching creditor payments.

The main challenges faced by the firm is to rebuild stakeholders' confidence. With the business in trouble, employees may be feeling uncertain and worried that they'll be out of work. Suppliers might also be on edge, thinking they won't get paid. The best way to manage this is by demonstrating, that the senior management is taking control of the situation and keeping the communication lines open. This will help rebuild confidence in the business. 'The Company also failed in financial restructuring and excessive gearing of debt than equity. Additionally, major setback came to the Company from expulsion of Quiklearn's Param, the founder and current CEO, by the Company's shareholders.

Quiklearn may explore turnaround strategies and see what fits best to its problem and offer optimum solution. Since the concept of 'One size does not fit all' applies to business organisations, as companies of different sectors as well as companies affiliated to the same sector have varied scale of operations, products, turnover, profits, board composition etc.. So, an organisation has to analyse various approaches or strategies to resolve the crisis. Quiklearn's management may explore as to which turnaround strategies may be most apt for them to steer the company from the crisis.

Further, it may witness more significant initiatives on the part of the management to resurrect the Company and bring it back from the brink of disaster.

In the background of above facts, the management has requested you to prepare a detailed report on the following :

- (a) Outline various corporate governance and other issues faced by Quiklearn, resulting in

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current financial struggles. Also indicate the possible solutions to address the corporate governance challenges effectively.

(10 marks)

(b) With the help of SWOT analysis, suggest the points which the management of Quiklearn shall evaluate.

(10 marks)

(c) Discuss various measures, which the management should consider to engage with stakeholders for their support and highlight the strategic measures relevant in case of a turnaround situation.

(10 marks)

(d) Identify the key takeaways from Quiklearn's case, which will help other start-ups in their journey.

(10 marks)

### Answer 1(a)

QUIKLEARN's has faced following several corporate governance issues in recent years, resulting in current financial struggles.

- **Eeriness among Venture Capitalists:** The QUIKLEARN's crisis has cautioned various venture capital firms. Corporate governance collapses in QUIKLEARN's are disseminating quivers through the South Asian nation's fledgling start-up economy. The fiasco at QUIKLEARN's has forced the complete business ecosystem to think about what could be wrong in every portfolio company, as most of the venture capital firms finances several firms.
- **Financial Turbulence:** On the financial front, QUIKLEARN's agony seems to exacerbate as settling of the ongoing dispute of Term Loan as it may prove to be more expensive for QUIKLEARN's. The distressed Edtech major may have to cough up an additional million to service the increased interest rate it has offered to finalize the new terms of the disputed term loan. QUIKLEARN's has been negotiating with its term loan creditors to freeze new terms for the loan, which has been a sore point for the Edtech firm for the past few months.
- **Inorganic Growth:** Another major development that may be attributed to the stressed QUIKLEARN's business conditions is declining of swapping of equity holdings by minority shareholders of new acquired company Aventurome Educational Services Limited (AESL) with the firm's parent.
- **Cessation of Operations and Retrenchment:** The impact on the operations of QUIKLEARN's from this calamity have been severe. Amid continuous cost-cutting exercises, QUIKLEARN's has shuttered some of its offices in Gurugram and Bengaluru, with multiple rounds of layoffs impacting occupancy. The Hyderabad-based startup has been consolidating its real estate spaces in tune with layoffs. Even the company has defaulted in provident fund payouts.

### Other major issues

- **Heavy Spending on Marketing:** QUIKLEARN faced a big problem with its spending on ads and promotions. They spent a whopping amount on marketing, even more than what they earned.
- **Illicit Sales Methodology & Loss of Trust:** We have seen how the user base of QUIKLEARN increased rapidly that is it was not an organic growth, since everyone may not prioritize a tuition class over an authentic school education and this is a significant point to ponder over.

In view of this, it may be opined that to expand its market share QUICKLEARN embraced illicit and unethical sales practices.

- Bad Reviews of QUICKLEARN's Education during the Pandemic that is during the lockdowns of the Covid pandemic when everything became online including work, business, and teaching.
- **Risky Loans:** QUICKLEARN took risky loans with high-interest rates, banking on the US's low rates. But when rates spiked due to world events, their debt burden ballooned. They struggled to repay, facing pressure from lenders and legal troubles.

Corporate governance issues that board members must prepare, shedding light on the evolving responsibilities and the strategic responses required to steer their organizations towards sustainable growth and integrity.

Corporate boards are under increasing pressure to navigate a complex landscape of governance issues. Directors have a real task ahead of them, needing to not only get the board more involved but also make sure they're bringing in diverse perspectives.

Here, are the issues to explore solutions and recommendations to address these governance challenges effectively.

- ✓ Increasing board accountability
- ✓ Prioritizing board diversity
- ✓ Addressing sustainability and ESG
- ✓ Strengthening internal controls
- ✓ Improving transparency and disclosure
- ✓ Navigating the evolving regulatory landscape
- ✓ Adapting to climate-related regulations
- ✓ Preparing for the corporate sustainability reporting directive
- ✓ Balancing short-term pressures and long-term strategy
- ✓ Managing investor expectations
- ✓ Navigating economic uncertainties
- ✓ Leveraging technology for effective governance
- ✓ Embedding ethics in decision-making
- ✓ Managing third-party risks
- ✓ Preparing for succession and talent management
- ✓ Ensuring smooth leadership transitions
- ✓ Ensuring compliance with all relevant laws and regulations, including data privacy and security regulations.

### Answer 1(b)

Some of the broad points that may be captured under the SWOT are as under:

#### Strengths

- High brand value enjoyed by QUICKLEARN.

- Effective product management by blending contextual, theoretical and visual dimensions.
- Wide product portfolio.
- Strong online presence on different social networking sites and efficient social media management.
- The geographic presence in different regions can act as one of the major strengths of the organization. It determines the business's reach to the target market and ensures the easy accessibility. Moreover, strong financial position and health can allow the firm to make further investments.
- Access to the suppliers that offer raw material at a lower cost can improve the overall business efficiency.
- High product quality increases brand loyalty and improves QUIKLEARN's the Learning App's performance in a competitive market.
- Workplace diversity can also act as a major business strength, particularly when the organization intends to operate in the international market.
- An organization may own different intellectual property rights that can make the product offerings unique and exclusive, making it difficult for competitors to imitate.

#### Weaknesses

- Loss of human capital due to retrenchment.
- Sense of insecurity among the human capital who are continuing with QUIKLEARN.
- Lost confidence of the investors, especially private equity / venture capitalists.
- Loss of Brand Value and Brand Equity.
- Mammoth spending on acquisitions thereby weakening financial position.
- Inability to envisage the probable changes in the business environment especially after the Corona Pandemic.
- The organization can draw the criticism from the environmentalists for its poor waste management practices and inability to integrate sustainability in business operations.
- The company may lose efficiency due to poor inventory management practices.
- The shortage or excessive inventory can either result into the cash shortage or insufficient current assets negatively affect the liquidity position and harms the overall business performance.
- Less expenditure on the research and development activities can weaken the company performance due to poor local/international market knowledge.
- The prices charged by the business may not be perceived as justified when compared to the product/service characteristics. It indicates the need to revise the pricing strategy.
- The poor customer service (such as inefficient customer complaint handling) can trigger the negative word of mouth about the business and affect business growth.
- The misalignment between the organization's leadership style and its core strategic objectives can make the business organization directionless.
- High rate of interest of loan and new acquisition on higher valuation.

### Opportunities

- Rapid growth in education technology which is engendering the concept of anytime, anywhere learning for the learners is big boon for Edtech companies like QUIKLEARN.
- Special focus on online education in National Education Policy, 2020.
- QUIKLEARN may further leverage itself.
- Focus on creation of virtual labs in QUIKLEARN may assist in providing practice to students on their theoretical knowledge and also provide course contents in various languages thereby capturing a sizeable market share.
- The 'Saptarishi' concept of Government contains an element of unleashing the Potential, wherein the thrust is on elimination of obstacles for the expansion and advancement of the economy by implementing reforms in vital sectors like education. In this regard, QUIKLEARN being an education industry related company may stand benefitted.
- The exponential growth in the population, and particularly in the existing or potential customer segments is a great growth opportunity for the business organization.
- The changing customer needs, tastes and preferences can act as an opportunity if the business organization has good market knowledge.
- The development of new technologies to assist the product/service production and delivery process can be exploited to embed the innovation in business operations. The advanced technological integration can decrease costs, improve efficiency and result in the quick introduction of innovative products.
- Customers may start preferring new and creative products/services as a result of changing tastes.
- The emergence of e-commerce and social media marketing as a trend can be a great opportunity for QUIKLEARN's the learning App if it can ensure strong online presence on different social networking sites.
- The emergence of new market segments and new niches provide business and product line expansion opportunities.
- The subsidies provided by the government and other policies to make the business environment more friendly is a positive external environmental factor for QUIKLEARN's the Learning App.
- Improvement in the customers lifestyle and standards mean more consumption on consumer goods and services, and more opportunities to encourage the purchase.

### Threats

- Growing competition in the Edtech industry.
- Surviving in a VUCA business world. VUCA means for volatility, uncertainty, complexity, and ambiguity.
- Data privacy.
- Possibility of resignations by key Board Members and difficulty in getting Independent Directors on the Board in future. If the swapping of equity holdings by minority shareholders of A (AESL) failed to materialize then it may result into erosion of synergistic effect expected from the merger deal between Aventure Educational Services Limited (AESL) and TLPL. The changing regulatory framework and introduction of new stricter regulations impose a major



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threat to the QUIKLEARN's the Learning App. It makes compliance with legal standards more complex and challenging for the business organization. Inability to comply with changed regulations raises the risk of expensive law suits.

- The increasing number of direct and/or indirect competitors affects the organization's ability to sustain and expand the customer base.
- The deteriorating economic conditions affect business performance when they directly influence the customers' spending patterns and purchasing power.
- The rise in inflation increases the cost of production and affects the business profitability.
- The globalization pushes the organization to cross national boundaries and deal with cultural diversity, which may have a detrimental impact if the organization lacks the cultural intelligence.

### Answer 1(c)

During a business turnaround, once the initial crisis has been stabilized and leadership has been replaced or realigned, the next step is managing the company's stakeholders – those with a vested interest in its success. Ensuring stakeholders are on board with a turnaround plan is crucial. Not only do supportive stakeholders have the power to accelerate improved performance, but their backing, or lack of, can be the difference between feat and failure. With reference to management of stakeholders, the following measures may be thought of-

- i) Prioritizing stakeholders in a turnaround:** Once a company's stakeholders have been identified, the next step is to figure out how important a part they play in the business and how crucial their support is for turnaround success. It can be easy to assume that it's only financiers you need to focus on in a financial crisis, but it's important all stakeholders are included. However, each stakeholder or group will have different interests, attitudes, and priorities and varying things at stake. Financial and creditor stakeholders, for example, will be focused on payment, employees would have jobs and income on the line, while government may be worried about tax payable. To figure out which stakeholders to prioritize, a good exercise to carry out is stakeholder mapping. This involves plotting your stakeholders according to both their interest and their influence or power.
- ii) Rebuilding relationships in a turnaround situation:** Quite often in a crisis situation, communication between a business and its stakeholders will have broken down or can be notably fractious. In some instances, the relationships can be past the point of no return. The challenge is often convincing these stakeholders that turning around the business will be a better option than termination and winding up. This involves being honest and sharing clear and concise information with them.

Often CEOs and senior management don't have the knowledge to deal with financiers effectively in a crisis situation. Because of this, having a turnaround expert to negotiate and communicate on their behalf can be highly beneficial.

- iii) Developing a communications strategy:** Once relationships have been initially smoothed and the lines of communication are open, a plan should be developed for ongoing communications. Managing competing interests is often a complex and delicate task. It requires timely communication of relevant information throughout the turnaround period. The process of stakeholder mapping and determining stakeholder and stakeholder group characteristics, interests, and influence can help identify the most suitable communications for each and how to structure them. With this in mind, a communications strategy needs to be developed and agreed upon. This should include the channels to be used, the frequency of communications, and the information to be shared.

- iv) **Mapping out the communication plan:** For mapping out the communication plan a communication matrix or grid may be developed at first. The matrix or grid should cover the following: Which stakeholders the company is communicating with? What message is going to be communicated? When and how often there will be communication? Which Channels/ methods of communication are going to be used?

As a part of strategic focus, the following measures may be embraced:

- a) **Redefine the core business:** Redefining the core business (or businesses) that is the primary area or activity the company was founded on is the most fundamental form of strategic change. While doing so presents significant risks, it can also offer numerous rewards, including increasing market share, attracting new customers, securing competitive advantage and unlocking valuable new sources of revenue.

- b) **Downsize or right-size the business:** Downsizing a business involves digging into its layers to determine where the real work is done and eliminating the unproductive workers and divisions. This requires a lot of research work. How many layers are removed depends on the structure the management is looking to achieve.

Right-sizing, on the other hand, involves restructuring a business to make it more efficient, profitable and better able to meet its new objectives. Like downsizing, it may include terminating employees, but right-sizing isn't just about reducing expenses; it's about getting the business to its optimal size.

- c) **Strategic divestments:** During crisis stabilization, divesting involves liquidating current assets or the disposal of surplus plant and machinery to make quick cash. However, at this point in turnaround, divesting is a little different.

Decisions may be made to cut out product lines, customers, or whole areas of the business, which are then liquidated or divested. The focus here is the disposal of significant parts of the company (division or operating subsidiaries).

This type of divestment is about eliminating unrelated, unprofitable or unmanageable operations. It may involve spinning off a portion of the company, selling it to another organization, or closing it. Its purpose is to enable growth and secure a better competitive position.

- d) **Growth via acquisition:** Acquisitions are most commonly used to turn around stagnant firms i.e. firms not in a financial crisis but whose financial performance is poor. However, growing by the acquisition of firms in the same or related industries rather than organically means turnaround can be achieved faster.

- e) **Product-market refocusing:** Less radical than a complete redefinition of the business, but still involving fundamental strategic change, is a refocusing of the product-market mix. This occurs at the operating-company or business-unit level and involves the firm deciding what mix of products or services it should be selling to what customer segments.

In many cases, businesses lose their focus and have spread themselves too thin by adding products and customers while continuing to compete in all their historical product or market segments. To figure out if this is the case, the Pareto (80:20 Rule) can be applied. Pareto analysis quickly shows when there is an excessively broad product range and customer base - which consists of loss-making or low-margin business. Once identified, they can be dropped, and efforts refocused on more profitable products and customers.

**Answer 1(d)**

So, here are the key takeaways from QUIKLEARN case study that will help you to reach your business goals better-

- ✓ **Start with a Purpose:** QUIKLEARN began with a clear purpose of improving education, highlighting the importance of starting a venture with a genuine mission. Innovation Matters i.e., QUIKLEARN success was fuelled by innovative teaching methods and technology integration, showing the importance of innovation in staying ahead in the market.
- ✓ **Ethical Practices:** You must never forget your ethics in any kind of business because it determines whether you are trustworthy or not. QUIKLEARN downfall due to unethical sales tactics underscores the significance of maintaining ethical standards in business operations. They lost the trust of the audience as well as shareholders.
- ✓ **Financial Management:** QUIKLEARN financial mismanagement serves as a lesson in the importance of sound financial planning and transparency.
- ✓ **Adaptability & Quality:** QUIKLEARN experience during the COVID-19 pandemic emphasizes the need for businesses to be adaptable and have good quality in the face of unexpected challenges.
- ✓ **Balanced Growth:** QUIKLEARN aggressive expansion and acquisition strategy led to financial strain, highlighting the importance of balanced growth and sustainability.
- ✓ **Learning from Mistakes:** QUIKLEARN journey showcases the importance of learning from mistakes and setbacks and continuously evolving to meet changing market dynamics.
- ✓ **Prioritize Sustainability:** Focusing solely on rapid growth and short-term gains can be detrimental to long-term sustainability. Startups should prioritize building a sustainable business model with a focus on long-term value creation.

**Question 2**

- (a) Dharu Khera Automobile Ltd. mobilised funds from the general public by sponsoring a scheme for the purpose of its operations. Though it was a Collective Investment Scheme (CIS), the Company had mobilised such funds without obtaining registration from Securities and Exchange Board of India (SEBI). An investigation into the affairs of the Company was conducted by SEBI and eventually a show cause notice was issued for violation of Section 12(1B) inter alia other provisions of the SEBI (Collective Investment Schemes) Regulations, 1999. SEBI also passed an order against the Company and its directors imposing a penalty of ₹ 1 crore to be paid jointly and severally by the Company and its directors. One of the directors being aggrieved by the said order filed an appeal before SAT, contending that he was director only for 50 days and had neither attended any of the board meetings nor played any role in connection with the CIS. SAT remitted the matter back to the adjudicating officer, with a direction to decide the matter afresh. Proceedings were again initiated and after considering the reply of the appellant, a fresh order was passed imposing a penalty of ₹ 1.5 crore. The appellant being aggrieved by the said order had filed the instant appeal. With reference to a case law, evaluate whether SEBI was justified in holding the appellant responsible and imposing a penalty upon him ?

(6 marks)

- (b) Dharma Fintech Ltd. was going through Corporate Insolvency Resolution Process. Roma was duly appointed as the Resolution Professional. In a meeting of Committee of Creditors, the resolution plan was duly approved by the financial creditors, with a majority of 90%

votes. Roma was asked by the Committee of Creditors to approach the NCLT' for its final order on the Resolution Plan. Instead of issuing its final order, NCLT issued a direction to the official liquidator of the Company to carry out a revaluation of the assets of the Company. Aggrieved by the order of NCLT, the Committee of Creditors asked Roma to approach NCLAT. On appeal, NCLT's decision was upheld by the NCLAT. Roma was evaluating to approach Supreme Court in this matter. In the background of a judicial precedent, advise Roma.

(6 marks)

### Answer 2(a)

The facts and legal issue of the question similar to the case of *Dr. Uppal Devinder Kumar (Appellant) vs. SEBI (Respondent)*. In this case Securities Appellate Tribunal, judgement dated 25 September, 2019 inter alia observed that a perusal of section 12(1B) of the SEBI Act clearly indicates that no person shall sponsor or cause to be sponsored or carry on or cause to be carried on any collective investment scheme, unless he obtains a certificate of registration from the Board in accordance with the regulations. From the aforesaid, it is clear that the appellant has not made a promise or given surety for another. The appellant has not sponsored not pledged any money in advance. There is no evidence to indicate that he had contributed to bear the expenses of the scheme in return for some gain.

Section 12(1B), read with regulations 3 and 4 further states that no person shall sponsor or cause to be sponsored or carry on or caused to be carried on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations. There is no specific finding by the SEBI that the appellant was involved in carrying on the CIS or was involved in the execution of the scheme or was involved in the collection of the money pursuant to the scheme. Appellant was director only for 50 days and there is no evidence brought on record to show that the appellant attended any meeting of the Board of Directors nor there is any document to show that the appellant had any role at all in connection with the CIS or sponsoring a CIS or being responsible for the registration of the CIS. Thus, the finding of the SEBI that appellant had sponsored and carried on the CIS is patently based on surmises and conjectures. Thus, in the absence of any documentary evidence the SEBI was not justified in holding that the appellant had sponsored or carried on the CIS or was instrumental in the collection of the monies pursuant to the scheme especially when the SEBI has specifically recorded that month wise mobilization of the companies was not available.

The SEBI by a separate order has already given a finding that the company and its directors were directly responsible for sponsoring the CIS without registration and were instrumental in generating the monies through this scheme in violation of the Regulations and the Act. The SEBI has already imposed penalties against the company and the said directors. The appellant in the instant case no doubt was a director only for a period of 50 days and there is no finding that he was responsible either for sponsoring the scheme or for carrying out the scheme. The appellant was not instrumental in the launching/sponsoring or carrying on the scheme. In the light of the above case law, it can be concluded that a director cannot be held liable in case he was holding onto his position for a short period of time and that proves that he was not aware of the default:

Therefore:

- (1) SEBI was not justified in holding that appellant had sponsored or carried out CIS as director was not aware of the default.
- (2) The impugned order passed by SEBI imposing penalty upon appellant was not justified as the director had no knowledge of default.

**Answer 2(b)**

The facts and legal issue of the question similar to the case of *Ramkrishna Forgings Limited (Appellant) Vs. Ravindra Loonkar, Resolution Professional of ACIL Limited & Anr. (Respondents)*

The present appeal under Section 62 of Insolvency and Bankruptcy Code before the Hon'ble Supreme Court against the Impugned Judgment passed by the NCLAT.

Hon'ble Supreme Court inter alia observed that having considered the matter in depth, the Court is unable to uphold the decisions rendered by the Adjudicating Authority-NCLT as also the NCLAT. The moot question involved is the extent of the jurisdiction and powers of the Adjudicating Authority to go on the issue of revaluation in the background of the admitted and undisputed factual position that no objection was raised by any quarter with regard to any deficiency/irregularity, either by the RP or the appellant or the CoC, in finally approving the Resolution Plan which was sent to the Adjudicating Authority-NCLT for approval. Further, the statutory requirement of the RP involving two approved valuers for giving reports on fair market value and liquidation value was duly complied with and the figures in both reports were not at great variance. Significantly, the same were then put up before the CoC, which is the decision-maker and in the driver's seat, so to say, of the Corporate Debtor. K Sashidhar (supra) and Committee of Creditors of Essar Steel India Ltd. (supra) are clear authorities that the CoC's decision is not to be subjected to unnecessary judicial scrutiny and intervention. This came to be reiterated in *Maharashtra Seamless Limited (supra)*, which also emphasised that the CoC's commercial analysis ought not to be qualitatively examined and the direction therein of the NCLAT to direct the successful Resolution Applicant to enhance its fund flow was disapproved of by this Court. Thus, if the CoC, including the FC(s) to whom money is due from the Corporate Debtor, had undertaken repeated negotiations with the appellant with regard to the Resolution Plan and thereafter, with a majority of 88.56% votes, approved the final negotiated Resolution Plan of the appellant, which the RP, in turn, presented to the Adjudicating Authority(NCLT) for approval, unless the same was failing the tests of the provisions of the Code, especially Sections 30 & 31, no interference was warranted. In *Kalpraj Dharamshi v Kotak Investment Advisors Limited, (2021) 10 SCC 401*, the Court concluded that '... in view of the paramount importance given to the decision of CoC, which is to be taken on the basis of "commercial wisdom", NCLAT was not correct in law in interfering with the commercial decision taken by CoC by a thumping majority of 84.36%.' In the present case, the CoC has approved the resolution plan with a majority of 90%. Thus, the order passed by NCLT and the NCLAT is in contradiction of the IBC, 2016.

Thus, Roma is advised to approach the Supreme Court for relief.

**Question 3**

- (a) Asheesh had taken an insurance policy from Cobord Insurance Company Ltd. (Cobord), for insuring his office building. The term of the insurance was for a period of 4 years and Asheesh paid the premium regularly. In the 3rd year of the insurance term, a fire accident took place in the insured building, causing huge damage to the property. Asheesh was too disturbed with this accident and there was a delay of 4 months 16 days in intimating Cobord about the accident. Thereafter, Cobord appointed a surveyor to assess the loss caused due to the fire. The surveyor after detailed inspection submitted his report to Cobord, stating that the claim is not payable on account of Asheesh's failure to comply with the primary condition of the policy, which is timely reporting of the incident to the insurance company. Acting upon the said report, Cobord repudiated the claim.

Asheesh challenged the repudiation on the ground that the delay in intimation should be condoned, since a surveyor was appointed by Cobord.

With support of a relevant case law, comment whether Asheesh's contention is valid.

(6 marks)

(b) Aitreya Sports Company, is a company primarily engaged in the wholesale business of trading footwear, sports apparel and sports equipment. It holds various franchise- based stores across India. The management of the Company has decided to convert it from 'unlimited liability company' to 'limited liability company'. In this regard, Company has passed the resolution in the meeting of the Board of Directors and shareholders of the company as per Section 18 of the Companies Act, 2013. Aitreya Sports, applied for the said conversion, along with the necessary forms and documents to Registrar of Companies (ROC). The ROC rejected the application in view of investigation under SFIO and IPC, pending against the Company.

Aggrieved by the said rejection letter and communication as well as receiving no reply from the ROC despite multiple attempts to follow up with the matter, the Company approached the Court by filing a Writ Petition, thereby challenging the rejection of conversion from the ROC.

In the background of a judicial pronouncement, evaluate whether the Company will succeed.

(6 marks)

### Answer 3(a)

The facts of the given situation are similar to the case *Sonell Clocks And Gifts Ltd.(Appellant) Vs. New India Assurance Co. Ltd. (Respondent)*.

In this case, it was common ground that the letter of repudiation elucidates that the claim of the appellant was rejected on the ground that neither the intimation of the loss had been given to the Insurance Company immediately after the loss nor were the requisite particulars of the loss conveyed within stipulated period and there was breach of terms and conditions of Clause 6 of the general conditions of the policy. Additionally, the surveyor report predicates that it was very difficult to estimate the damages for the reasons mentioned therein and that the claim of the appellant was not payable on account of breach of Clause 6 of the general conditions of the policy.

The event occurred on 4th August, 2004 but intimation was given to the insurer only on 30th November, 2004 after a gap of around 3 months 25 days. No explanation was offered for such a long gap much less plausible and satisfactory explanation. The stipulation in condition No.6 of the policy to forthwith give notice to the insurer is to facilitate the insurer to make a meaningful investigation into the cause of damage and nature of loss, if any. Thus, the appointment of a surveyor by the respondent after receipt of intimation of the loss from the appellant, in the context of the present insurance policy, coupled with the 2000 Regulations and in particular an express stand taken in the repudiation letter sent by the respondent to the appellant after consideration of the surveyor's report, it cannot be construed to be a case of waiver on the part of the respondent.

In view of the above, we uphold the conclusion of the Commission that the respondent (insurer) had not waived the condition relating to delay stipulated in Clause 6 of the general 6 conditions of the policy, by appointing a surveyor. Accordingly, these appeals must fail.

In view of the above case law, it can be concluded that the Insurance Company can reject the claim for delay in intimation. Therefore, contention of Asheesh is invalid as appointment of surveyor does not mean any kind of waiver for delay in intimation.

### Answer 3(b)

The facts of the case were similar to the case decided in *Reebok India Company Vs. Union of India & Ors.*

The brief facts of the case are that the Registrar of Companies vide order dated 07-08-2020 rejected

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the conversion of the petitioner's company from an "Unlimited Liability Company" to a "Limited Liability company". This order was in challenge in the present petition.

The Division Bench of the Hon'ble Delhi High Court in its order dated 03-03-2020 had only directed the RoC to decide the application of the petitioner afresh in accordance with law. As of today, there is no challenge to the 2016 Regulations.

This Court is of the opinion that since the 2016 Amendment Regulation was only curative in nature and only intended to protect the interest of the creditor, the amended rules, therefore, must apply to the application which are pending with RoC and the same must apply to the applications of the petitioner/company.

The right of the petitioner for conversion from unlimited company to limited company has not been taken away. In fact, the petitioner/company had no vested right to be granted a certificate of conversion to a limited liability company.

The rules have only become more stringent in as much as the RoC has additional criteria to satisfy himself regarding the net worth of the company and as to whether any the investigation/inspection is pending against the company or not and only on being satisfied, permission for conversion can be granted. Viewed in this light, the reasons given by the RoC for rejecting the application of the petitioner on the ground that various prosecutions have been filed by the Serious Fraud Investigation Organisation against the petitioner for the offences under the Companies Act and the IPC and that the e-form 27 which was to be filed with the RoC was not in compliances with Rule 37 of the 2016 Rules cannot be said to be so perverse especially keeping in mind the interest of the shareholders and the interest of the creditors. The RoC has also observed that the petitioner/company has suffered substantial financial losses and has a net deficit in current liabilities over the assets in excess of Rs. 2100 Crores. The Registrar was also not provided with an NOC or undertaking from all the shareholders to support the conversion application and the petitioner did not even issue a public advertisement inviting objections from various creditors/stakeholders on the issue of conversion. The anxiety on the part of the Registrar of Companies that the creditors and the stakeholders should not be left high and dry cannot be said to be completely unjustified.

Accordingly, the writ petition is dismissed. Delhi High Court Denies Reebok's Shift to Limited Liability Status.

Accordingly, Aitreya Sports Company will not succeed in its writ petition.

#### Question 4

- (a) Kusha purchased a vehicle on loan from PI Financing Ltd., for which a loan cum hypothecation agreement dated February 24, 2020 was entered between the parties. The agreement allowed appointment of sole arbitrator by the finance company in the event of any dispute. A dispute arose between Kusha and the finance company regarding payment of monthly interest. Pursuant to the agreement, a sole arbitrator was appointed, who gave an award in favour of PI Financing. However, it approached the High Court seeking execution of an "arbitral award" passed by arbitrator in its favour.

Meanwhile, Kusha also challenged the award before the Civil Court under section 34 of the Arbitration and Conciliation Act, 1996. Further, he contended that the "arbitral award" was not appropriate, as the sole arbitrator was unilaterally appointed by PI Financing. Also, the arbitral proceedings were conducted without participation of the award debtor and so, the arbitral award was passed ex-parte.

Referring to a case law, analyse whether Kusha's contention is tenable.

(6 marks)



(b) Black Marbel Resorts Ltd., availed a loan of ₹ 50 crore from Industrial Financial Loan Corporation (IFLC), a financial institution. This loan was secured and the Company entered into a corporate loan agreement with IFLC. The agreement included creation of a special mortgage to secure the corporate loan. The mortgaged property comprised of Resort property at Una, a district of Himachal Pradesh.

The Company defaulted in repayment of the loan and its account became a Non-Performing Asset (NPA). After issuing a demand notice under section 13(4) of the SARFESI Act, IFLC took symbolic possession of the Resort property. Subsequently, it also initiated recovery proceedings in DRT and sold the resort property in public auction, which was purchased by Swayam LLP.

The Company challenged the recovery proceedings before the High Court which held the entire proceedings for recovery and sale of the Resort property to be illegal, being in violation of the Act.

In the background of a judicial pronouncement, evaluate whether enforcement of security interest by IFLC is valid.

(6 marks)

#### Answer 4(a)

The facts of the given situation are similar to the case *Cholamandalam Investment and Finance Company Ltd. Vs Amrapali Enterprises and Anr- 14-03-2023- High Court of Calcutta*. The present application was filed under Section 36 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as the 'Act') by Cholamandalam Investment and Finance Company Ltd (hereinafter referred to as the 'award holder') seeking execution of an arbitral award dated November 22, 2021 (hereinafter referred to as the 'impugned award') passed by Sole Arbitrator. The award debtors were Amrapali Enterprises represented by proprietor Mohammad Jahangir (hereinafter referred to as the 'borrower') and Saif Khan (hereinafter referred to as the 'guarantor').

It was submitted that the impugned award has been challenged under Section 34 of the Act before the City Civil Court. However, the court understood that the same may be time barred. From the submissions made by the parties and perusal of the arbitral award, it is apparent that the Sole Arbitrator was unilaterally appointed by the award holder vide its letter dated June 24, 2021. Further, the arbitral proceedings were conducted without participation of the award debtors and consequently, the arbitral award was passed ex-parte. The position of law on unilateral appointment of an arbitrator is no more res integra and has been settled by the Supreme Court through various judicial pronouncements.

The proscription under section 12(5) read with schedule VII of the Act was extended to persons unilaterally appointed to act as an arbitrator. Such persons who are unilaterally appointed lack inherent jurisdiction unless an express written approval is given by the parties subsequent to disputes having arisen.

Firstly, in the case of *HRD Corporation -vs- GAIL* reported in (2018) 12 SCC 471, the Apex Court ruled that when a person directly falls under Schedule VII, ineligibility goes to the root of the appointment as per prohibition under Section 12(5) read with Schedule VII. Such person lacks inherent jurisdiction.

The Court said that I find myself in complete concurrence with the aforesaid judgments, and in my view, the impugned award is unsustainable and *non-est* in the eyes of law.

It is a settled principle of law that compliance with Section 12(5) read with Schedule VII is *sine qua non* for any arbitral reference to gain recognition and validity before the Courts. In the present facts in hand, an arbitral reference which itself began with an illegal act has vitiated the entire

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arbitral proceedings from its inception and the same cannot be validated at any later stage. Thus, it would be a logical inference to consider the aforesaid arbitral proceedings as *void ab initio*.

The High Court said that in my view, the impugned award, which was passed by a de jure ineligible arbitrator, suffers from a permanent and indelible mark of bias and prejudice which cannot be washed away at any stage including the execution proceedings. In fact, as the arbitrator was de jure ineligible to perform his functions and therefore lacked inherent jurisdiction or competence to adjudicate the disputes in hand, the impugned award cannot be accorded the privileged status of an award.

In view of the above mentioned judgement whose facts are similar to the given case, Kusha's contention is tenable.

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

The facts of the case were similar to the case decided *ITC Ltd. Vs. Blue Coast Hotels Ltd. Civil Appeal Nos. 2928-2930 of 2018 [Arising out of SLP (C) Nos. 10215-10217/2016] [Decided on 19/03/2018 by Supreme Court of India]*

In this case, the creditor did not have actual possession of the secured asset but only a constructive or symbolic possession. The transfer of the secured asset by the creditor therefore cannot be construed to be a complete transfer as contemplated by Section 8 of the Transfer of Property Act. The creditor nevertheless had a right to take actual possession of the secured assets and must therefore be held to be a secured creditor even after the limited transfer to the auction purchaser under the agreement. Thus, the entire interest in the property not having been passed on to the creditor in the first place, the creditor in turn could not pass on the entire interest to the auction purchaser and thus remained a secured creditor in the Act. The High Court in its judgment renders a finding that there was in fact fraud and collusion between the creditor and the auction purchaser. According to the High Court, since the measures were taken in breach of all laws, the inference of manipulation and collusion cannot be ruled out.

We fail to see how such a finding of manipulation and collusion is sustainable on account of breach of law in the present case. A risk of this kind taken up by an intending purchaser cannot lead to an inference of collusion. Mainly, the finding is based on the fact that the sale is a collusion because the auction purchaser was aware that a dispute between the parties was pending and still went ahead and made a bid for the property. It is not unusual in the sale of immovable properties to come across difficulties in finding suitable buyers for the property. We find that the property was eventually sold on the fourth auction, and all the auctions were duly advertised.

Another fact on the basis of which the High Court has observed an inference of collusion is that the property was sold and the sale was confirmed in favour of ITC Ltd. There is no dispute that the property was actually purchased by ITC Ltd in pursuance of a public auction and that the entire amount of sale consideration has been deposited by it.

We have anxiously considered the entire matter and find that the undisputed facts of the case are that a loan was taken by the debtor which was not paid, the debtor did not respond to a notice of demand and made a representation which was not replied to in writing by the creditor. The creditor, however, considered the proposals for repayment of the loan as contained in the representation in the course of negotiations which continued for a considerable amount of time. Several opportunities were in fact availed of by the debtor for the repayment of the loan after the proceedings were initiated by the secured creditor. The debtor failed to discharge its liabilities and eventually undertook that if the debtor fails to discharge the debt, the creditor would be entitled to take realize the secured assets.

As held, we are of the view that non-compliance of sub-section (3A) of Section 13 of the SARFAESI Act cannot be of any avail to the debtor whose conduct has been merely to seek time and

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not repay the loan as promised on several occasions. Therefore, the debtor is not entitled for the discretionary equitable relief under Articles 226 and 136 of the Constitution of India in the present case. We accordingly, set aside the impugned judgment of the High Court and direct the debtor and its agents to handover possession of the mortgaged properties to the auction purchaser within a period of six months from the date of this judgment along with the relevant accounts.

Therefore, in view of above judgement, it can be held that enforcement of security interest by IFLC is valid.

### Question 5

- (a) Sumedh Jaina passed away leaving his wife, Suma Jaina, as the nominee to his 39.88% shareholding in Jaina Agro Mills Ltd. ("Jaina Agro"). Upon his demise, the Company registered the entire shareholding of Sumedh Jaina to Suma Jaina. Meanwhile, all was not well within the family, Archit Jaina, son of Sumedh Jaina, filed a partition suit before the Delhi High Court, claiming his one-fourth right, title and interest in his father's estate, including the shares of Jaina Agro. The Delhi High Court granted a status quo in the matter as interlocutory relief. Archit also had 0.03% equity shareholding in Jaina Agro. Subsequently, Archit filed a petition under Section 241 of the Companies Act, 2013, alleging acts of oppression and mismanagement in Jaina Agro.

Suma filed a maintainability application on the ground that Archit did not hold the requisite 10% shareholding in the Company to maintain the petition under Section 244. This was resisted by Archit, by claiming entitlement and legitimate expectation of 9.97% shareholding, by virtue of being a legal heir of his deceased father, in addition to his personal holding 0.03% in the Company. NCLT dismissed Suma's application, holding Archit to be entitled to the one-fourth share. Suma also appeals that the admission of Archit's petition is not legal, as the civil suit is still pending. With reference to a settled case law, comment whether Suma's contention is justified ?

(6 marks)

- (b) Kirit, was a non-executive director in Partho Technologies Private Ltd. The Company was in need of funds for future expansion, they approached Saxon Inc, venture capitalist company for funding. Saxon had agreed to disburse an amount of ₹ 50 Lakh to the Company as per the agreement dated March 3, 2018. Subsequently, cheques were purportedly issued by the Company to discharge its liability towards Saxon Inc. The cheques in question, all dated December 31, 2023 were issued by the Company for a total amount of ₹ 50 Lakh and the same were dishonoured due to insufficient funds vide bank memo dated January 11, 2024.

Kirit ceased to be a director of the company effective October 27, 2017, at least six years prior to the issuance of the cheques in question. His resignation was also notified to the Registrar of Companies by filing the requisite forms, which are publicly available. A case was filed against the Company and its directors for dishonour of cheques including Kirit.

Examine the liability of retired directors in such cases, with supporting case law.

(6 marks)

### Answer 5(a)

The facts of the case were similar to the case decided in *Aruna Oswal (Appellant) vs Pankaj Oswal & Ors (Respondent)* - (Supreme Court) (06 Jul 2020).

Present appeals have been preferred against the judgment passed by the National Company Law Appellate Tribunal, New Delhi, ('the NCLAT') in Company Appeal, thereby affirming the order

passed by the National Company Law Tribunal ('the NCLT') concerning maintainability of the applications filed under Sections 241 and 242 of the Companies Act, 2013. The case is the outcome of a family tussle. Late Abhey Kumar Oswal, during his lifetime, held as many as 5,35,3,960 shares in Oswal Agro Mills Ltd., a listed company. Pankaj Oswal, respondent No.1, filed a partition suit being claiming entitlement to one-fourth of the estate of Abhey Kumar Oswal.

Learned senior counsel appearing on behalf of Aruna Oswal, wife of the deceased, vehemently argued that the appellant was the sole nominee of shares of erstwhile shareholder Late Abhey Kumar Oswal. In view of the provisions contained in Section 71 of the Companies Act, 2013 Respondent No.1 could not claim any interest in the said shares because of the nomination. After excluding shares in the name of mother Aruna Oswal, respondent No.1 Pankaj Oswal would have only 0.03% of the shareholding in Oswal Agro Industries Ltd. Given the provisions in Section 244 of the Act, as respondent no.1 lacked requisite shareholding of 10%, as such, the application was not maintainable under Sections 241 and 242 of the Act. Abhey Kumar Oswal died intestate. Because of the provisions of Section 72 of the Act, all the rights vested in Aruna Oswal, the appellant. Thus, the shareholding purchased by Respondent No.1 to the extent of 0.03% in May, 2017 after filing of civil suit, did not bestow any right upon him to maintain the company petition. The application could not be said to be maintainable. Admittedly, Respondent No.1 is not holding the shares to the extent of eligibility threshold of 10% as stipulated under Section 244 of Act in order to maintain an application under Sections 241 and 242 of Act. The question as to the right of respondent no.1 is required to be adjudicated finally in the civil suit. The decision in a civil suit would be binding between the parties on the question of right, title, or interest. It is the domain of a civil court to determine the right, title, and interest in an estate in a suit for partition. In Sangramsinh P. Gaekwad and Ors. v. Shantadevi P. Gaekwad (Dead) through LRs. and Ors., it was held that the dispute as to inheritance of shares is eminently a civil dispute and cannot be said to be a dispute as regards oppression and/or mismanagement so as to attract Company Court's jurisdiction under Sections 397 and 398 of Act. Adjudication of the question of ownership of shares is not contemplated under Section 397 of Act. In M/s. Dale & Carrington Invt. (P) Ltd. and Anr. v. P.K. Prathapan and Ors., the question of locus standi to entertain the petition under sections 397 and 398 of the Companies Act, 1956, which are pari materia to Sections 241 and 242 of the Companies Act, 2013, was considered. This Court held that in order to maintain the petition, one should have requisite number of shares in the company on the date of filing of the petition. The High Court in the pending civil suit passed an order maintaining the status quo concerning shareholding and other properties. Because of the status quo order, shares have to be held in the name of Mrs. Aruna Oswal until the suit is finally decided. The question of right, title, and interest is essentially adjudication of civil rights between the parties, as to the effect of the nomination decision in a civil suit is going to govern the parties' rights.

It would not be appropriate to entertain these parallel proceedings and give waiver as claimed under Section 244 of Act before the civil suit's decision. Respondent No. 1 had himself chosen to avail the remedy of civil suit, as such filing of an application under Sections 241 and 242 of Act after that is nothing but an afterthought. In the facts and circumstances, it would not be appropriate to permit Respondent No.1 to continue the proceedings for mismanagement initiated under Sections 241 and 242 of Act, that too in the absence of having 10% shareholding and firmly establishing his rights in civil proceedings to the extent he is claiming in the shareholding of the companies.

Present Court refrains to decide the question finally in these proceedings concerning the effect of nomination, as it being a civil dispute, cannot be decided in present proceedings and the decision may jeopardise parties' rights and interest in the civil suit. With regard to the dispute as to right, title, and interest in the securities, the finding of the civil Court is going to be final and conclusive and binding on parties. In order to maintain the proceedings, the Respondent should have waited for the decision of the right, title and interest, in the civil suit concerning shares in question. The entitlement of Respondent No.1 is under a cloud of pending civil dispute.

Present Court deems it appropriate to direct the dropping of the proceedings filed before the NCLT regarding oppression and mismanagement under Sections 241 and 242 of the Act with the liberty to file afresh. Impugned orders passed by the NCLT as well as NCLAT are set aside, and the appeals are allowed.

In light of the above judgement, it can be stated that Suma's contention is justified till civil suit is finally decreed.

### Answer 5(b)

Hon'ble Delhi High Court in the case of *Alibaba Nabibasha (petitioner) v. Small Farmers Agri-Business Consortium, (Respondents)* encapsulates the legal position that a retired director of a company cannot be held liable for the day-to-day acts of the company and cheques issued and dishonoured post his retirement.

The instant petition was filed seeking quashing of five complaint cases initiated by the respondent No.1 against the petitioner. These complaint cases were primarily grounded on the return of five cheques, which formed the subject matter of the dispute and were issued by the Company for a sum total of Rs.45 Lakhs. The petitioner was a Non-Executive Director for a brief period and ceased to hold his directorship position eight years prior to the issuance of the cheques in question. Consequently, the Company notified his resignation to the Registrar of Companies (ROC) / Ministry of Company Affairs (MCA) by filing Form 32. A pertinent question that arose for consideration was whether the petitioner, who ceased to be the Director when the underlying contract was executed, can be held vicariously liable for the affairs of the company.

As per the provisions enumerated under section 141 of NI Act, it is pertinent that the person who shall be deemed to be guilty of the offence and liable to be proceeded against and punished accordingly, must be in-charge of and responsible for the conduct of the day-to-day affairs of the Company. Moreover, the court concluded that it is settled law that mere repetition of the phraseology of Section 141 of NI Act that the accused was in-charge and responsible for the conduct of the day-to-day affairs of the Company may not be sufficient and facts stating as to how the accused was so responsible must be averred.

Additionally, the court observed that if the case of the respondent No.1 was to hold true that the petitioner was involved in the discussion and represented the company before the agreement was executed, however, that does not mean even after his resignation, he continues to be responsible for the actions of the Company including the issuance of cheques and dishonour of the same which then attracts proceedings under Section 138 of the NI Act against him. Taking note of various submissions, the High court concluded that the petitioner had resigned from the Company therefore in instances wherein cheques are subsequently issued and dishonoured, then an accused cannot be held liable.

In view of the above-stated decisions, the present petition was allowed and all proceedings pending before the Metropolitan Magistrate including summons were quashed.

### Question 6

AFB Ltd., the flagship company of AFB conglomerates, is listed on recognised stock exchange in India. It is still managed by a Board, which mainly has promoter directors. As a part of its rebranding exercise the management appointed KLI Consultants to help them revamp their brand, including their operations and other business aspects.

The Group launched a re-branding exercise in 2015, the most visible part being a new logo, uniform across all group companies. It had well diversified businesses – cyclical (property : owning 300 acres in Mumbai's Vikhroli, Ahmedabad, Pune and Kalyan), stable (fast moving consumer goods),

rural (Kirana stores) and urban (organised retail stores – Walk-in departmental stores, domestic appliances and modern furniture). 'The group sells fatty acids to tyre manufacturers; animal feed to 1,00,000 farmers; and premium wine in Mumbai and Delhi. Its customers range from five-year olds (nutrient), ageing man (hair-dye), to housewives (soaps & locks), IT companies (renting sprawling spaces), to Government of India (like components for manufacturing rockets for space mission), and to 5,000 barbers (hair dye). But it is yet to explore new-age industries like health care and information technology.

AFB Ltd. has adopted a '3 by 3' strategy, sticking to emerging markets in three regions– Asia, Africa and Latin America, as their culture, tastes and even skin colours are quite similar to India and in three categories–personal care, hair-care and insecticide. Since 2015, AFB Ltd. has made seven acquisitions, including its biggest acquisition of Singapore's Mun Lee Group for ₹ 1,800 crore in 2018.

"Acquisitions overseas add status and value to the brand-owners in the domestic market" says an expert. Anili Chug says, "by having a presence in multiple markets our risk assessment is neutralized".

Recently, AFB Ltd. top honchos toured the hinterlands, an indicator of the renewed focus on consumer. To reach out to new customers, especially those in rural India, it has gone in for destructive innovation. The group has been manufacturing refrigerators for more than 25 years, but its penetration has been only 8%. It found out that people do not need a 180 litre fridge due to space and cost constraints. It came out with 'Small Fit'—a square 45 litre mini fridge priced at just ₹ 3,250. Another example of destructive innovation is the launch of 'U & Us'— a 'by appointment', design studio where customers co-design their furniture with the help of artificial intelligence, as customers sees furniture as an extension of their personality. Thus, AFB Ltd. is transiting from manufacturing oriented to consumer oriented. Meanwhile, the consultants also suggested that the group should evaluate integrated reporting, as it would be helpful in gaining international recognition.

In the background of above facts, answer the following :

- (a) Outline strengths and weaknesses of AFB Ltd. Also indicate the main reasons due to which companies go global.
- (b) Elucidate the framework of integrated reporting and its advantages to the Company.

(6 marks each)

#### Answer 6(a)

Strengths of the AFB Limited are:

**Diversified Portfolio:** Operating across multiple sectors like real estate, consumer goods, and retail provides stability and reduces reliance on a single market.

**Strong Market Presence:** The company has a well-established presence in India and is expanding into emerging markets with significant growth potential.

**Customer Focus:** AFB Ltd. demonstrates a strong focus on understanding and meeting consumer needs through initiatives like "Small Fit" and "U & Us."

**Innovation:** The company is embracing "destructive innovation" by challenging existing market norms and offering new solutions.

**Rebranding Efforts:** The rebranding exercise suggests a proactive approach to adapting to the changing market landscape.

Weaknesses of the group are :

**Promoter-Driven Management:** While this can bring stability, it may also limit flexibility and responsiveness to changing market dynamics.

**Limited Exploration of New-Age Industries:** The company has yet to venture into sectors like healthcare and information technology, which could represent untapped growth opportunities.

**Potential for Cultural Differences:** Expanding into emerging markets with diverse cultures and consumer preferences can pose challenges.

**Competition:** The company faces competition from established players in each of its business segments.

There are many reasons due to which the companies go global :

**Market Expansion:** Accessing new markets with untapped growth potential.

**Resource Acquisition:** Gaining access to raw materials, skilled labor, and other resources at lower costs.

**Diversification:** Reducing risk by operating in multiple markets and reducing dependence on a single economy.

**Competitive Advantage:** Gaining a competitive edge by accessing new technologies, talent, and knowledge.

**Brand Building:** Enhancing brand image and reputation by expanding into international markets.

### Answer 6(b)

#### Framework of Integrated Reporting:

Integrated reporting provides a comprehensive view of a company's value creation by connecting its financial performance with its environmental, social, and governance (ESG) performance. It aims to provide stakeholders with a holistic understanding of the company's strategy, business model, and performance.

#### Key Elements of Integrated Reporting:

- **Governance:** Describes the company's governance structure and how it oversees value creation.
- **Business Model:** Explains the company's business model and how it creates value.
- **Strategy and Resource Allocation:** Outlines the company's strategy and how it allocates resources to create value.
- **Risk and Opportunities:** Identifies and analyzes key risks and opportunities that could affect the company's ability to create value.
- **Metrics and Key Performance Indicators (KPIs):** Measures and reports on the company's performance against its strategic objectives.
- **Stakeholder Relationships:** Explains how the company engages with stakeholders and considers their interests.

#### Advantages of Integrated Reporting for AFB Ltd.:

- **Enhanced Transparency and Accountability:** Integrated reporting provides stakeholders with a more complete and transparent picture of the company's performance.
- **Improved Stakeholder Engagement:** By addressing ESG issues and engaging with stakeholders, the company can build stronger relationships and trust.
- **Enhanced Reputation and Brand Value:** Demonstrating a commitment to sustainability and responsible business practices can enhance the company's reputation and brand value.



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- **Improved Decision-Making:** Integrated reporting can provide valuable insights into the company's performance and help inform strategic decision-making.
- **Access to Capital:** Investors increasingly value ESG factors, and integrated reporting can attract socially and environmentally conscious investors.

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## BANKING LAW & PRACTICE

### MODULE 3 ELECTIVE PAPER 9.1

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer All Questions.

#### Question 1

- (A) The Banking Regulation (Amendment) Ordinance, 2017 introduced sections 35AA and 35AB as amendments to the Banking Regulation Act on 4th May, 2017, which were replaced by Banking Regulation (Amendment) Bill, 2017 dated 14.07.2017.

Sections 35AA and 35AB were legislatively introduced as follows :

35AA. The Central Government may, by order, authorise the Reserve Bank to issue directions to any banking company or banking companies to initiate insolvency resolution process in respect of a default, under the provisions of the Insolvency and Bankruptcy Code, 2016.

Explanation - For the purposes of this Section, "default" has the same meaning assigned to it in clause (12) of Section 3 of the Insolvency and Bankruptcy Code, 2016. 35AB (1) Without prejudice to the provisions of section 35A, the Reserve Bank may, from time to time, issue directions to any banking company or banking companies for resolution of stressed assets.

(2) The Reserve Bank may specify one or more authorities or committees with such members as the Reserve Bank may appoint or approve for appointment to advise any banking company or banking companies on resolution of stressed assets.

#### Facts of the Case and the Impasse :

- The real bone of contention was a Reserve Bank of India ["RBI"] Circular issued on 12.02.2018, by which the RBI promulgated a revised framework for resolution of stressed assets in respect of borrowers whose exposure is over INR 2,000 crores.
- In terms of the Circular, unless a restructuring process in respect of debts with an aggregate exposure of over INR 2,000 crore is fully implemented on or before 195 days from the reference date or date of first default, the lenders will have to file applications as financial creditors under the Insolvency Code.
- The circular had been issued under section 35A of the Banking Regulation Act read with the Central Government's circular dated 05.05.2017, as well as under sections 35AA, 35AB and Section 45 L of the Reserve Bank of India Act, 1934.

#### The petitioners contended that :

- Circular issued by RBI is arbitrary and discriminatory and violative of Article 14 of the Constitution as the circular applied a 180-day limit to all sectors of the economy without going into the special problems faced by each sector thus would treat unequals equally. The circular has picked defaults of ₹ 2,000 crores randomly and the lender whose stake is 1 per cent can also stall the resolution process.
- The impugned circular was ultra vires the provisions of Banking Regulation Act and the RBI Act. It was stated that section 35A and section 35AB of the Banking Regulation Act cannot possibly be the source of power for the and cannot, therefore, be used

to empower the RBI to relegate companies to insolvency under the Insolvency Code as it did not exist at the time, or to give directions for resolution of stressed assets. RBI's functions under Section 35A are confined to the boundaries of the RBI Act and the Banking Regulation Act and not to other statutes, such as the Insolvency Code.

- (c) It was argued that sections 35AA and 35AB are part of one composite scheme. Section 35AA alone refers to, and can alone be the source of power for directing banking and non-banking companies to file applications under the Insolvency Code. Section 35AB clearly refers to resolution of stressed assets in a manner which is de hors the Insolvency Code.

**On behalf of the Union of India, following arguments were advanced :**

- (a) Sections 35AA and 35AB are regulatory provisions made in public interest that cannot possibly be said to be manifestly arbitrary in any way. The aforesaid Sections cannot be said to be unguided provisions as the RBI gets sufficient guidance from the Preamble as well as other provisions of the Banking Regulation Act.
- (b) Ideally there ought to be a sector wise contingency analysis by the RBI before exercising power provided by the Central Government to it under Section 35AA. In any case, so far as the power sector is concerned, RBI ought to have treated it differently from all other sectors in view of the steps that the Central Government is taking in order to bring back the power sector on its feet.

**In the light of the above arguments and the decided case, answer the following questions :**

- (A) (i) Whether the sections 35AA and 35AB introduced pursuant to the Ordinance and Amendment Act are unconstitutional ? Explain. (6 marks)
- (ii) Whether the impugned Circular dated 12.02.2018 issued by RBI is ultra vires Section 35AA of the Banking Regulation Act and consequentially all cases in which debtors have been proceeded against by financial creditors under Section 7 of the Insolvency Code, only because of the operation of the impugned circular are non-est ? (6 marks)
- (iii) Whether RBI can give directions under Section 35A of the Banking Regulation Act to the Banks to exercise their powers under the Insolvency Code ? (8 marks)
- (B) Climate change has been recognised as one of the most critical challenges faced by the global society and economy in the 21st century. The financial sector can play a pivotal role in mobilizing resources and their allocation thereof in green activities/ projects. Green finance is also progressively gaining traction in India. In this regard, RBI has examined the aspects in detail and has released a broad framework in this regard.

With this end in view, as all of us know, Deposits constitute a major source for mobilizing of funds by the Banks/Regulated Entities (REs). It is seen that some REs is already offering green deposits for financing green activities and projects.

Taking this forward and with a view to fostering and developing green finance ecosystem in the country, Reserve Bank of India has put in place a Framework for acceptance of Green Deposits for the Regulated Entities.

With this background, answer the following questions :

- (B) (i) What are the sectors of green activities/projects identified for allocation of proceeds under the guidelines in terms of the above framework/circular ?

(4 marks)

- (ii) Name the projects which have been excluded from the above classification of green activities/projects ?

- (iii) Define the following terms :

- (a) Green Deposit;
- (b) Green Finance; and
- (c) Green Washing.

(4 marks)

- (iv) Explain the impact indicators identified under the Green activities/projects ? What are the expectations envisaged from the REs ? How the scheme ensures it being adhered ?

(6 marks)

#### Answer 1A(i)

The facts of the question are similar to the case of *Dharani Sugars and Chemicals Ltd. Vs. Union of India (2019)*, wherein the Supreme court noted that the scheme of sections 35A, 35AA, and 35AB of Banking Regulation Act, 1949, is as follows:

- (i) When it comes to issuing directions to initiate the insolvency resolution process under the Insolvency Code, Section 35AA is the only source of power.
- (ii) When it comes to issuing directions in respect of stressed assets, which directions are directions other than resolving this problem under the Insolvency Code, such power falls within Section 35A read with Section 35AB. This also becomes clear from the fact that Section 35AB (2) enables the RBI to specify one or more authorities or committees to advise any banking company on resolution of stressed assets. This advice is obviously defying the Insolvency Code, as once an application is made under the Insolvency Code, such advice would be wholly redundant, as the Insolvency Code provisions would then take over and have to be followed.

Sections 35AA and 35AB are constitutional since they fall under the regulatory purview of the RBI and align with public interest objectives. However, their application must not exceed statutory limits.

#### Answer 1A(ii)

The circular imposed a 180-day deadline for resolution of stressed assets exceeding Rs. 2,000 crore, failing which banks were mandated to initiate insolvency proceedings under the Insolvency and Bankruptcy Code, 2016.

Issued under Sections 35A, 35AA, 35AB of the Banking Regulation Act, 1949 and Section 45L of the Reserve Bank of India Act, 1934 it sought to streamline and expedite resolution processes.

The Supreme Court in *Dharani Sugars and Chemicals Ltd. vs. Union of India (2019)* held the impugned circular to be ultra vires as a whole declared it to be of no effect in law. Consequently, all actions taken under the said circular, including actions by which the Insolvency Code has been triggered

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must fall along with the said circular. As a result, all cases in which debtors have been proceeded against by financial creditors under Section 7 of the Insolvency and Bankruptcy Code, 2016, only because of the operation of the impugned circular will be proceedings which, being faulted at the very inception, are declared to be non-est.

The Supreme Court in *Dharani Sugars and Chemicals Ltd. vs. Union of India* (2019), further held that:

- The circular was ultra vires to Section 35AA as the RBI lacked specific authorization for issuing such a directive.
- Cases initiated solely due to the circular's operation were declared non-est (invalid).

The circular is ultra vires to Section 35AA, rendering actions taken under it void. The RBI must act within its statutory limits with explicit government authorization for such directives.

### Answer 1A(iii)

The Supreme Court in *Dharani Sugars and Chemicals Ltd. vs. Union of India* (2019) noted that the established principle that when one section of a statute grants general powers, as opposed to another section of the same statute which grants specific powers, general provisions cannot be utilised where a specific provision has been enacted with a specific purpose in mind.

The Supreme Court finally concluded as under:

“Stressed assets can be resolved either through the Insolvency Code or otherwise. When resolution through the Code is to be effected, the specific power granted by Section 35AA can alone be availed by the RBI. When resolution de hors the Code is to be effected, the general powers under Sections 35A and 35AB are to be used. Any other interpretation would make Section 35AA otiose. Absent the Central Government authorisation under Section 35AA, it is clear that the RBI would have no such power.”

The Court further noted that since section 35AA uses the word “default” the directions by the Central Government can be issued in case of a particular default of a particular debtor. Hence, Section 35AA refers only to specific cases of default and not to the issuance of directions to banking companies generally, as has been done by the impugned circular. It is clear that directions that can be issued under Section 35AA can only be in respect of specific defaults by specific debtors.

### Answer 1B(i)

The green activities / projects identified in terms of the RBI circular are:

- (i) **Renewable Energy:** Projects like wind, solar, hydropower, biomass, and geothermal energy.
- (ii) **Energy Efficiency:** Activities that promote reduced energy consumption or increased energy efficiency in buildings, industry, and appliances.
- (iii) **Clean Transportation:** Initiatives supporting public transportation, Electric Vehicles (EVs), or other low-carbon transportation solutions.
- (iv) **Sustainable Water and Waste Management:** Projects focusing on water efficiency, wastewater treatment, and waste-to-energy initiatives.
- (v) **Climate Change Adaptation:** Measures enhancing resilience to climate-related risks.
- (vi) **Sustainable Land Use and Forestry:** Afforestation, reforestation, and sustainable agriculture.
- (vii) **Terrestrial and Aquatic Biodiversity Conservation:** Projects aimed at protecting natural ecosystems and endangered species.
- (viii) **Pollution Prevention and Control:** Projects aimed at reducing, controlling, or preventing

pollution through initiatives like Waste management (e.g., recycling, composting), Air and water pollution control technologies, Sustainable waste disposal practices and Industrial process improvements to reduce emissions or waste.

- (ix) **Green Buildings:** Refers to buildings designed to reduce environmental impacts throughout their lifecycle, typically through Energy efficiency (e.g., efficient heating, cooling, and lighting systems), Use of sustainable building materials, Water efficiency and rainwater harvesting systems, and Certification under recognized green building standards.

#### Answer 1B(ii)

In terms of the RBI Circular, the projects which have been excluded from the green activities/projects classification are:

- (i) Projects involving new or existing extraction, production and distribution of fossil fuels, including improvements and upgrades; or where the core energy source is fossil-fuel based.
- (ii) Nuclear power generation.
- (iii) Direct waste incineration.
- (iv) Alcohol, weapons, tobacco, gaming, or palm oil industries.
- (v) Renewable energy projects generating energy from biomass using feedstock originating from protected areas.
- (vi) Landfill projects.
- (vii) Hydropower plants larger than 25 MW.

#### Answer 1B(iii)

- (a) **Green Deposit:** Green Deposit means an interest-bearing deposit, received by the Regulated Entities for a fixed period and the proceeds of which are earmarked for being allocated towards green finance.
- (b) **Green Finance:** Green Finance means lending to and/or investing in the activities/ projects meeting the requirements prescribed that contributes to climate risk mitigation climate adaptation and resilience, and other climate-related or environmental objectives – including biodiversity management and nature-based solutions.
- (c) **Green Washing:** Green Washing means the practice of marketing products/services as Green, when in fact they do not meet requirements to be defined as green activities/projects.

#### Answer 1B(iv)

The impact indicators identified under the Green activities/projects along with the unit of measure are as follows:

(i) **Renewable Energy:**

- Total renewable capacity (in MWh).
- Energy generated per year (MWh).
- Greenhouse Gas (GHG) emissions avoided per year (measured in tonnes CO<sub>2</sub> equivalent, tonnes of carbon dioxide equivalent (tCO<sub>2</sub>e)).

(ii) **Waste Management:**

- Waste diverted from landfill per year (tonnes).

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**(iii) Clean Transportation:**

- GHG emissions avoided per year (tCO<sub>2</sub>e).
- New clean transportation infrastructure built (km).
- Number of electric or low emission vehicles produced.

**(iv) Energy Efficiency:**

- Energy savings per year (MWh).
- GHG emissions avoided per year (tCO<sub>2</sub>e).

**(v) Afforestation / Reforestation:**

- GHG emissions reduced/Carbon Sequestration achieved (measured in tCO<sub>2</sub>e).

It is expected that the Regulated Entities shall ensure that the funds raised through green deposits are allocated to the eligible green activities/projects.

The allocation of funds raised through green deposits by Regulated Entities (REs) during a financial year shall be subject to an independent Third-Party Verification/Assurance which shall be done on an annual basis. The third-party assessment would not absolve the RE of its responsibility regarding the end-use of funds for which the laid down procedures of internal checks and balances would have to be followed as in the case of other loans. The related terms and conditions to be additionally fulfilled by the borrowers to meet the requirements of the framework laid out would be the additional check points while ascertaining the end-use of funds.

**Question 2**

- (a) A significant section of the workforce of the Indian economy consists of artisans and craftspeople who work with their hands and tools, are usually self-employed and are generally considered to be a part of the informal or unorganised sector of the economy.

Explain the name of the scheme launched in the recent past which has been specifically drawn out by the Government exclusively for the above artisans and craftspeople together with its goals and objectives.

(8 marks)

- (b) Calculate the provision that needs to be earmarked by the Bank in respect of the following case :

Outstanding Balance	–	₹ 4 lakhs
ECGC Cover	–	50%
Value of security held	–	₹ 1.50 lakhs

Period for which the advance has remained doubtful–More than 2 years remained doubtful  
(As on March 31, 2024)

(4 marks)

**Answer 2(a)**

The traditional artisans and craftspeople are referred to as 'Vishwakarmas' and are engaged in occupations like Blacksmiths, Goldsmiths, Potters, Carpenters, Sculptors, etc. These skills or occupations are passed from generation-to-generation following a guru-shishya model of traditional training, both within the families and other informal groups of artisans and craftspeople.



In the above backdrop, the Government of India launched the **Pradhan Mantri Vishwakarma Scheme (PM Vishwakarma)** on September 17, 2023, to provide comprehensive support to artisans and craftspeople who work with their hands and tools.

It is the goal of the Scheme to offer holistic end-to-end support to the Vishwakarmas, i.e., the artisans and craftspeople, to enable them to move up the value chain in their respective trades. It will bring a qualitative shift in the way these occupations are practised by artisans and craftspeople and this will uplift their socio-economic status as well as their quality of life.

The objective of the scheme in terms of the circular/directions are:

- (i) To enable the recognition of artisans and craftspeople as Vishwakarma making them eligible to avail all the benefits under the Scheme.
- (ii) To provide skill upgradation to hone their skills and make relevant and suitable training opportunities available to them.
- (iii) To provide support for better and modern tools to enhance their capability, productivity, and quality of products and services.
- (iv) To provide the beneficiaries an easy access to collateral free credit and reduce the cost of credit by providing interest subvention.
- (v) To provide incentives for digital transactions to encourage digital empowerment of Vishwakarmas.
- (vi) To provide a platform for brand promotion and market linkages to help them access new opportunities for growth.

#### Answer 2(b)

In the problem given, the provision that requires to be made by the Bank are as follows:

Particulars	Amount (Rs. in Lakhs)
Outstanding Balance	4.00
Less: Value of security held	1.50
Unrealised Balance	2.50
Less: ECGC Cover (50% of Unrealisable Balance)	1.25
Net Unsecured Balance	1.25
Provision for unsecured portion of advance [@ 100 percent of Unsecured Portion]	1.25
Provision for Secured Portion of advance (as on March 31, 2024) [@ 40 per cent of the Secured Portion]	0.60
Total Provision to be made (as on March 31, 2024)	1.85

**Question 3**

- (a) What are the objectives of Countercyclical Capital Buffer (CCCB) ? (5 marks)
- (b) Information Systems play a pivotal role in modern day banking. Today's banking is totally dependent on information systems and more so on CBS. What are the directions of the RBI regarding Information Systems Audit of the Regulated Entities ? (5 marks)
- (c) Briefly explain the term, Annual Percentage Yield (A.P.Y.) (2 marks)

**Answer 3(a)**

The objectives of the Counter Cyclical Capital Buffer (CCCB) are as under:

- (i) To build a buffer of capital in good times, which may be used to maintain the flow of credit to the real sector in difficult times.
- (ii) To restrict the banking sector from indiscriminate lending in periods of excess credit growth that are often been associated with the building up of system-wide risks.
- (iii) The purpose of CCCB is that the Reserve Bank of India monitors credit growth and make decisions on the size of the Countercyclical Capital Buffer. The size will vary between 0% and 2.5% of RWA to be held in the form of CET-1 Capital, depending on the central banks' Judgment as to the extent of the build-up of system-wide risk. It is dependent on:
  - Credit-to-GDP Gap (the difference between the Credit/GDP ratio at a point in time and the long-term trend of the ratio)
  - Gross NPA Growth.

**Answer 3(b)**

The directions of the RBI as regards Information Systems (IS) Audit of the regulated entities under Chapter VI- Information Systems Audit Para (30) under Information Systems Audit are as follows:

- (i) The Audit Committee of the Board shall be responsible for exercising oversight of IS Audit of the Regulated Entity (RE).
- (ii) REs shall put in place and IS Audit Policy. The IS Audit Policy shall contain a clear description of its mandate, purpose, authority, audit universe, periodicity of audit etc. The policy shall be approved by the Audit Committee of the Board and reviewed at least annually.
- (iii) The Audit Committee of the Board shall review critical issues highlighted related to Information Technology / information security / cyber security and provide appropriate direction and guidance to the RE's Management.
- (iv) REs shall have a separate IS Audit function or resources who possess required professional skills and competence within the Internal Audit function. Where the RE uses external resources for conducting IS audit in areas where skills are lacking within the RE, the responsibility and accountability for such external IS audits would continue to remain with the competent authority within Internal Audit function.
- (v) REs shall carry out IS Audit planning by adopting a risk-based Audit Approach.
- (vi) REs may consider, wherever possible, a continuous auditing approach for critical systems, performing control and risk assessments on a more frequent basis.

**Answer 3(c)**

The Annual Percentage Yield (APY) is the rate actually earned or paid in one year, taking into account the effect of compounding interest. Compounding interest includes the interest earned on both the principal amount and any previously accrued interest. APY is commonly used for savings accounts, fixed deposits, and other investment products to help investors compare returns.

The formula for APY is:

$$APY = \left(1 + \frac{r}{n}\right)^n - 1$$

Where:

- r is the nominal interest rate (annual rate).
- n is the number of compounding periods per year.

A higher APY indicates better returns, assuming all other factors are equal.

For example, a 1% per month rate has an A.P.Y. of 12.68% ( $1.01^{12} - 1$ ). Thus, APY is the effective or true annual rate of return.

**Question 4**

- (a) A customer tenders export bill for GBP 5,00,000 payable 45 days from sight. The transit period is 15 days. He wants to retain 10% of bill value in the foreign currency. Bank's margin is ₹ 0.10. What Rupee amount will be credited to the customer's account ?

The rates are as under :

USD/INR Spot	44.7000/44.7500
Swap Points 2 Months	00.1800/00.1900
GBP/USD Spot	1.7500/1.7510
Swap Points 2 Months	00.0025/00.0020

(5 marks)

- (b) "Cheques payable to a firm should not be credited to the private account of a partner without the concurrence of the other partners." Comment.

(2 marks)

- (c) The following information is available of a state government bond :

Face value	:	₹ 100
Coupon rate	:	12 percent payable annually
Years to maturity	:	6
Current market price	:	₹ 110

What is the duration of the Bond ? Use the approximate formula for calculating the yield to maturity.

(5 marks)

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#### Answer 4(a)

The bill period is 45 days. The transit period is 15 days.

Total period is 2 months. Hence, 2 months forward rate will be applied.

We want outright 2 months GBP/INR rate. For this we have to calculate outright GBP/USD and USD/INR rates.

USD/INR Spot 44.7000 / 44.7500

Swap Points 2 Months 00.1800 / 00.1900

Outright 2 Months 44.8800 / 44.9400

GBP/USD Spot 1.7500 / 1.7510

Swap Points 2 Months 00.0025 / 00.0020

Outright 2 Months 1.7475 / 1.7490

It is an export covering, hence from bank's point of view it is buying. Hence Buying (Bid) Rate will be applied.

$$\text{GBP / [INR]}_{\text{BID}} = \text{GBP / [USD]}_{\text{BID}} \times \text{USD / [INR]}_{\text{BID}}$$

$$= 44.8800 \times 1.7475$$

$$= 78.4278$$

This is an inter-bank rate. To arrive at the Customer rate, exchange margin will be added.

Inter-Bank Rate 78.4278

Less: Margin 00.1000

Customer Rate 78.3278

The bill is for GBP 5,00,000 of which, he wants to retain 10% in foreign currency account. Hence, he would be converting GBP 4,50,000.

For GBP 4,50,000, the account would be credited with  $78.3278 \times 4,50,000 = ₹3,52,47,510$

#### Answer 4(b)

The answer lies in the fact that, prima-facie, the payee of the cheque is the firm and crediting the proceeds to any other account will expose the bank to the charge of 'conversion'.

Legally a Partnership account may be maintained in the name of a partner. The bank has to get the approval of all the partners to credit the proceeds of the cheques payable to the firm to the account of the partner. A firm operates as a separate entity from its partners. Cheques payable to the firm represent the firm's funds, not the personal property of an individual partner.

Crediting such cheques to a partner's private account violates the principle of separation between the firm's and the partner's finances.

The rule that cheques payable to a firm should not be credited to the private account of a partner without the concurrence of other partners is vital for:

- Preserving the integrity of the partnership's financial management.
- Protecting the rights and interests of all partners.

- Avoiding legal liabilities for banks and ensuring adherence to fiduciary obligations.

Partners and banks must exercise caution and follow proper authorization procedures to prevent disputes and financial irregularities.

#### Answer to Question No. 4(c)

The yield to maturity, using the approximate formula, is:

$$YTM = \frac{\text{Annual Coupon Payment} + \frac{\text{Face Value} - \text{Current Price}}{\text{Year to Maturity}}}{\frac{\text{Face Value} + \text{Current Price}}{2}}$$

$$YTM = \frac{12 + \frac{100 - 110}{6}}{\frac{100 + 110}{2}}$$

$$YTM = \frac{12 - 1.67}{105}$$

$$YTM = (12 - 1.67) / 105$$

$$YTM = 10.33 / 105$$

$$YTM = 0.0984 = 9.84\% \text{ say } 10\%$$

$$YTM = \frac{10.33}{105}$$

$$YTM = 0.0984 = 9.84\% \text{ say } 10\%$$

The duration is calculated below:

Year	Cash Flow	Present Value at 10%	Present Value	Proportion of the bond's value	Proportion of the bond's value x time
1	12	0.909	10.91	0.100	0.100
2	12	0.826	9.91	0.091	0.182
3	12	0.751	9.01	0.083	0.249
4	12	0.683	8.20	0.075	0.300
5	12	0.621	7.45	0.069	0.345
6	112	0.564	63.17	0.581	3.486
			108.65		4.662 Years

#### Question 5

(a) NBFCs play a major role in Indian Financial System by complementing and competing with banks and by bringing in efficiency and diversity into financial intermediation. In this context, answer the following questions :

- Under which statute, NBFCs are registered in India and what is their nature of business ? What is the 50-50 Rule for NBFC ?

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(ii) How do NBFCs differ from Banks ?

(8 marks)

(b) One of the important functions of RBI is Monetary Control. RBI uses various tools to control Money in Circulation and of those Tools, Reserve requirements and Liquidity Adjustment Facility have Pivotal Roles.

What do you understand by Liquidity Adjustment Facility (LAF) and how does it operate in India ? Distinguish between CRR and SLR.

(4 marks)

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

NBFCs are registered under the Companies Act, 2013 and their operations are governed by the **Reserve Bank of India** under the provisions of the **Reserve Bank of India Act, 1934**, particularly Sections 45-IA to 45-IC.

**Nature of Business:**

NBFCs engage in financial intermediation activities, including:

- Providing loans and advances.
- Acquisition of shares, stocks, bonds, and debentures.
- Leasing, hire-purchase, and factoring services.
- Managing portfolios of securities.
- Providing infrastructure finance, housing finance, and microfinance.

NBFCs **do not perform core banking functions** like accepting demand deposits or issuing cheques but play a pivotal role in niche sectors such as SME financing, rural development, and infrastructure funding.

**The 50-50 Rule for NBFCs:** The 50-50 Rule is a criterion for classifying a company as an NBFC. According to 50-50 rule:

- **50% of Assets:** The company's financial assets should constitute at least 50% of its total assets.
- **50% of Income:** At least 50% of the company's gross income should come from financial activities.

This test ensures that only companies with a significant focus on financial activities are categorized and regulated as NBFCs by the RBI.

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

NBFCs Differ from Banks on the following Grounds:

Sr. No.	Grounds	NBFCs	Banks
(i)	<b>Regulating Authority</b>	Regulated by RBI under the RBI Act, 1934 and the Companies Act, 2013.	Regulated by RBI under the Banking Regulation Act, 1949.
(ii)	<b>Deposits</b>	Cannot accept demand deposits.	Accept demand deposits and provide cheque-issuing facilities.

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(iii)	<b>Payment and Settlement</b>	NBFCs cannot be part of the payment and settlement system (e.g., NEFT, RTGS).	Banks are part of the payment and settlement system.
(iv)	<b>Cheques Issuance</b>	NBFCs cannot issue cheques to customers.	Banks can issue cheques to customers.
(v)	<b>CRR and SLR</b>	NBFCs are not required to maintain CRR or SLR with RBI.	Banks must maintain CRR and SLR as stipulated by the RBI.
(vi)	<b>Loan Categories</b>	Specialize in loans for SMEs, infrastructure, and rural development	Offer a wider range of loans, including personal, corporate, and retail loans.
(vii)	<b>Credit Creation</b>	Do not create credit directly; rely on funds raised through market instruments.	Banks create credit directly by accepting deposits and providing loans.
(viii)	<b>FDI Norms</b>	FDI up to 100% is allowed under the automatic route (with certain conditions).	FDI in banks is subject to specific caps and government approval.
(ix)	<b>DICGC</b>	DICGC Insurance cover is not available for the deposit received.	Deposit insurance cover is available under DICGC.

**Answer 5(b)**

The monetary policy environment in India has been greatly influenced with the launch of Liquidity Adjustment Facility (LAF) by the RBI in June 2000. With the introduction of LAF. The important tools of monetary policy are Repo & Reverse Repo rates became the prime instruments at the hands of RBI for controlling the monetary policy. LAF is a mechanism for adjusting liquidity in banking system. It has twin aims of withdrawing funds or increasing the same, in the banking system when there are excess/short of liquidity in the system. LAF is operated daily by RBI through Repo/Reverse Repo mechanisms. Normally reverse repo rate is lower than repo rate. Both change simultaneously.

If the repo rate changes by 0.25 basis points, reverse repo also changes by 0.25 basis points or on any other basis as decided by RBI. Thus, LAF is a competent tool for controlling the monetary system in the country.

**Difference between Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)**

Sr. No.	Grounds	Cash Reserve Ratio (CRR)	Statutory Liquidity Ratio (SLR)
(i)	<b>Definition</b>	The percentage of a bank's Net Demand and Time Liabilities (NDTL) that must be maintained with the RBI in cash.	The percentage of a bank's NDTL that must be maintained in the form of liquid assets (cash, gold, or approved securities).
(ii)	<b>Purpose</b>	To control liquidity and inflation by regulating the amount of funds banks can lend	To ensure the liquidity and solvency of banks and to control credit growth



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(iii)	<b>Form of Maintenance</b>	Only cash is allowed.	Can be maintained in cash, gold, or government-approved securities.
(iv)	<b>Regulator</b>	Maintained with the RBI.	Maintained within the bank itself.
(v)	<b>Earning Potential</b>	Banks do not earn interest on CRR balances	Banks earn returns on the securities held under SLR.
(vi)	<b>Impact on Lending</b>	Affects banks' ability to lend directly, as it reduces the amount of money available for lending.	Restricts excessive lending indirectly by mandating asset reserves.
(vii)	<b>Flexibility in Usage</b>	Used primarily as a monetary policy tool by the RBI.	Used more as a prudential measure to ensure financial stability.

**Question 6**

- (a) Ramesh availed a Car Loan of ₹ 100 lakhs from Excellent Bank of India on 01.02.2015 for purchase of an Audi Car, repayable over 15 years by EMI. The Bank collected post-dated cheques duly signed by Ramesh drawn on his SB Account at Maha Bank as Security. Though the Cheques were paid on presentation from time to time, the cheque which was presented during April 2024, was bounced. Can the Lender Bank sue Ramesh for dishonour of cheque under Section 138 of Negotiable Instruments Act, 1881 ? Answer the questions based on a decided Case Law.

(6 marks)

- (b) From the following data, calculate maximum permissible bank finance under the three methods suggested by Tandon Committee.

Extracts from Balance Sheet of M/s Sunrise Energy Ltd as on 31.03.2024.

Liabilities	₹ (in Lacs.)	Assets ₹	₹ (in Lacs.)
Borrowings from Bank of India	100	Stock of Raw Materials	225
		Value of Work in Process	135
Creditors for materials supplied	200	Stock of Finished Goods	285
		Book debts	240
Creditors for expenses	25	Other current assets	165
Other Current Liabilities	75		
Total Value of Core Current Assets (CCA) ₹ 420 Lacs.			

(6 marks)

**Answer 6(a)**

Under Section 138 of the Negotiable Instruments Act, 1881, dishonour of a cheque is a criminal offence liable to be punished with 2 years' imprisonment. To make dishonour a criminal offence under the said provisions, it is necessary that:

- (i) There is a legally enforceable debt and the cheque was given for repayment/discharge of the liability.
- (ii) The cheque was returned due to insufficient funds.
- (iii) The cheque was presented within its validity period (within 3 months from the date mentioned on the cheque).
- (iv) Notice is sent to the drawer of the cheque within 30 days along with the cheque return memo.
- (v) The payer / holder of the cheque doesn't receive the payment within 15 days of such intimation.
- (vi) Cheques issued towards payment of debt only attract the provisions of Section 138 of Negotiable Instruments Act, 1881. Post-dated cheques issued for security purpose, cheques given for donation, undated cheques etc. don't fall under the above provision.

#### Facts of the Case:

Here the post-dated cheques were given to the Bank as security to the loan for discharging the instalment dues. The post-dated cheques carried different dates based on the instalment due dates. When the cheque was presented for payment, it was dishonoured.

#### Relevant Case Laws:

- *ICDS Ltd. vs. Beena Shabeer & Anr.*, (2002) 6 SCC 426: The Supreme Court clarified that for Section 138 to apply, the cheque must be issued in discharge of a legally enforceable debt. Cheques issued as security may not fulfil this requirement.
- *Sampelly Satyanarayana Rao vs. Indian Renewable Energy Development Agency Ltd.*, (2016) 10 SCC 458: The court differentiated between cheques issued as security and those issued in discharge of a liability. If the liability arises in the future, the cheque is not considered for an existing debt under Section 138.
- *Balaji Seafoods Exports (India) Ltd. vs. Mac Industries Ltd.*, (1998) 1 CTC 222 (Madras HC): A cheque issued as security, even if dishonoured, does not constitute an offense under Section 138.

Excellent Bank of India **cannot sue Ramesh under Section 138 of the Negotiable Instruments Act, 1881** unless it can demonstrate that the dishonoured cheque was issued specifically to discharge the April 2024 EMI. If the cheque was collected as a general security for the loan, its dishonour does not constitute a violation of Section 138, as per the principles established in the cases cited above.

The bank, however, retains the right to recover the dues through other legal mechanisms, such as enforcing the loan agreement or initiating civil proceedings.

#### Answer 6(b)

The Maximum Permissible Bank Finance (MPBF) for the company under three methods of Tandon Committee can be ascertained as follows:

Total Current Assets = 225+135+285+240+165 = 1050 Lacs

Current Liabilities excluding Bank Borrowings = 200+25+75 = 300 Lacs

Core Current Assets = 420 Lacs.

#### Method I

Maximum Permissible Bank Finance (MPBF) = 75% of (Current Assets- Current Liabilities)

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$$=0.75(1050-300)$$

$$=Rs.562.50 \text{ Lacs}$$

**Method II**

Maximum Permissible Bank Finance (MPBF) = (75% of Current Assets)- Current Liabilities

$$=(0.75 \text{ of } 1050)-300$$

$$=787.50-300$$

$$=Rs.487.50 \text{ Lacs}$$

**Method III**

Maximum Permissible Bank Finance (MPBF)= 75% of (Current Assets - Core Current Assets) - Current Liabilities

$$= 75\% (1050-420)-300$$

$$=Rs.172.50 \text{ Lacs}$$

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# INSURANCE – LAW & PRACTICE

## MODULE 3 ELECTIVE PAPER 9.2

*Time allowed : 3 hours*

*Maximum marks : 100*

*NOTE : Answer All Questions.*

### Question 1

**Case Study :**

**Introduction :**

Ravi Kumar, a dynamic entrepreneur from Surat, Gujarat, had worked tirelessly to establish and grow his textile manufacturing unit, "Ravi Textiles," over the last twenty-five years. Surat, often referred to as the textile hub of India, had been the perfect place for his venture to flourish. Over the years, Ravi invested heavily in modernizing his factory with the latest technology, expanding his workforce, and securing long-term contracts with national and international buyers. By 2022, Ravi Textiles had grown into a significant player in the industry, known for its quality fabrics and reliable delivery.

Aware of the risks involved in running a manufacturing unit, Ravi had always been prudent about insuring his assets. He had purchased a fire insurance policy worth ₹ 10 crores, which he believed was adequate to cover any unforeseen damage. His policy covered the factory building, machinery, and raw materials, giving him a sense of security that his business was well-protected against the potential threat of fire, a common risk in the textile industry.

**The Unfortunate Incident :**

In June 2023, during a hot summer afternoon, a fire broke out in Ravi's factory. The origin of the fire was traced back to a short circuit in the main power supply unit, which had been overburdened due to the increased load from newly installed machinery. The fire spread quickly, fueled by the flammable materials used in textile production. Despite the best efforts of the fire brigade, which arrived within minutes, the fire caused extensive damage to the factory. The building structure was weakened, several high-end machines were destroyed, and a substantial portion of raw materials and finished goods was lost to the flames.

Ravi was devastated. The total damage was estimated at around ₹ 12 crores. While his fire insurance policy seemed substantial, Ravi soon realized that the actual financial impact of the fire extended far beyond the physical damage to the property and machinery.

**Consequential Loss and Business Interruption :**

After the fire, Ravi Textiles had to shut down its operations completely to assess the damage and start the repair work. What Ravi had not anticipated was the severe financial strain this shutdown would impose. The factory remained closed for six months as rebuilding and repair work took place. During this period, Ravi faced mounting financial pressure. There were significant losses due to the inability to fulfill existing orders, penalties for delayed deliveries, and the cancellation of some major contracts. Additionally, Ravi still had to pay fixed expenses, including employee salaries, rent, and loan interest, even though the factory was not generating any revenue.

Ravi had heard about Consequential Loss Insurance, also known as Business Interruption Insurance, from his insurance agent, but he had never considered it a priority. He had assumed that the chances of a significant disruption in business operations were minimal and that his fire insurance

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policy would suffice. However, this incident made it clear that the loss of income due to business interruption was just as detrimental as the physical damage itself.

Had Ravi invested in Consequential Loss Insurance, he could have been compensated for the loss of profits during the period of shutdown, the fixed expenses he incurred, and even the costs of relocating or setting up temporary production facilities to mitigate the impact. The lack of this coverage now threatened the very survival of his business.

#### **The Insurance Claim Process :**

Immediately after the fire, Ravi initiated the claim process with his insurance company. The insurer appointed a surveyor to assess the extent of the damage and to verify the circumstances leading to the fire. This is where Ravi encountered another set of challenges.

Firstly, the surveyor found that the fire had destroyed some newly installed machinery that was not listed in the policy coverage, as Ravi had not updated his policy to include these assets.

Secondly, there were discrepancies in the inventory records, some raw materials and finished goods were not accounted for properly, leading to complications in assessing the exact value of the loss.

Thirdly, the surveyor noted that some of the damaged goods were stored in an area of the factory deemed high-risk by the insurer, which had not been disclosed during the policy issuance.

These issues delayed the claim settlement process and reduced the amount Ravi eventually received. After several rounds of negotiations and scrutiny, the insurance company settled the claim at ₹ 7.5 crores, which was significantly less than the actual loss incurred. By the time the claim was settled, Ravi had already drained his savings and was on the verge of taking a substantial loan to keep his business afloat.

#### **The Aftermath and Lessons Learned :**

This experience was a harsh lesson for Ravi. He realized that while he had been diligent in insuring his physical assets, he had overlooked the importance of insuring against business interruptions and the consequential financial losses that could arise from such incidents. He also recognized the need for maintaining accurate and up-to-date records, ensuring all assets are covered under the insurance policy, and fully disclosing all relevant information to the insurer to avoid complications during the claim process.

Ravi took proactive steps to prevent such a situation from occurring again. He invested in a comprehensive Consequential loss Insurance policy that would cover future business interruptions and ensure that his fixed costs and loss of profits would be compensated in the event of another disruption. He also reviewed and updated his fire insurance policy regularly, ensuring that all new assets were included, and that the coverage was adequate for the current value of his business.

Moreover, Ravi implemented stricter fire safety measures in his factory, including regular maintenance of electrical systems, installation of fire alarms, and conducting fire drills to prepare his staff for emergencies. He also improved the storage of flammable materials, ensuring they were kept in designated safe zones as per the guidelines.

Today, Ravi Textiles is back on its feet, and Ravi is more prepared than ever to face any potential risks. He often shares his experience with fellow entrepreneurs, emphasizing the critical importance of comprehensive insurance coverage, regular policy reviews and the need for Consequential Loss Insurance as part of a robust risk management strategy.

#### **Required :**

- (a) Explain the significance of Consequential Loss Insurance in the context of Ravi's experience. How could it have helped mitigate the financial impact of the fire on his business ?

(8 marks)

- (b) Analyze the impact of business interruption on Ravi Textiles due to the fire. What strategies could Ravi have employed to minimize the losses during the six-month shut- down ?  
(8 marks)
- (c) Examine the importance of regular policy reviews and updates in the context of Ravi's experience. How can businesses ensure their insurance policies remain adequate over time?  
(8 marks)
- (d) Ravi Textiles incurred a total loss of ₹ 12 crores due to the fire. The insurance company settled the claim at ₹ 7.5 crores for the physical damage. However, Ravi had fixed monthly expenses of ₹ 50 lakhs (including salaries, rent and loan interest) and a monthly revenue of ₹ 1.5 crores before the fire. The factory remained closed for six months. Calculate the total business interruption loss Ravi incurred during this period. If Ravi had taken a Consequential Loss Insurance policy, how much would he have been compensated for the business interruption?  
(8 marks)
- (e) Suppose Ravi's fire insurance policy covered ₹ 10 crores at the time of the fire, and he had installed new machinery worth ₹ 2 crores just before the incident. Given that the policy had not been updated to include the new machinery, and the total damage to machinery was ₹ 6 crores (including ₹ 2 crores for the new machinery), calculate the percentage of the claim that was not covered due to the omission of the new machinery. If the insurer applied a proportional reduction based on the underinsurance, what would be the revised claim amount for the machinery ?  
(8 marks)

### Answer 1(a)

**Significance of Consequential Loss Insurance in the Context of Ravi's Experience:** Consequential Loss Insurance commonly known as Business Interruption Insurance, is essential for safeguarding a business against the financial repercussions of operational disruptions caused by insured events, such as fires. While traditional fire insurance typically covers physical damage to assets like buildings, machinery, and stock, it often overlooks the broader financial impact that a business might face due to a halt in operations. This was the case for Ravi, whose textile manufacturing business suffered significant physical damage due to a fire. Although his fire insurance policy provided coverage for the physical losses, it failed to account for the substantial financial losses that arose during the six-month shutdown period.

Without the protection of Consequential Loss Insurance, Ravi struggled to meet his ongoing financial obligations, including employee salaries, rent, and loan interest, despite having no revenue during this period. The lack of income compounded the strain on his business, threatening its overall solvency.

If Ravi had secured Consequential Loss Insurance, the policy would have provided compensation for the loss of profits during the period of shutdown, the fixed expenses he incurred and even the cost of relocating or setting up temporary production facilities to mitigate the impact. This would have alleviated the financial burden of ongoing expenses and could have even covered additional costs associated with temporary relocation or expedited repairs, facilitating a quicker return to normal operations. Consequently, Consequential Loss Insurance would have acted as a financial safety net, allowing Ravi to maintain his business's financial health and recover more swiftly from the incident, highlighting the critical role this type of insurance plays in comprehensive business risk management.

### Answer 1(b)

**Impact of Business Interruption on Ravi Textiles Due to the Fire:** The fire at Ravi Textiles led to a complete shutdown of operations for six months, which had a profound impact on the business. The most immediate consequence was the significant loss of revenue, as the factory was unable to produce or deliver goods to fulfill existing orders. This loss of income created a ripple effect throughout the business, leading to missed deadlines, the imposition of penalties, and the eventual cancellation of key contracts that were crucial for sustaining the business. Moreover, despite not generating any revenue during this period, Ravi still had to bear the burden of fixed costs, such as employee salaries, rent, and loan repayments, which placed additional financial strain on the company.

The interruption of business operations also dealt a severe blow to Ravi's reputation with clients. The delays and the inability to meet previously agreed-upon commitments eroded the trust that Ravi Textiles had built over the years. This deterioration in client relationships could have long-term consequences, making it much harder for Ravi Textiles to secure future contracts and maintain its market position.

To minimize these losses, Ravi could have employed several strategies:

- **Securing Business Interruption Insurance:** This insurance would have compensated him for the loss of profits during the shutdown and helped cover fixed costs, such as salaries and rent, providing much-needed financial relief during the period of non-operation.
- **Establishing a contingency plan:** A well-defined business continuity plan, including options like relocating operations or temporarily outsourcing production, could have mitigated the impact of the shutdown by allowing some level of operations to continue.
- **Diversifying suppliers and production:** By ensuring that production was not concentrated in a single location, Ravi could have reduced the overall risk of a complete operational shutdown, thereby maintaining some level of output and revenue.

By taking these proactive steps, Ravi could have significantly reduced the financial and reputational damage caused by the business interruption, ensuring a quicker recovery and preserving his company's market standing.

### Answer 1(c)

**Importance of Regular Policy Reviews and Updates in Ravi's Experience:** Ravi's experience highlights the vital importance of regularly reviewing and updating insurance policies to ensure they remain comprehensive and adequate over time. As businesses grow, evolve, and expand, the risks they face also change. New assets are acquired, operations may diversify, and market conditions can shift, all of which can significantly impact the adequacy of existing insurance coverage. In Ravi's case, his failure to update his fire insurance policy to include newly installed machinery resulted in underinsurance. This oversight led to a reduced claim settlement when a fire caused extensive damage, ultimately leaving his business exposed to financial vulnerability.

To ensure that insurance policies remain adequate, businesses should:

- (i) **Conduct regular policy reviews:** At least annually, businesses should review their insurance policies to ensure all assets are covered, and the coverage limits are sufficient to reflect current values.
- (ii) **Assess your needs:** Consider your specific insurance needs and select a policy that aligns with them.
- (iii) **Prepare a list:** Make a list of items that need to be insured and their correct value. Also, look upon the aspect of under insurance.

- (iv) **Check exclusions:** Understand what is excluded from the policy, such as damage caused by negligence or emergencies.
- (v) **Communicate with the insurer:** Regular communication with the insurer can help ensure that any changes in the business are reflected in the policy coverage.
- (vi) **Engage in risk assessments:** Periodically assess potential risks and make necessary adjustments to insurance coverage to address any new exposures.
- (vii) **Seek professional advice:** Consulting with an insurance advisor can help identify gaps in coverage and recommend appropriate policy adjustments.

By prioritizing these proactive measures-regular reviews, open communication, thorough risk assessments, and professional guidance-businesses can better protect themselves against unforeseen events, ensuring their insurance coverage remains aligned with their evolving needs and safeguarding their financial stability.

#### Answer 1(d)

##### Calculation of Business Interruption Loss

##### Step 1: Calculate the total fixed expenses during the shutdown period

Total Fixed Expenses = Fixed Monthly Expenses x Number of Months of Shutdown

Total Fixed Expenses = 0.5 crores x 6 = 3 crores.

##### Step 2: Calculate the total revenue loss during the shutdown period

Total Revenue Loss = Monthly Revenue x Number of Months of Shutdown

Total Revenue Loss = ₹ 1.5 crores x 6 = ₹ 9 crores

##### Step 3: Calculate the total business interruption loss

Total Business Interruption Loss = Total Fixed Expenses + Total Revenue Loss

Total Business Interruption Loss = 3 crores + 9 crores = 12 crores

##### Step 4: If Ravi had taken a Consequential Loss Insurance policy, he would have been compensated for:

The fixed expenses during the shutdown period = ₹ 3 crores

The loss of profits (revenue loss) = ₹ 9 crores

Total Compensation under Consequential Loss Insurance = ₹ 3 crores + ₹ 9 crores  
= ₹ 12 crores

#### Answer 1(e)

##### Step 1: Calculate the total value that should have been insured

Total Insurable Value = Original Policy Coverage + Value of New Machinery (not covered) Total

Insurable Value = ₹ 10 crores + ₹ 2 crores = ₹ 12 crores

##### Step 2: Calculate the percentage of the claim that was not covered (underinsurance)

$$\begin{aligned} \text{Percentage of Underinsurance} &= \frac{\text{Value of New Machinery} \times 100}{\text{Total Insurable Value}} \\ &= \frac{2 \text{ crores} \times 100}{12 \text{ crores}} = 16.67\% \end{aligned}$$



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**Step 3: Calculate the revised claim amount for the Machinery**

Revised Claim Amount = Claim on Machinery x (1- Percentage of Underinsurance)

$$= ₹ 6 \text{ crores} \times (1 - 16.67\%)$$

$$= ₹ 6 \text{ crores} \times 0.8333 = ₹ 5 \text{ crores}$$

**Question 2**

- (a) Given the importance of Policy Lapsation and Renewal in life insurance, evaluate a scenario where a policyholder's ULIP (Unit Linked Insurance Plan) lapses due to non-payment of premiums. Discuss the implications for both the policyholder and the insurance company, including the process of policy revival and the potential financial impact on the policyholder. What steps can a policyholder take to avoid lapsation, and how can insurance companies mitigate the risks associated with policy lapsation ?

(6 marks)

- (b) Corporate governance plays a crucial role in ensuring transparency and accountability within insurance companies. Discuss the role of the Appointed Actuary and the Statutory Auditor in promoting corporate governance in an insurance company. How do these roles contribute to the overall integrity and stability of the company ?

(6 marks)

**Answer 2(a)**

Every Policy has a due date for payment of renewal premiums (other than Single premium). If the Policyholder is not able to pay the premium by the due date, additional period called days of grace is allowed. If the Policy-holder does not pay the premium even after the days of grace, the Policy lapses.

When a policyholder's Unit Linked Insurance Plan (ULIP) lapses due to non-payment of premiums, the consequences are significant for both the policyholder and the insurance company. For the policyholder, a lapsed policy means the suspension of life cover, loss of investment returns, and potential penalties. Additionally, the policyholder may face higher costs or stricter conditions when attempting to revive the policy, which typically must be done within a specified revival period. Failure to revive the policy can lead to the loss of accumulated benefits and investments, impacting the policyholder's financial goals.

For the insurance company, lapsation affects the continuity of premium income and may lead to administrative costs associated with policy revival processes. To mitigate lapsation risks, policyholders should opt for auto-debit payment options, set reminders for premium due dates through SMS, Whatsapp, Email, Telephonic call and letters, and maintain sufficient funds for premium payments. Insurance companies, on the other hand, can reduce lapsation rates by offering flexible payment options, providing timely reminders, and educating policyholders on the importance of regular premium payments. Additionally, insurers can implement customer retention strategies and offer incentives for maintaining the policy, ensuring a mutually beneficial relationship and financial security for the policyholder.

**Answer 2(b)**

The Appointed Actuary and the Statutory Auditor are pivotal in promoting corporate governance within an insurance company, ensuring transparency, accountability, and financial stability.

The Appointed Actuary is responsible for assessing the insurer's financial health, particularly in terms of its ability to meet future liabilities. By conducting regular evaluations of reserves, premiums, and

solvency margins, the actuary provides crucial insights into the financial risks the company faces. This role ensures that the company maintains sufficient capital to cover its obligations, thereby protecting policyholders' interests and contributing to the company's long-term stability. The Appointed Actuary regularly reports to the board of directors regarding the actuarial aspects of the business. This includes the adequacy of reserves, pricing adequacy, and risk exposure. This role ensures that the board is well-informed about the company's financial condition and future prospects. The Appointed Actuary plays a significant role in managing and evaluating the company's exposure to various risks, including underwriting, investment, and liquidity risks.

The Statutory Auditor ensures the accuracy and fairness of the company's financial statements. By independently verifying the company's financial records, the auditor plays a key role in detecting and preventing fraud, misrepresentation, or errors. This oversight reinforces stakeholders' confidence in the company's financial reporting, ensuring that management adheres to ethical and legal standards. The Statutory Auditor communicates any material weaknesses in the company's financial reporting or internal controls to the board of directors and management. Additionally, they report to regulatory authorities.

The roles of the Appointed Actuary and the Statutory Auditor are critical in promoting strong corporate governance in an insurance company. The Appointed Actuary ensures financial stability, risk management, and compliance with actuarial regulations, while the Statutory Auditor provides an independent assessment of financial integrity, regulatory compliance, and transparency. Together, they contribute to the overall integrity, stability, and long-term success of the company, building trust among stakeholders and ensuring that the company operates in a sound and responsible manner.

Strengthen corporate governance by providing checks and balances, ensuring that the company operates transparently, maintains its financial integrity, and adheres to regulatory requirements. Their contributions are vital to the overall stability and trustworthiness of the insurance company.

### Question 3

- (a) Evaluate the role of life insurance in retirement planning. How can life insurance products be integrated into a retirement plan to balance both risk management and income generation? Discuss the advantages and disadvantages of using life insurance products for retirement purposes, with specific reference to annuities and pension policies.
- (6 marks)*
- (b) A shipping company, Oceanic Ventures Ltd., insured its cargo of electronics being transported from Mumbai to Singapore under a marine insurance policy. During the voyage, the ship encountered severe weather, leading to the loss of several containers, including the one carrying the insured electronics. Upon investigation, it was discovered that some of the cargo was improperly secured, contributing to the loss. Additionally, there were allegations that the ship's captain and crew were involved in a fraudulent scheme to overstate the value of the lost cargo to claim a higher insurance payout.

**As an Insurance Assessor analyze the following :**

- (i) How would you approach the claim assessment, considering the improper securing of the cargo and the allegations of fraud? State the challenges you might face during this process.
- (2 marks)*
- (ii) How would the principles of utmost good faith and proximate cause be applied in this situation? Evaluate their impact on the claim's validity and the insurer's liability.

*(2 marks)*

- (iii) Examine the legal and ethical implications for both Oceanic Ventures Ltd. and the insurance company if the allegations of fraud are proven true.

(2 marks)

### Answer 3(a)

Life insurance plays a critical role in retirement planning by providing both risk management and income generation. It helps ensure financial security for dependents in the event of the policyholder's death, covering outstanding liabilities and replacing lost income. Integrating life insurance products into a retirement plan allows individuals to balance these protective needs with the goal of generating a stable income post-retirement. Life insurance products can also offer tax advantages, which are important for retirement planning. In many jurisdictions, the premiums paid for life insurance are tax-deductible (subject to limits), and the death benefit paid to beneficiaries is typically tax-free. Additionally, the growth of the cash value in certain types of insurance policies (like whole life) may be tax-deferred.

Annuities and Pension Policies are common life insurance products used in retirement planning. Annuities provide a guaranteed income stream for life, protecting against the risk of outliving one's savings (longevity risk). They offer a predictable income, which can be particularly valuable in managing retirement expenses. Payments are tied to the performance of underlying investments (such as stocks or bonds), providing the potential for higher returns but with added risk. Pension policies, on the other hand, accumulate a corpus during the policyholder's working years, which can be used to purchase an annuity or withdrawn in a lump sum at retirement. Payments begin at a future date, allowing the individual to accumulate funds tax-deferred until retirement.

Advantages of Using Life Insurance for Retirement Planning are fixed annuities offer a guaranteed income stream for life, which provides retirees with a reliable source of income and peace of mind, knowing they will not outlive their savings. Contributions to life insurance policies (like pension plans) may be tax-deferred, and in many cases, the death benefit is tax-free. These features can help optimize savings and reduce tax burdens. Life insurance policies can serve as an estate planning tool, ensuring that beneficiaries are provided for upon the policyholder's death. By incorporating life insurance products like annuities into a retirement plan, individuals can create a diversified income strategy that combines market-based returns with guaranteed income, offering protection against market volatility and providing stability.

However, there are disadvantages. Annuities often come with lower returns compared to other investment options, and once purchased, they offer limited liquidity, which can restrict access to funds in emergencies. Additionally, the terms and conditions of these products can be complex, and the cost of annuities can be high, reducing the overall returns.

In summary, while life insurance products like annuities and pension policies provide essential security and a steady income in retirement, they must be carefully considered within the broader context of an individual's financial goals and needs.

### Answer 3(b)(i)

**Claim Assessment Approach:** As the insurance assessor, my approach would involve a thorough investigation into the circumstances surrounding the cargo loss. The improper securing of cargo suggests negligence, which may reduce or invalidate the claim under the marine insurance policy. Examine evidence of cargo loading and securing procedures. This could include loading photographs, videos, and third-party inspections. Review Policy Details which includes assess the terms, coverage, and exclusions under the marine insurance policy. Additionally, the allegations of fraud require scrutiny of the cargo's value and the actions of the captain and crew. Challenges include gathering evidence of improper securing, verifying the actual value of the lost cargo, and

distinguishing between genuine losses and fraudulent claims. Coordinating with maritime experts and legal authorities may be necessary to establish the facts. Gathering sufficient evidence to substantiate allegations of fraud can be complex and time-consuming. Potential resistance from stakeholders reluctant to cooperate or disclose information.

### Answer 3(b)(ii)

**Application of Utmost Good Faith and Proximate Cause:** The principle of utmost good faith mandates that Oceanic Ventures Ltd. that both the parties i.e. the insured and the insurer should have a good faith towards each other and must have disclosed all relevant information, including the proper securing of cargo. If they failed to do so, the claim might be deemed invalid.

Proximate cause determines the primary cause of the loss. It emphasis on:

- The loss of insured property can be caused by more than one cause in succession to another.
- The property may be insured against some causes and not against all causes.
- In such an instance, the proximate cause or nearest cause of loss is to be found out.
- If the proximate cause is the one which is insured against, the insurance company is bound to pay the compensation and vice versa.

In this case, the severe weather is a natural peril covered by insurance, but the improper securing and potential fraud complicate the situation. These factors could diminish the insurer's liability, depending on the extent to which negligence and fraudulent intent contributed to the loss.

### Answer 3(b)(iii)

If fraud is proven, Oceanic Ventures Ltd. could face legal consequences, including criminal charges for fraud and breach of contract, leading to denial of the claim and potential penalties. The company may be required to reimburse the insurer for investigation expenses and any preliminary payouts made. Ethically, the company's reputation would be severely damaged, affecting future business dealings. Evidence of fraud may indicate a lack of internal controls and ethical oversight within the organization. Employees, customers, and shareholders may lose confidence in the company, leading to reputational and financial losses. For the insurance company, proving fraud would relieve them of liability, but they must handle the investigation with integrity to avoid legal backlash. If the insurer mishandles the investigation or fails to prove fraud convincingly, Oceanic Ventures Ltd could counterclaim for bad faith denial of the claim. Ethically, they must balance protecting their financial interests with fairness and transparency in dealing with the claimant. Mishandling the fraud investigation or unfairly denying the claim could tarnish the insurer's reputation. By addressing fraud effectively and ethically, the insurer reinforces the importance of integrity in the industry.

### Question 4

- (a) Discuss the role of reinsurance as a risk transfer technique within the broader context of Enterprise Risk Management (ERM). How does reinsurance contribute to the solvency and financial stability of an insurance company? Provide an example to illustrate your explanation.

(6 marks)

- (b) Rajesh, an owner of a logistics company, had insured his fleet of commercial vehicles under a comprehensive motor insurance policy. One of his trucks, while transporting goods from Delhi to Mumbai, was involved in a major accident due to brake failure. The accident resulted in significant damage to the truck, loss of cargo, and injury to a third party. Upon investigation, it was revealed that the truck had not undergone the required periodic maintenance, and the insurance company raised concerns about negligence on the part of Rajesh's company.

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As Rajesh's insurance advisor, analyze the following :

- (i) How will the basic principles of motor insurance, including the duty of maintenance and the concept of negligence, impact the claim settlement for the damaged truck and third party liabilities ? State the potential reasons the insurance company might use to reduce or deny the claim.
- (ii) Considering the provisions of the Motor Vehicle (Amendment) Act, 2019, what legal obligations do Rajesh's company have in this situation ? How might these obligations affect the outcome of the claim and any potential legal action ?
- (iii) Suggest how adopting innovative trends in auto insurance, such as telematics- based policies, could have mitigated the risks in this scenario.

(2+2+2=6 marks)

#### Answer 4(a)

Reinsurance plays a critical role in Enterprise Risk Management (ERM) by allowing insurance companies to transfer portions of their risk portfolios to other insurers. This risk transfer technique helps insurers manage their exposure to large or catastrophic losses, thereby stabilizing their financial performance and ensuring solvency.

By ceding a portion of their risks to reinsurers, primary insurers can reduce the financial impact of claims, particularly in the case of significant or unexpected events. Reinsurance enables insurers to underwrite larger or riskier policies than they could manage on their own, thus expanding their capacity while maintaining financial stability. Additionally, reinsurance provides capital relief by lowering the amount of capital required to cover potential losses, contributing to the overall solvency of the insurance company. Reinsurance helps insurers meet solvency requirements set by regulatory authorities. By ceding risk to reinsurers, insurers mitigate the likelihood of insolvency due to unexpected large claims.

For example, consider an insurance company that covers properties in a region prone to natural disasters. By purchasing reinsurance, the insurer can mitigate the risk of being overwhelmed by claims after a major event like a hurricane. The reinsurer would cover a significant portion of the claims, allowing the primary insurer to maintain its financial health and continue operating.

So, reinsurance is a vital component of ERM, helping insurance companies manage risk, preserve capital, and ensure long-term solvency and stability.

#### Answer 4(b)(i)

The basic principles of motor insurance, particularly the duty of maintenance and the concept of negligence, play a crucial role in claim settlement. Since the truck had not undergone the required periodic maintenance, the insurance company may argue that Rajesh's company was negligent, leading to the brake failure. This negligence could result in the insurer reducing or denying the claim for the damaged truck, as well as limiting coverage for third-party liabilities. The insurance company could cite the failure to maintain the vehicle as a breach of the policy terms, justifying their decision to limit the payout.

#### Answer 4(b)(ii)

Under the Motor Vehicle (Amendment) Act, 2019, Rajesh's company is legally obligated to ensure that all vehicles in their fleet are properly maintained and roadworthy. Failing to do so not only expose the company to financial liability but also potential legal action for endangering public safety. This negligence could lead to increased penalties, third-party claims, and possible litigation.

The company's failure to meet these legal obligations could adversely affect the outcome of the insurance claim and result in significant legal and financial repercussions.

#### Answer 4(b)(iii)

Adopting innovative trends like telematics-based policies could have mitigated the risks in this scenario. Telematics systems monitor vehicle performance and driving behavior in real-time, providing alerts for maintenance issues like brake problems. If Rajesh's company had implemented telematics, they could have identified the brake issue before the accident, potentially avoiding the incident altogether. Additionally, telematics data could provide the insurance company with accurate information about the truck's condition and usage, potentially supporting a fairer claim settlement and reducing the likelihood of disputes over negligence.

#### Question 5

- (a) In the maritime industry it has been found that one of the party succeeds unjustly or illegally in obtaining money or goods from another party to whom, on the face of it, he has undertaken specific trade, transport and financial obligations. Explain.

(6 marks)

- (b) How does Insurance differ from Reinsurance ? Also elaborate the statement that the financial condition of an insurance company cannot be adequately assessed without sound loss reserve estimates.

(6 marks)

#### Answer 5(a)

**Maritime Fraud:** Maritime fraud is the illegal or unfair acquisition of money or goods from another party in an international trade transaction. It can occur in many places, including on ships, in shipping company offices, and in trading firms. Maritime fraud has many guises and its methods are open to infinite variations. Majority of these crimes can be classified into four categories as under:

- (i) Scuttling of ships
  - (ii) Documentary frauds
  - (iii) Cargo Thefts
  - (iv) Fraud related to the chartering of vessels
- (i) **Scuttling of Ships:** Also known as 'rust bucket' frauds, this involves deliberate sinking of vessels in pursuance of fraud against both cargo and hull interests. With occasional exceptions, these crimes are committed by ship-owners in a situation where a vessel is approaching or has the end of its economic life, taking into account the age of the vessel, its condition and the prevailing freight market. The crime can be aimed at hull insurers alone or against both hull and cargo interests.
- (ii) **Documentary Frauds:** This type of fraud involves the sale and purchase of goods of documentary credit terms and some or all of the documents specified by the buyer to be presented by the seller to the bank in order to receive payment, are forged. Bankers pay against documents. The forged documents attempt to cover up the fact that the goods actually do not exist or that they are not of the quality ordered by the buyer. When the unfortunate purchaser of the goods belatedly realizes that no goods are arriving, he starts checking, only to find that the alleged carrying vessels either does not exist or was loading at some other port at the relevant time.

- (iii) **Cargo Thefts:** There are several variations in the modus operandi of cargo thefts. In a typical example, the vessel, having loaded a cargo, deviates from its route and puts it into a port of convenience. The cargo may be discharged and stored on the quayside or in a more sophisticated manner. Such an act is often accompanied by a change of the vessel's name or a subsequent scuttling in order to hide the evidence of theft. The whole process of investigation is proved difficult as by the time the loss is known the cargo disappears and the actual recovery of goods is unlikely. The owners of these ships are "paper companies" set up a few days prior to the operation.
- (iv) **Fraud related to Chartering of vessels:** This is also known as Charter-part fraud". Establishing a chartering company required a modest initial financial commitment and is usually subject to little regulation. In depressed conditions of shipping market, there is no demand on tonnage and owners anxious to avoid laying up their vessels are tempted to charter them to unknown companies without demanding any substantial financial guarantee for the performance of the charter contract.

### Answer 5(b)

Insurance, is a protection for the individual, whereas reinsurance is the protection taken out by a large insurance firm to ensure that they survive large losses. The premium that is paid by an individual will be received by the company that provides the insurance whereas the insurance premium paid for reinsurance will be divided among all the insurance companies in the pool that bear the risk of loss. Insurance spreads the financial risk of a specific individual or entity among all policyholders, so that the burden of a potential loss is shared and manageable. Reinsurance helps insurers manage risk by transferring a portion of their liabilities to the reinsurer, especially in cases of large-scale losses (such as natural disasters).

Reinsurance is a financial transaction where an insurance company transfers some of its risk to another insurance company, called the reinsurer, in exchange for a payment. The goal of reinsurance is to limit the losses of insurance companies in the event of a major disaster or claims event.

Reinsurance helps insurance companies by:

- **Risk Transfer:** Sharing or transferring specific risks with other companies
- **Arbitrage:** Purchasing insurance elsewhere for less than the premium collected from policyholders
- **Capital Management:** Avoiding having to absorb large losses by passing risk. Reinsurance is less regulated than insurance for individual consumers because the purchasers of reinsurance are considered sophisticated buyers.

The financial condition of an insurance company cannot be adequately assessed without sound loss reserve estimates sufficient to meet any outstanding liabilities at any point of time. The estimation process involves not only complex technical tasks but considerable judgment as well. It is important for the insurance company to understand the data before embarking on the task of estimating loss reserve which has a significant impact on the financial strength and stability of the company. Loss reserves constitute a significant portion of an insurer's liabilities. Accurate estimation ensures that the balance sheet reflects the true financial position of the company. If the company has inadequate funds that may lead to liquidity issues, as the company might not have sufficient funds to settle claims promptly.

The general insurance companies apart from the general reserves maintain a number of technical reserves which can be divided into following six categories, namely, Unearned Premium Reserves



(UPR), Unexpired Risk Reserve (URR), Unexpired Risk Reserve (URR), Outstanding Claims Reserve (OCR), Incurred but Not Reported Reserves (IBNR), catastrophe reserves, and claims equalization reserves. A brief explanation of each of these reserves along with their significance has been given as follows;

**Unearned Premium Reserves (UPR):** Unearned premium reserves are the proportion of premiums received which relates to the future period. It is assumed that the risk is uniform over the duration of the policy and the liability arising out of the risk can be met by reserving a pro rata amount of the balance of the premium after deducting initial expenses. In the circumstances of high inflation, changes in expenses and widely fluctuating claims ratio; the expected claims liability under the unexpired risks can differ significantly from the UPR provision. If the UPR is regarded as inadequate, an additional reserve is necessary. The insurer therefore needs to create extra reserve to offset the shortfalls in the UPR by creating an additional unexpired risk reserve (or AURR).

**Unexpired Risk Reserve (URR):** Unexpired risk reserve is created by the insurer to manage the risk arising out of the non-receipt of future premiums. It is estimated by multiplying with the unearned premiums the ratio of the claims incurred in the year to the premiums earned in the same year. The unearned premiums also allow for inflation and changes in experience in the various risk groups and their relative proportion of the total premium. Over and above, a prudent fluctuation margin may be added to the above to minimize the impact of errors associated with the estimation process.

**Outstanding Claims Reserve (OCR):** OCR is maintained by the general insurance companies to meet the outstanding liability for claims which have already been reported and not settled. The commonly used method to estimate OCR is to obtain estimates in respect of all outstanding claims on an accounting date after taking into consideration the following:

- (i) The certainty of the claim;
- (ii) The likely time needed to complete settlements;
- (iii) The rate of inflation on claims costs between the accounting date and the date of settlements; and
- (iv) The judicial trends in claims settlements.

**Incurred But not Reported Reserves (IBNR):** The IBNR reserve is the estimated liabilities for the unknown claims arising out of incidents occurred prior to the year-end but have not been notified to the company during the accounting period. In practice, the provision for future development on known claims, which is called as incurred but not enough reserved (IBNER) is included in IBNR. The average cost of an IBNR claim often differs from that of currently reported claims. The insurance companies hence develop the ratio of average cost of an IBNR claim to average cost of reported claims, for different classes of business on the basis of historical data in order to measure the effectiveness of the IBNR reserves.

**Catastrophe Reserves:** The catastrophe reserves are created to meet any unprecedented and/or uncontrollable risk factor affecting the insurer. These reserves are created out of taxed income after taking into account the operating position and the effect of provision upon the presentation of its results. Catastrophe reserve in the long run equates the accumulated catastrophe loadings in premiums without impacting the financial stability of the insurer.

**Claims Equalization Reserves:** Claims equalization reserves are made to smooth out the effects of year-to-year fluctuations in the incidence of larger claims such as the unusual floods in Mumbai in 2005 and in Surat in 2006. The provision is created based on past experience of the frequency of claims and the 'probability density function' of this risk. Claims equalization reserve is not created to meet an inevitable liability.

**Question 6**

(a) (i) RK a businessman insured his machinery and stock of goods stored in the factory premises against damage by fire and a protection note was given, which is further subject to the usual conditions of the company's policy, one warranty clause being "smoking and cooking be strictly prohibited in or about the premises". The stocks were damaged by fire said to be accidental in nature. But the insurance company claimed that smoking a cigarette or bidi carelessly by some employee occasioned the fire. Is the denial justified ?

(3 marks)

(ii) Explain the difference between Open Policy and Open Cover.

(3 marks)

(b) Explain portability of Health Insurance Policies.

(6 marks)

**Answer 6(a)(i)**

In the above case, the company denied the claim on the ground that there was a breach of warranty as the fire was occasioned by smoking which is strictly prohibited. But as there was no eye-witness to the origin of the fire, the court held that the cause of fire was a matter of conjecture. (*Bhattacharjee vs. Sentinel Insurance Co.*)

In the famous case *Dekhari Tea Co. vs. Assam Bengal Roadways Co.* it was also held that fire cannot always be explained, and it must be a matter of conjecture. As regards the warranty, as the plaintiff had put notices strictly prohibiting smoking in and around the places, in fact there is no breach of warranty. Hence, the denial on the part of the insurance company is not justified. On the other hand, the company should make good the loss.

Based on the strict nature of the warranty clause in the insurance policy, the insurance company's denial of the claim is likely justified. The breach of the warranty by allowing smoking, even if it was careless and not directly intended to cause the fire, typically allows the insurer to deny the claim.

RK's claim for damages due to the fire would be denied because the warranty regarding smoking was violated, and insurance contracts usually enforce such conditions strictly.

**Answer 6(a)(ii)**

The differences between Open Policy and Open Cover are:

(i) An open policy is also known as 'floating policy'. It is worded in general terms and is issued to take care of all "shipments" coming within its scope. It is issued for a substantial amount to cover shipments or sending during a particular period of time. Declarations are made under the open policy and these go to reduce the sum insured.

On the other hand, an open cover is particularly useful for large export and import firms-making numerous regular shipments who would otherwise find it very inconvenient to obtain insurance cover separately for each and every shipment.

(ii) The open policy is a stamped document and is, therefore, legally enforceable in itself, whereas an open cover is unstamped and has no legal validity unless backed by a stamped policy/certificate of insurance.

(iii) An open policy is issued for a fixed sum insured, whereas there is no such limit of amount under any open cover. As and when shipments are made under the open policy, they have to be declared to the insurers and the sum insured under the open policy reduces by the

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amount of such declarations. When the total of the declarations amounts to the sum insured under the open policy, the open policy stands exhausted and has to be replaced by a fresh one.

**Answer 6(b)**

Portability is the right accorded to the Policyholder to transfer the credit gained for pre-existing conditions and time-bound exclusions from one insurer to another insurer or from one plan to another plan of the same insurer.

In simple words, it is the right conferred on a Policyholder who decides to move from one General or Health insurer to another or to another plan of the same General or Health insurer.

Portability is not applicable to fixed benefits payable under Health insurance policies issued by a Life insurer. The advantage of portability is the carry forward of the credits accrued on account of having a Policy with the previous Insurer.

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

An insurer may reject the request for portability if the Policyholder approaches 60 days before or within 45 days of the date of expiry of the insurance policy. However, an insurer may at their option consider the request for renewal even outside the above period.

New insurer is under obligation to accept or reject within a period of 15 days from the date of receipt of the Portability form. If the new insurer does not convey any decision with the aforesaid 15 days, the new insurer is deemed to have accepted the request for portability. No charges for portability can be levied either by the previous insurer or the new insurer.

No commission shall be paid to any Agent or Intermediary for the policy which is ported from one insurer to another insurer.

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# INTELLECTUAL PROPERTY RIGHTS – LAWS AND PRACTICES

## MODULE 3 ELECTIVE PAPER 9.3

*Time allowed : 3 hours*

*Maximum marks : 100*

*NOTE : Answer All Questions.*

### Question 1

The Plaintiff, Adidas AG, manufacturer and distributor of sports accessories and apparel under the trademark "ADIDAS," has filed the suit seeking to secure their rights against the use of an identical mark by the Defendants for various classes of goods, including textiles.

In 1948, the founder of the Plaintiff Company, Mr. Adolf Dassler, also known as 'Adi', coined the mark "Adidas" by combining his name 'Adi' with the first three letters of his surname 'Das'. The mark was put to commercial use in 1949 when Mr. Dassler incorporated the company 'Adolf Dassler adidas Sportschuhfabrik' for manufacturing and marketing a wide range of sporting equipment, accessories, and apparels. Over the years, the company underwent corporate restructuring and is presently known as Adidas AG. The Plaintiff launched several brands, including "Adidas Originals," for its range of products. The cumulative global sales of the Plaintiff till the year 2010, the period preceding the filing of the suit, amounted to € 11,990 million. The trademark "Adidas" has been registered in the Plaintiff's favour in various countries, with the earliest one dating back to 1954. Further, the Plaintiff expended substantial amounts in promoting its products across the world. The Plaintiff has also periodically sponsored popular football, rugby, and cricket leagues. Owing to Plaintiff's extensive promotion and high quality standards of the "ADIDAS" products, they are widely recognized all over the world and exclusively associated with the Plaintiff.

The Plaintiff's predecessor first registered its mark "ADIDAS" in India in the year 1971. In 1989, the Plaintiff granted a license to commercially trade in India to M/s Bata India Pvt. Ltd., thus marking their entry in the Indian market. Later, in 1996, Plaintiff established a joint venture company named 'Addidas India Marketing Private Limited' (formerly, Adidas India Trading Private Limited) in India. This joint venture was terminated in 2006, when 'Adidas India Marketing Private Limited' became Plaintiff's subsidiary. Thus, the Plaintiff has been openly and continuously carrying on their business in India since 1989. Even before 1989, the Plaintiff's goods were being purchased by Indian consumers travelling abroad. Further, their products were also available in duty-free shops at Indian airports. That apart, there were extensive broadcasting in India of sporting events which were either sponsored by the Plaintiff or where competing players used the Plaintiff's Adidas products. Such prevalence and widespread publicity even before their launch in India, indicate that Plaintiff's reputation garnered in other countries spilled into India.

To further promote their "ADIDAS" mark/products, the Plaintiff sponsored several teams participating in the Indian Premier League along with other tennis, athletics, and football tournaments, and issued advertisements in print media extensively distributed throughout the country. The mark has also been endorsed by celebrated cricketers. The Plaintiff has, over the years, secured multiple registrations for "ADIDAS" trademark including its variants.

The grievance arises when the plaintiff came to know that the Defendant has adopted identical word "ADIDAS" as a trademark as well as part of its tradename for their textile business (class 24) which was published in Journal No. 1029 dated 16th April, 1992. The said application was opposed by the Plaintiff's Licensee and Distributor—M/s Bata India Pvt. Ltd. stating that he has adopted this name in bad faith, with dishonest intention.

The Plaintiff adopted the “ADIDAS” trademark in 1971 and secured registration of the said trademark before Defendant registration. The Plaintiff has documented the use of the “ADIDAS” mark internationally well before 1987. They have also proved their commercial use in India from 1989 through their witness testimony, who has stated that Bata India Pvt Ltd. was appointed as the Plaintiff’s licensee and distributor in 1989.

Defendant claims that the adoption of the trademark “ADIDAS” was both bona fide and honest. The rationale for choosing a mark identical to that of the Plaintiff is rooted in personal affection. From childhood, Defendant held deep admiration for his elder sister, addressed as ‘ADI’ in the Sindhi community. This admiration was so profound that he was commonly described as her devotee (‘Das’ in Sindhi). Consequently, the term “ADIDAS” (to mean devotee of elder sister) was conceived, combining ‘ADI’ (elder sister) and ‘DAS’ (devotee), to reflect this familial devotion. Defendant applied for registration of the Impugned mark on 19th May, 1987 on proposed to be used basis and secured registration of the trademark “ADIDAS” under no. 472388 on 29th September, 2006. The Defendants have been the prior adopter and user of this mark in India since 1987.

As per the defendant, lawsuit warrants dismissal on the grounds of the stale nature of the cause of action and the Plaintiff’s evident acquiescence and laches. Despite the Plaintiff’s acknowledged awareness of the Defendants’ use of the trademark since 1987, no suit for infringement was initiated until 2011. This prolonged period of inaction, spanning over two decades, implies a tacit consent to the Defendants’ use of the mark. Given this context, initiating a suit after such a significant delay not only undermines the urgency normally associated with trademark infringement claims but also signals an abandonment of any objections to the Defendants’ use. Consequently, the Plaintiff’s claim is barred by principles of delay, estoppel, acquiescence, and waiver, each underscoring the unreasonable delay and its prejudicial impact on the Defendants.

As per the defendant there is no reasonable likelihood of confusion between the Plaintiff’s and the Defendants’ trademarks, despite their textual similarity. The Defendant’s trademark “ADIDAS” is consistently used in all capital letters, distinctly differentiating it from the Plaintiff’s use of lowercase letters in ‘Adidas.’

This deliberate stylistic choice mitigates confusion among consumers, emphasizing a visual distinction in branding. Additionally, the Defendants’ adoption of the trademark was conducted honestly at a time when the Plaintiff had not yet established any commercial presence in India. This timing further supports the argument that the Defendants’ use of the trademark did not seek to capitalize on the Plaintiff’s brand identity, as it was non-existent in the Indian market at that point.

The Defendants contend that they are the prior users of the “ADIDAS” trademark for textiles, arguing that when they adopted and began using the mark in 1987, the Plaintiff’s products were not commercially available in India under that trademark. However, the Plaintiff’s evidence shows that their products bearing the “ADIDAS” mark were introduced into the Indian market in 1989 through Bata India Pvt. Ltd., who acted as their licensee and distributor. A registered proprietor can initiate legal proceedings for infringement, without actual use of the registered mark. Thus, the relevant date for the purpose of establishing prior use in the present case would be the date of registration of the mark and not when the Plaintiff actually started using it.

- (a) How infringement/passing off is relevant with respect to the use of the mark “ADIDAS” in respect of textile pieces by the Defendants ?
- (b) Explain how doctrine of Transborder reputation is associated in this case.
- (c) Explain the meaning of dilution of trademark.

- (d) Explain the exception in which the Registrar may permit the registration of trademark which is identical or similar to other trademark.

(10 marks each)

### Answer 1(a)

Infringement of trademarks as per Section 29 of the Trade Marks Act, 1999 is defined as a use of a mark, by an unauthorised or an authorised person or a person who is not the registered proprietor, which is identical or deceptively similar to the trademark in relation to the goods or services in respect of which the trademark is registered. In simple words, it is defined as the violation of exclusive rights that are attached to a registered trademark without the permission of the registered owner or licensees. The courts have time and again assumed that similarity of two marks and the kind of goods and services results in causing confusion in the minds of general public. They may take an undue advantage of enjoying the hard-earned reputation of the registered trademark. In order to have a successful claim against a person infringement of trademark, what needs to be proved is that the infringing trademark is deceptively similar or identical to the registered trademark.

*When can a person be considered as infringing a trademark*

A registered trademark is said to be infringed in case of the following situation:

1. If the mark in dispute is identical with or deceptively similar to the registered trademark and is in relation to the same or similar goods or services;
2. If the identical or similar mark can cause confusion in the minds of general public to have an association with the registered trademark
3. If the registered trademark is used as a part of trade name or business concern for goods and services in respect of which the trademark is registered
4. If the trademark is advertised and as a result it takes unfair advantage or is contrary to the honest practices or is detrimental to the distinctive character and reputation of the registered trademark.
5. If the registered trademark is used in the material meant for packaging or labelling of other goods or as a business paper without due authorization of the registered user.

According to Section 103 of the Trade Marks Act, 1999, a person is said to be applying for a trademark wrongfully in the following conditions:

1. If falsification of trademark has been committed;
2. If any trademark has been falsely applied to goods and services;
3. Makes, possesses or disposes of any instrument with the object and purpose of falsifying a trademark;
4. Falsely indicates name of the country or place where the goods have been made or the name or address of the person who is responsible for its manufacturing;
5. Alters or tampers with the indication of origin that is applied or required to be applied to a product.

The punishment for infringement of trademarks as a result of falsification shall not be less than six months but which may extend to three years and with fine which shall not be less than fifty thousand rupees but which may extend to two lakh rupees. Provided that the alleged offender has not committed such falsification based on the following grounds:

1. All reasonable precautions were taken against commission of such falsification and that at

the time of commission of the alleged offence there was no genuine reason to suspect the genuineness of the trademark

2. That he had acted innocently
3. On demand of the prosecutor, such necessary documents of the manner and person from whom the goods were received.

#### *Kind of legal action and remedies that can be taken against infringement of Trademarks*

Whenever a trademark is said to be infringed, both civil and criminal action can be brought about. The complaining party can either file a criminal complaint. The Trademark Act, 1999 recognises infringement of trademarks as a cognizable offence i.e. a police complaint can be lodged, and the infringers can be prosecuted directly. Even the courts are empowered with the authority to suo moto conduct raids and seizure operations. On the other hand, a civil action can also be brought about against such infringements. A suit can be initiated depending on whether the trademark is registered, pending or unregistered. Since trademark infringement is a continuing offence, there is no limit on the time period for filing a suit. The court of competent jurisdiction can give the following remedies if the infringements are successfully proved:

1. Injunction/stay against the use of trade mark;
2. Appropriate Damages;
3. Handing over of accounts and profits;
4. Appointment of a local commissioner by the respective court for custody or sealing of infringing material and accounts. The court can even go up to the extent of granting injunctions and directing the custom authorities to withhold the infringing material from being shipped or being disposed so that the proprietary interest of the owner gets protected;
5. An application under Order 39 rule 1 & 2 of CPC for grant of temporary or ad interim ex parte injunction. Interim orders are generally ex-parte or after notice.

#### **Passing Off**

Passing is recognised as a common law tort which is used to protect and enforce unregistered trademarks in India. Like protection of trademarks, Passing off also prevents a person from misrepresenting its goods and services from that of the other. The concept of passing off has emerged in the recent past. It has extended its ambit from goods to businesses and services. Today it is even applied to many forms of unfair trading and competition.

There are three elements of passing off popularly known as the classical trinity. These include Reputation, Misrepresentation and damage to goodwill. Common law courts have come up with a few basic characteristics of passing off which include the following:

1. Misrepresentation
2. Made by a person in the course of trade
3. To prospective or ultimate consumers of goods and services
4. To injure the business or goodwill of the other person
5. It causes actual damage to the person by whom the action is brought about.

Whenever such a case of passing off is brought before a court of law, it generally goes to the extent of deciding issues such as firstly, nature of mark, secondly, degree of resemblance, thirdly, whether the misrepresentation has resulted into causing confusion in the minds of people and ultimately causing loss to the plaintiff, fourthly, nature of goods, fifthly, similarity in the nature, character and



performance of the goods of rival mark, sixthly, class of purchasers, the education and intelligence level, seventhly, mode of purchasing and surrounding circumstances.

In, *Kaviraj Pandit Durga Dutt Sharma Vs. Navaratna Pharmaceutical Laboratories*, 1965 AIR 980 the Apex court held that there are some differences between the trial for passing off and trial for infringement of a trademark. In' *American Home Products Corpn. Vs. Lupin Laboratories Ltd.*, AIR 1995, Supreme Court held that it is well-settled law that in the infringement of a registered trademark is important to carry in mind the difference between the search for infringement and the search in passing off. In a passing off action, the courts seem to see whether there is deception whereas, in infringement matter, it is important to note that the Trademark Act gives to the owner an exclusive right to the use of the mark which will be infringed in the case of indistinguishable and/or related marks, even though there is deception, infringement can still take place.

### Answer 1(b)

A trademark is a mark which represents the goods, products or services in a graphical manner. It helps to associate the goods and services of a business group by representing its brand name or trade name graphically and in a way which is appealing to the human eye. It is a mere representation which denotes the brand name or trade name with a combination of colours, shape of goods and coined terms. It is a distinctive way to designate a mark to a business group so that it can show a connection with the said trade. It helps to distinguish the goods and services of one trader from the other and also denote the origin of the goods.

The prolonged usage of a trademark in association with a particular business group helps the trader to gain reputation and goodwill with respect to its particular trademark. In the due course of time, general public gains the knowledge and is aware of a brand name or trade name and associates the particular trademark with the specific goods and services. In this manner, a particular trademark gains its reputation and goodwill which eventually expands to a larger area making the trademark known globally. Such recognition of a trademark globally is known as the trans-border reputation of a trademark.

Trans-border reputation exists when a trademark and the product associated with the trademark surpasses the physical borders of the region and gain reputation across the border or beyond the territorial limitation of the geographical region due to its promotions, commercial publicity, advertisements and its presence in the market at large. Distribution of information of a trademark associated with a product through advertisements and publicity in media amounts to use of the trademark even if the advertisement is not combined with the actual presence or use of the product in the market. The source of information or medium of awareness of the trademark stands immaterial.

Due to the development of organisations and removal of restrictions, there has been an increase in globalisation and liberalisation due to which the concept of trans-border reputation was given representation in the society. No person has the authority to imitate or adopt a trademark which is likely to cause confusion or deceive the general public and people in common trade. The phenomenon of trans-border reputation helps a trader to protect its well reputed trademark globally. This concept of trans-border reputation helps to protect the reputation of any popular trademark of one country in other countries as well. Due to this any third party of other countries is restricted to register any identical or similar trademark in their name.

The emergence of this concept goes back to the 1950s when the famous case of N.R. Dongre and Whirlpool Corporation came up. In *N R Dongre v. Whirlpool Corporation*, 1996 (16) PTC 583, Whirlpool Corporation obtained the registration of the trademark 'Whirlpool' in India in 1956 for cloth dryers, dish washers, washing machines among other appliances. However, initially the corporation used to sell products only to the U.S embassy in India bearing the name 'Whirlpool'.

In 1986 Mr. N.R Dongre filed for registration of trademark 'Whirlpool'. After the publication, TVS Whirlpool Ltd opposed the said registration. But it was dismissed on the grounds of Non-use and non-reputation of trademark 'Whirlpool' in India and on the ground that no confusion is likely to arise if Mr. N.R Dongre and his company is allowed to sell out products bearing the name 'Whirlpool'.

The TVS Whirlpool Ltd filed for an appeal against the order of the Assistant Registrar before the Delhi High Court. The Single Judge Bench held in favour of TVS Whirlpool Ltd that they had been selling their products to the U.S embassy and ATO in India before Dongre even came into the market. Also, they have given advertisements in various international magazines being circulated in India about the products under the trademark and name 'Whirlpool'. And hence, a temporary injunction was granted stating that there were no reliable and conclusive evidence of Mr. N.R Dongre and Co. having carried out marketing of their washing machines bearing the trademark 'Whirlpool' for any considerable time prior to the date of grant of injunction.

Thereafter an appeal was filed before the division bench of the High Court and the decision of the Single Judge bench was upheld. Then in a Special Leave Petition before the Supreme Court under Article 136 of the Indian Constitution, the court upheld the decision of the Learned Single Judge as well as that of the Division Bench.

Thus, in this manner the concept of 'Trans-Border Reputation' was recognized by the Supreme Court. And the trademark 'Whirlpool' was deemed to have acquired trans-border reputation which enjoys due protection of law in India as well, irrespective of its market base or registration in India.

In the case of *Toyoto Jidosha Kabushiki Kaisha. vs. M/S Prius Auto Industries Ltd. And Ors. 2018 (73) PTC 1*, Prius Auto Industries is a manufacturer and seller of auto parts and accessories in India since 2001, whereas Toyota is an automobile manufacturer incorporated under the laws of Japan, When the case was instituted, the Single Judge of the Delhi High Court permanently enjoined Prius Auto from violating Toyota's rights in the marks TOYOTA, INNOVA, and PRIUS. The court said that PRIUS is a well-known trademark and Toyota was the prior user of PRIUS in other countries and had a trans- order reputation even in India through advertisements in international magazines and on the internet even though Prius Auto was the prior user and registered proprietor of the mark PRIUS in India. Prius Auto Industries filed an appeal with the Division Bench. The Division Bench set aside the permanent injunction and said that Toyota had no trans-border reputation in India as the reporting of launch of Prius (Car) in print media was not ground breaking in India and would not have had a huge impact on the public. Also, between the launch and 2001, the use of internet in India was limited. Also, the court could not find any substantial evidence as to confusion amongst public. This decision came to be challenged under the present appeal before the Supreme Court.

The Supreme Court upheld the decision of divisional bench and gave acceptance to Prius Auto's arguments on 'Territoriality Principle' stated that there needs to be substantial evidence to show that a mark has acquired substantial trans-border goodwill in India even if it already has acquired a huge good will in other jurisdictions. The supreme court also held that once an action of passing off is brought in, claimant has to establish his goodwill in the jurisdiction in which he claims defendants are trying to pass off their goods under the brand name of claimant's goods, the claimants are required to prove possibility of confusion and not actual confusion in public.

### Answer 1(c)

For better protection of trade marks for goods and services and for the prevention of the use of fraudulent marks, parliament repealed the 1958 Act and replaces it by the Trade Marks Act, 1999. Under Trade Marks Act, 1999 Trademark dilution was introduced. Trademark dilution is a trademark law concept giving the owner of a famous or well-known trademark power to forbid others from using the mark in a way that would lessen its uniqueness. To confuse the people, an unauthorised

user makes similar marks of the famous trademarks. To stop this, Trademark Dilution is the concept to give power to the famous owner of the trademarks.

Dilution of a Trademark is a surface of Trademark infringement, where the owner of a wellknown trademark has the power to prevent others from using their mark on the ground that it kills their uniqueness or lessen their reputation. Practically Speaking, No one has the right to copy a well-known trademark or to misuse the well-known trademark's reputation. Instead, dilution protection aims to protect sufficiently strong and well-known trademarks from losing their singular association in the public mind with a particular product.

One of the famous cases, where court used the dilution prior to the act is *Daimler Benz Aktiegessellschaft & Anr. v. Hybo Hindustan*, in which the issue was with the mark BENZ along with a three-pointed human being in a ring which the defendant used or his undergarment line. The High Court, in this case, granted the injunction to the plaintiff and stated that copying of mark such as Mercedes-Benz by anyone would result in the perversion of the trademark law in India. The court stated that "Such a mark is not up for grabs—not available to any person to apply to anything or goods. That name is well known in India and worldwide, with respect to cars, as is its symbol a three-pointed star".

This is the first case In India where the court restrained the defendant from using the plaintiff well-known trademark on the sole ground to avoid confusion or deception into a picture.

The famous case of *ITC v Phillip Morris Products SA & Ors*. This case provides a good understanding of the trademark dilution cause of action in India. High Court while referring to section 29(4) of the Trade Marks Act, 1999 held a dilution cause of action established if the following essential elements are satisfied:

1. The impugned mark is identical or similar to the well-known mark
2. The well-known or the injured mark has a reputation in India
3. The use of the impugned mark is without due cause
4. The use of the impugned mark amounts to taking unfair advantage of or is detrimental to the distinctive character or reputation of the registered trademark.

### Answer 1(d)

In the case of honest concurrent use or of other special circumstances which in the opinion of the Registrar, make it proper so to do, he may permit the registration by more than one proprietor of the trademarks which are identical or similar (whether any such trade mark is already registered or not) in respect of the same or similar goods or services, subject to such conditions and limitations, if any, as the Registrar may think fit to impose.

An Honest Concurrent Use of a Trade Mark is said to exist where two distinct entities have coexisted for an extended period of time while honestly utilizing the same or a strikingly similar representation of the same name or mark that is registered. It is important to note that in India, even the unregistered Trade Marks have been given statutory protection by the virtue of Sections 34 and 35 of the Trade Marks Act, 1999. Thus, the concept of honest concurrent use acts as a barrier of protection for those entities who have been honestly using such marks and/or names that are same or have a strikingly similar representation, thereby also allowing for the same to be registered as Section 12 of Trademark Act, 1999 provided that it satisfies the Registrar that it is a result of special circumstance and not an ordinary case of infringement.

#### Scope of Honest Concurrent Use

It is common knowledge that the use of a Trade Mark that is deceptively similar to another's

constitutes infringement. Nevertheless, honest concurrent use can be utilized as a defense strategy in the event of infringement claims or proceedings. However, the person taking the defense of Honest Concurrent Use must not take actions that intensify uncertainty beyond what is unavoidable and so infringe upon the claimant's goodwill. However, such defense strategies, if satisfied, can be used to register such Trade Marks as per S.12 of the Trade Marks Act, 1999, which provides for registration in cases of Honest Concurrent Use.

#### *Confusion Arising Out of Resemblance and Remedies*

Every time a product has a resemblance to another or is comparable to one in the market, there is a likelihood of the same creating confusion in the minds of the public. Thus, exploiting the more well-known brand's reputation for one's own advantage would be an infringement on the other's Intellectual Property Rights. However, there are also instances when such confusion is due to Trade Marks that are deceptively similar to each other. Therefore, the Registrar must determine, based on the facts of the case, whether a specific Trade Mark is likely to mislead or create confusion.

#### *Indian Courts on the subject matter:*

1. The Hon'ble Supreme Court of India in *National Sewing Thread Co. Ltd., Chidambaram Vs. James' Chadwick & Brothers Ltd.* has observed that the burden of proof lies on the Applicant who seeks to register his Trade Mark, so as to prove that his mark is not likely to deceive or cause confusion in the minds of the public. Thus, the onus lies on him to satisfy the Registrar that his mark does not fall within the ambit of S.8 of the Trade Marks Act, 1940 and therefore, it should be registered. Moreover, in deciding whether a particular Trade Mark is likely to deceive or cause confusion, that duty is not discharged by merely comparing it with the Trade Mark that is already registered and whose proprietor is offering opposition to the registration of the said mark. The Hon'ble Apex Court further observed that in such cases, the real issue to be decided is how a purchaser, who must be perceived as an average man of average intelligence, would react to a particular Trade Mark, what associations he would form by looking at the Trade Mark, and how he would associate the Trade Mark with the goods he would be purchasing.
2. The Hon'ble Supreme Court of India in *Renaissance Hotel Holdings Inc. Vs. B. Vijaya Saihas* provided clarity on the subject by observing the following:

When the defendant's mark is identical to the plaintiff's registered Trade Mark, and the goods or services covered are similar to those covered by such a registered Trade Mark, it may be necessary to prove that it is likely to cause public confusion, or that it is likely to have an association with the registered Trade Mark.

Similarly, when the Trade Mark of the plaintiff is similar to the registered Trade Mark of the defendant and the goods or services covered by such registered Trade Mark are identical or similar to the goods or services covered by such registered Trade Mark, it may again be necessary to establish that it is likely to cause confusion on the part of the public.

However, when the Trade Mark of the defendant is identical to the registered Trade Mark of the plaintiff and that the goods or services of the defendant are identical with the goods or services covered by registered Trade Mark, then the Court shall presume that it is likely to cause confusion on the part of the public.

#### **Question 2**

Samir Kasal, a novel personality in the field of sports entertainment conceptualized the format and novel features of an International Cricket League wherein famous retired cricketers would compete against each other amidst a test cricket format divided over 2 innings of 10 overs each that which would be intended to roll out in non-cricket playing countries to bolster

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the interest and spirit of the sport within the same. It was claimed by the him that he alongside Prashant Mehta had started working on the project, who also successfully roped in Vivek Khushalani to join as an investor and in light of the same, the allied format, conceptual clarity and other information about the project had been shared to Vivek collectively in discretion and due confidentiality underlying the project titled "Legends Premiere League."

However, after getting notified from media coverage Samir came to know that Prashant and Vivek were intending to organize a league titled "Legends League Cricket" rather than "Legends Premiere League" which had been previously agreed between them, Samir (herein after plaintiff) filed a petition seeking interim relief claiming that there was an undue copyright infringement of the concept that was primarily developed by him and a clear breach of confidentiality on which the Prashant and Vivek (herein after Defendants) misappropriated his original concept in light of the same.

Defendants submitted that the "format" which the Plaintiff claimed to have been introduced by him had been first introduced in the public domain in 1997, holding that the Plaintiff's idea which he desired exclusively and claimed for copyright infringement itself lacked originality. Further, the Defendants asserted that their Tournament's format was different from that of the Plaintiff's pertaining to the novel features that included the number of teams, overs, venues, franchises, innings and league names per say; thus vehemently denying any such claims of undue copyright infringement.

(a) Decide the case with the help of case laws.

(b) Explain nature of copyright protection in designs.

(6 marks each)

### Answer 2(a)

As per Section 2(y) of Copyright Act, 1957, work means any of the following works namely: a literary, dramatic, musical or artistic work; a cinematograph film; a sound recording.

The concept claimed by the Plaintiff, as his original idea, does not fall in any of these definitions. Thoughts, without being expressed in a material form, print or writing, would not constitute a "literary work".

The court viewed and concluded that parts of the concept already existed in the public domain for a long time and could not be considered as original ideas of the Plaintiff. The court said that the Plaintiff could not claim exclusive rights over ideas such as naming the teams using the words such as "Asia" and "World" or restrict the players from participating in the defendant's league.

The court relied on the judgment of *R.G. Anand v/s Delux films*, in this the court stated that all the games of cricket would have some of the elements common or derived from the same concept so the burden would be on the Plaintiff to prove that his idea had some novelty which could be protected but the plaintiff failed to do so. As the Plaintiff's ideas already existed and were adopted from one form or other.

The Plaintiff and Defendant number 1 had not prepared a proper document that could give rise to contractual obligations on part of the other defendants or third parties. So, it was concluded that there was no existence of the formation of a quasi-contract.

The Court opined that the obligation of confidentiality could not continue indefinitely. It would further depend on the nature of the information to be kept confidential. The information related to organizing a league as per Plaintiff's concept cannot stop Defendant number 2 from holding league matches forever, especially when it was observed by the court that he was continuously

involved in management of an IPL team. The Plaintiff was also at the fault that he failed to contact defendant number 2 between 2018 and 2020 to proceed with the proposal. It was also observed by the court that the Plaintiff was unable to explain the delay in approaching the court.

The Court stated that no one can claim copyright on the game of cricket and there can be no copyright on the evolution of the game from five-day test matches to the recent format of T-20 cricket either. The court dismissed the Plaintiff's claim for monetary loss as the damage suffered by the Plaintiff would still be insignificant as compared to the Defendant if an interim injunction was granted against them. So he dismissed the applications filed by the Plaintiff. The court directed the league organizers to maintain clear accounts of their earnings and expenditure with respect to matches and file the same before the Court within one month after the completion of the tournament.

### Answer 2(b)

Section 11 of the Designs Act 2000 provides that after registration the registered proprietor has copyright in the design. Copyright for the purpose of this act means the exclusive right to apply a design to any article in any class in which the design is registered. Duration of copyright in design- Once a design is registered the inventor of such design enjoys the copyright over it for a period of ten years subject to the provisions of the act. After the expiry of the ten years copyright over the design can be further increased for five years if before the expiration of the term of ten years application for the extension of the period of copyright is made to the Controller along with the prescribed fees.

### Question 3

The "Solidworks" software is a computer-aided design (CAD) programme designed towards modelling and simulating three-dimensional (3D) solid items in a variety of industries, including aerospace, defense, automotive, transportation, consumer goods, and education. The "Solidworks" software package is a small Computer-aided design and computer-aided engineering (CAE) programme that simplifies product development in a 3D environment. This matter revolves around their "Solidworks" software. Dassault's software was created by its employees, and the rights to it belong to Dassault. The Copyright Act of 1957 protects its software programme and manuals. The software programme was first published in the United States of America.

Dassault Systems, a French corporation, filed a lawsuit alleging copyright infringement of their Solidworks software by the defendant Spartan Engineering. Dassault said that in May 2018, it discovered that Spartan Engineering Industries Private Limited ("Spartan") was allegedly using pirated and illegal modifications of the "Solidworks" software. Dassault launched a lawsuit against Spartan in the Delhi High Court, alleging copyright infringement. Dassault stated that illicit use of the software had doubled since August 2020 and that its efforts to find a solution had failed because Spartan denied infringing on Dassault's software.

The defendant stated that as the copyright for the said software is not registered in India they are not liable for copyright infringement.

- (a) Will the Solidwork succeed in this case ?
- (b) Apart from remedies for infringement of copyright, the Act expressly provides for the protection of special rights of the author. Explain.

(6 marks each)

### Answer 3(a)

The Copyright Act applies only to works first published in India, irrespective of the nationality of the

author. However, Section 40 of the Copyright Act empowers the Government of India to extend the benefits of all or any of the provisions of the Act to works first published in any foreign country. The benefits granted to foreign works will not extend beyond what is available to the works in the home country and that too on a reciprocal basis i.e., the foreign country must grant similar protection to works entitled to copyright under the Act. The term of Copyright in India to the foreign work, will not exceed that conferred by the foreign country. Government of India has passed the International Copyright Order, 1958. According to this order any work first published in any country which is a member of the Berne Convention or the Universal Copyright Convention will be accorded the same treatment as if it was first published in India.

The following are the requisites for conferring copyright protection to works of international organisations: (a) The work must be made or first published by or under the direction or control of the International Organisation. (b) There should be no copyright in the work in India at the time of making or on the first publication of the work. (c) If the work is published in pursuance of an agreement with the author, such agreement should not reserve the author any copyright in the work or any copyright in the work should belong to the organisation.

Further, the facts of the given case in the question is similar to *Dassault Systemes Solidworks vs. Spartan Engineering Industries* decided by the Delhi High Court.

The software programme of the plaintiff, as well as the instruction manuals relating thereto are, in the submission of plaintiffs, "literary work" entitled to copyright protection. These software programmes were developed by the employees of the plaintiffs for use by the plaintiffs and that, by application of the "work for hire" doctrine, the copyright therein belongs to the plaintiffs, as the employer of the employees who had developed the software.

The Plaintiff is, therefore, the copyright owner in the software programmes which are "works", within the meaning of the Copyright Act, 1957.

The software programme in issue was, first published in the United States of America. India and the United States are members of the Berne Convention, Universal Copyright Convention and the World Trade Organisation Agreement (WTO), which provide for protection of copyright, in India, for works which were first published in United States, as though they were first published in India, under Section 40 of the Copyright Act, 1957 read with the International Copyright Order, 1999.

Clearly, this makes out a case of unauthorised infringement of the copyright held by the plaintiff in its "SOLIDWORKS" software.

In light of the foregoing, the Plaintiff may seek:-

- a. An ad interim temporary injunction restraining the Defendants, their principal officers, directors, agents, franchisees, servants and all others acting for and on their behalf at the Defendants' premises, from directly or indirectly using for any kind of computer related activities or otherwise in any other manner, any pirated/unlicensed/unauthorized software programs of the Plaintiffs or reproducing and distributing any pirated/unlicensed/unauthorized software of the Plaintiffs in contravention of the terms of the End User License Agreement(s) (EULA)/ Customer License and Online Services Agreement (CLOSA), or infringing in any other manner or causing or enabling or assisting others to infringe the copyrights of the Plaintiffs including SOLIDWORKS software and its various versions or any other software programs developed by the Plaintiffs in any manner that may amount to infringement of the Plaintiffs' copyright subsisting in its software programs and software related documentation;
- b. An ad interim temporary injunction restraining the Defendants, their principal officers, directors, agents, franchisees, servants and all others acting for and on their behalf at the Defendants' premises, from directly or indirectly formatting the computer systems and/or erasing any



data, log files, installations, etc. pertaining to assisting others to infringe the copyrights of the Plaintiffs subsisting in its software programs and software related documentation including SOLIDWORKS software and its various versions or any other software programs developed by the Plaintiffs.

### Answer 3(b)

Apart from remedies for infringement of copyright, the Act expressly provides for the protection of special rights of the author known as moral rights. Under Section 57 of the Act an author of copyright work can restrain or claim damages in respect of any distortion or mutilation of the work or any other action in relation to the said work which would be prejudicial to his honour or reputation. These rights can be exercised even after the assignment of the copyright. They can be enforced by an action for breach of contract or confidence, a suit for defamation, or passing off, as the case may be.

In the case, *Mannu Bhandari v. Kala Vikas Pictures Ltd.* the plaintiff, a Hindu writer, had assigned rights over her novel "Aap ka Bunty" to the defendants for producing a movie. The defendants produced a movie called "Samay ki Dhara" based on the novel. The plaintiff argued that the movie and the novel were based on different plots, which harmed her reputation as a writer and filed a suit for permanent injunction in the court. The court held that even though the plaintiff had transferred all her rights to the defendant, she still had moral rights over the work. Moral rights are not only in literary works but also apply to films and documentaries. It also held that some modifications while transforming a novel into a movie are permissible but should not harm the reputation of the author. Concerning the contract between the parties, the court stated that the provisions in the contract should not be in contravention of section 57 of the Copyright Act, 1957. Finally, it was agreed by the defendants that the name of the plaintiff and her novel's name should be removed from the film. The plaintiff will not have any rights over the film.

### Question 4

- (a) "Farmers have the right to be rewarded and recognised for making available assortment created from indigenously determined plant hereditary assets". Discuss.
- (b) Discuss briefly on 'Petty Patents'.

(6 marks each)

### Answer 4(a)

Plant breeders and legal entities including farmers who provide Plant Genetic Resources (PGR) to breeders for developing new varieties shall receive a fair share of benefit from the commercial gains of the registered varieties. Out of all the national plant variety protection laws enacted since 2001, the PPV&FR Act is the first that integrates a provision for access and benefit-sharing (ABS) along with Plant Breeder's Rights (PBRs). Accession of the genetic resource used in breeding is permitted under the Biological Diversity Act, 2002. However, the PPV&FR Act requires a breeder to make a sworn declaration on the geographical origin of the genetic resources used in the pedigree of the new variety, and its accession.

### Answer 4(b)

Utility Model is an exclusive right granted for an invention, which allows the right holder to prevent others from commercially using the protected invention, without his authorization for a limited period of time. In its basic definition, which may vary from one country (where such protection is available) to another, a utility model is similar to a patent. In fact, utility models are sometimes referred to as "petty patents" or "innovation patents." Only a small but significant number of countries and regions provide the option of utility model protection. At present, India does not have legislation on Utility models. The main differences between utility models and patents are the following: The

requirements for acquiring a utility model are less stringent than for patents. While the requirement of “novelty” is always to be met, that of “inventive step” or “non-obviousness” may be much fewer or absent altogether. In practice, protection for utility models is often sought for innovations of a rather incremental character which may not meet the patentability criteria.

The term of protection for utility models is shorter than for patents and varies from country to country (usually between 7 and 10 years without the possibility of extension or renewal). In most countries where utility model protection is available, patent offices do not examine applications as to substance prior to registration. This means that the registration process is often significantly simpler and faster, taking on an average six months. Utility models are much cheaper to obtain and to maintain. In some countries, utility model protection can only be obtained for certain fields of technology, and only for products but not for processes. Utility models are considered suitable particularly for SMEs that make “minor” improvements to, and adaptations of, existing products. Utility models are primarily used for mechanical innovations. The “Innovation patent,” launched in Australia some time back was introduced as a result of extensive research into the needs of small and medium-sized enterprises, with the aim of providing a “low-cost entry point into the intellectual property system.”

#### Question 5

- (a) “TRIPS Agreement and the Convention on Biological Diversity should be mutually supportive and promote the sustainable use of resources.” Explain.
- (b) Explain the persons entitled for the registration of Geographical Indications.

(6 marks each)

#### Answer 5(a)

The Convention on Biological Diversity (CBD) 1992 Opened for signature at the Earth Summit in Rio Delaneiro in 1992, and entering into force in December 1993, the Convention on Biological Diversity is an international treaty for the conservation of biodiversity, the sustainable use of the components of biodiversity and the equitable sharing of the benefits derived from the use of genetic resources. The interface between biodiversity and intellectual property is shaped at the international level by several treaties and process, including at the WIPO, and the TRIPS Council of the WTO. With 193 Parties, the Convention has universal participation among countries. The Convention seeks to address all threats to biodiversity and ecosystem services, including threats from climate change, through scientific assessments, the development of tools, incentives and processes, the transfer of technologies and good practices and the full and active involvement of relevant stakeholders including indigenous and local communities, youth, NGOs, women and the business community.

The Cartagena Protocol on Biosafety is a subsidiary agreement to the Convention. It seeks to protect biological diversity from the potential risks posed by living modified organisms resulting from modern biotechnology. The treaty defines biodiversity as “the variability among living organisms from all sources including, inter alia, terrestrial, marine and other aquatic ecosystems and the ecological complexes of which they are part; this includes diversity within species, between species and of ecosystems.” The Convention reaffirms the principle of state sovereignty, which grants states sovereign rights to exploit their resources pursuant to their own environmental policies together with the responsibility to ensure that activities within their own jurisdiction or control do not cause damage to the environment of other states. The Biodiversity Convention also provides a general legal framework regulating access to biological resources and the sharing of benefits arising from their use.

India is a party to the Convention on Biological Diversity (1992). The Convention on Biological Diversity establishes important principles regarding the protection of biodiversity while recognizing the vast commercial value of the planet’s store of germplasm. However, the expansion of international

trade agreements establishing a global regime of intellectual property rights creates incentives that may destroy biodiversity, while undercutting social and economic development opportunities as well as cultural diversity. The member countries were pressurized to change their IPR laws to conform to the TRIPS agreement. India also followed the suit by placing in place legal frameworks for the management of biodiversity and Intellectual property laws. Following India's ratification of the Convention on Biological Diversity (CBD) at international level, the Biological Diversity Act, 2002 was adopted. The Biological Diversity Act aims at conservation of biological resources and associated knowledge as well as facilitating access to them in a sustainable manner and through a just process. While the TRIPS and the CBD both attempt to legislate some form of intellectual property and technology transfer, the Agreement appear to provide contradictory prescriptions for the control over genetic control over generic resources and biodiversity. The two Agreements embody and promote conflicting objectives, systems of right and obligations.

The core issues is that, in the area of patentable subject matter, benefit sharing, protection of local knowledge, requirements of prior informed consent and role of state. Major tension between the CBD and the TRIPS is related to the case of National Sovereignty and the Rights of IPR Holders. Through the CBD, countries have the right to regulate access of foreigners to biological resources and knowledge and to determine benefit sharing arrangements. The TRIPS enable persons or institutions to patent a country's biological resources in countries outside country of origin of the resources or knowledge. In this manner TRIPS facilitates the conditions for misappropriation of ownership or rights over living organisms, knowledge and processes on the use of biodiversity. The sovereignty of developing countries over their resources and over their right to exploit or use their resources as well as to determine access and benefit sharing arrangements are compromised. The patent confers exclusive rights on its owner to prevent third parties for making, using offering for sale, selling or importing the patent product and to prevent third parties from using the patent process. This makes it an offence for others to do so, except with the owner's permission, which is usually given only on license or payment royalty.

#### Answer 5(b)

As per Section 11 Geographical Indications of Goods (Registration and Protection) Act, 1999, any association of persons or producers or any organisation or authority established by or under any law representing the interest of the producers of the concerned goods can apply for the registration of a geographical indication. The Applicant has to be a legal entity and should be representing the interest of producers of the goods applied for. Any such organisation or association being not that of the producers may have to prove that they represent the interest of producers. Any Applicant Authority also has to prove that they represent the interest of producers. An application for registration of a geographical indication is to be made in writing, along with the prescribed fees (as specified under First Schedule), and should be addressed to the Registrar of Geographical Indications.

#### Question 6

Human rights are fundamental as they are inherent to the human person. Whereas intellectual property rights seek to provide incentives for inventiveness and creativity, encourage the dissemination of creative and innovative productions, as well as the development of cultural identities, and preserve the integrity of scientific, literary and artistic productions for the benefit of the society as a whole.

- (a) Elaborate on above statement with reference to Indian scenario.
- (b) Explain the test for a cause of action for breach of confidence in the common law world.

(6 marks each)

**Answer 6(a)**

Human Rights and Intellectual Property, though two very different set of laws with no apparent connection, have gradually becoming intimate bedfellows. Since inception, the two subjects developed virtually in isolation from each other. But in the last few years, international standard setting activities have begun to map previously uncharted intersections between intellectual property laws on the one hand and human rights law on the other. Exactly how this new-found relationship will evolve is being actively studied and sometimes even fought over by states and non-governmental organizations (NGOs)

In international venues such as the World Intellectual Property Organization (WIPO), the U.N. Commission on Human Rights and the Sub- Commission on the Promotion and Protection of Human Rights, the World Trade Organization (WTO), the World Health Organization (WHO), and the Conference of the Parties to the Convention on Biological Diversity (CBD). A look at the law making which is underway in these for prima facie reveals two distinct conceptual approaches to the interface between human rights and the intellectual property.

- (a) The first approach finds that there is a conflict between human rights and the intellectual property rights. This view believes that a regime of strong intellectual property protection undermines and therefore is incompatible with the human rights obligations, especially in the area of economic, social, and cultural rights. In order to resolve this conflict it is suggested the normative primacy of human rights law over intellectual property law should be recognised in areas where specific treaty obligations conflict.
- (b) In the second approach, the Human Rights and the Intellectual Property Rights are seen as concerned with the same fundamental question, i.e., defining the appropriate scope of private monopoly power that gives authors and inventors a sufficient incentive to create and innovate, while ensuring that the consuming public has adequate access to the fruits of their efforts. This school of thought sees Human Rights law and the Intellectual Property Rights law as essentially compatible, although often disagreeing over where to strike the balance between incentives on the one hand and access on the other.

**Answer 6(b)**

The test for a cause of action for breach of confidence in the common law world is set out in the case of *Coco vs. A.N. Clark (Engineers) Ltd., (1969) R.P.C. 41*:

- the information itself must have the necessary quality of confidence about it;
- that information must have been imparted in circumstances imparting an obligation of confidence;
- there must be an unauthorized use of that information to the detriment of the party communicating it. The "quality of confidence" highlights the fact that trade secrets are a legal concept. With sufficient effort or through illegal acts (such as break and enter), competitors can usually obtain trade secrets. However, so long as the owner of the trade secret demonstrates that reasonable efforts have been made to keep the information confidential, the information remains a trade secret and is legally protected as such. Conversely, trade secret owners who do not demonstrate reasonable effort at protecting confidential information, risk losing the trade secret even if the information is obtained by competitors illegally. It is for this reason that trade secret owners shred documents and do not simply recycle them. Presumably an industrious competitor could piece together the shredded documents again. Legally the trade secret remains a trade secret because shredding the document is considered to have kept the quality of confidence of the information.

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# LABOUR LAWS & PRACTICE

## MODULE 3 ELECTIVE PAPER 9.6

*Time allowed : 3 hours*

*Maximum marks : 100*

*NOTE : Answer All Questions.*

### Questions.

#### 1. Case Study :

In furtherance of certain demands for wage revision made by the employees, in September 2022, the employees struck work for 4 hours on 29th December, 2022. On 16th January, 2023 the Bank issued a circular to its managers and agents directing them to deduct full day's wages of such employees who participated in the 4-hour strike. The employees filed a writ petition in the High Court for quashing the Circular. The petition was allowed. Hence the present appeal by the Bank. Counsel ABC of the employees stated that the deduction of the wages for the day amounted to unilaterally changing the service conditions, depriving the workers of their fixed monthly wages, under the contract of service. Wages were paid not from day to day or hour to hour basis but as a fixed amount on a monthly basis. In the absence of a specific term in the regulations, awards and settlements, the Bank could not unilaterally reduce the monthly wage and thus give the employees lesser monthly wages than the contracted one.

There is no doubt that whenever a worker indulges in a misconduct such as deliberate refusal to work, the employer can take a disciplinary action against him and impose on him the penalty prescribed for it which may include some deduction from his wages. However, when the misconduct is not disputed but is admitted and resorted to on a mass scale such as when the employees go on strike, legal or illegal, there is no need to hold an enquiry. When the contract, standing orders or the service rules/regulations are silent, but enactment such as the Payment of Wages Act providing for wage cuts for absence from duty is applicable to the establishment concerned, the wages can be deducted even under the provisions of such enactment.

The Bank's Counsel XYZ invokes the doctrine 'no work no pay' and invite employees to answer the question in the affirmative. Counsel XYZ said there is an implied contract to receive salary provided the employee does work. Promise to work and promise to pay are mutual. By resorting to the 4-hour strike that day, the employees absented themselves from work resulting in failure of consideration 'no work no pay'. Counsel XYZ justified the deduction of the entire day's salary on the ground that unless the employees work for the first 4 hours when the Bank is open to the public, there is precious little or nothing for them to do the rest of the day. No work no pay, says Counsel XYZ.

Counsel XYZ supported his battle-cry by taking employees through a number of decisions. The tentative view taken by the Calcutta High Court in *Algemene Bank v. Central Govt. Labour Court* (1978-II-LLJ-117) was no work no pay. On the same doctrine, the employees' writ petition was not countenanced and the employees' submission that a contract to pay wages is indivisible in character was rejected by the Madras High Court in *V. Ramchandran v. Indian Bank* (1979-I-LLJ-122), and *R. Rajamanickam v. Indian Bank* (1981-II-LLJ-367).

The High Court also rejected the contention of the Bank that it was entitled to make deductions under Section 7(2) of the Payment of Wages Act, 1936 by holding that the provision enabled the employer to deduct wages only if the Bank had power under the contract of employment. The Bank filed a civil appeal against the order of the High Court allowing the writ petition filed by the employees.

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It was further pointed out that whereas, a legal strike may not invite disciplinary proceedings, an illegal strike may do so, it being a misconduct. However, whether the strike is legal or illegal, the workers are liable to lose wages for the period of strike. The liability to lose wages does not either make a strike illegal as a weapon or deprive the workers of it. When workers resort to it, they do so knowing well its consequences. During the period of strike the contract of employment continues, but the workers withhold their labour. Consequently, they cannot expect to be paid. The court has given very sound reasoning for it. It was aptly remarked that it is not enough that the employees attend the place of work, they must put in the work allotted to them. It is for the work not for their mere attendance that the wages/salaries are paid. Thus appeal was allowed. The above problem is based on a leading case 'The Bank of India v. T.S. Kelawala and others' (1990) 11 LLJ 39 SC.

On consideration of the above facts, answer the following questions :

- (a) Is the contention of the Bank that it was entitled to make deductions under Section 7(2) of the Payment of Wages Act, 1936 correct and to deduct wages only if the Bank had power under the contract of employment? Explain. (4+4=8 marks)
- (b) Explain the kinds of strike under Industrial Disputes Act 1947. (8 marks)
- (c) Whether the strike is legal? What are the provisions of a legality of strike? Refer the relevant case laws. (3+3+2=8 marks)
- (d) Enumerate the authorized deductions under the provisions of the Payment of Wages Act 1936. (8 marks)
- (e) Define the term 'wages' under the Payment of Wages Act, 1936. Also explain the responsibility of employer in respect of payment of wages. (4+4=8 marks)

### Answer 1(a)

Section 7(2)(b) of the Payment of Wages Act, 1936, states that the deductions from the wages of an employed person shall be made only in accordance with the provisions of this Act, and may be in the kind of deductions for absence from duty.

Further, Section 9(1) of the Payment of Wages Act, 1936 stipulates that the deductions may be made under clause (b) of sub-section (2) of section 7 only on account of the absence of an employed person from the place or places where, by the terms of his employment, he is required to work, such absence being for the whole or any part of the period during which he is so required to work.

A division bench of the Supreme Court in the case of Bank of India v. TS Kelawala, (1990) 11 LLJ 39 held that the workers are not entitled to wages for the strike period. The Court observed that "the legality of strike does not always exempt the employees from the deduction of their salaries for the period of strike". The Court, further observed, "whether the strike is legal or illegal, the workers are liable to lose wages does not either make the strike illegal as a weapon or deprive the workers of it".

The Court also observed that the deliberate refusal to work may be the result of various actions, on their part such as a sit-in or stay-in-strike at the workplace or a strike whether legal or illegal, or a go-slow tactics. The legality of strike does not always exempt the employees from the deduction of

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their salaries for the period of strike. It only saves them from a disciplinary action since a legal strike is recognized as a legitimate weapon in the hands of the workers to redress their grievances.

The contention of the Bank that it was entitled to make deductions under Section 7(2) is incorrect unless the Bank had explicit authority under the contract of employment or standing orders. Without such authority, the unilateral decision to deduct a full day's wages for a 4-hour strike contravenes the provisions of the Payment of Wages Act, 1936.

### Answer 1(b)

The kinds of Strikes are provided below:

#### i. Stay-in, sit-down, pen-down or tool-down strike

In all such cases, the workmen after taking their seats, refuse to do work. Even when asked to leave the premises, they refuse to do so. All such acts on the part of the workmen acting in combination, amount to a strike.

Since such strikes are directed against the employer, they are also called primary strikes. In the case of Punjab National Bank Ltd. v. All India Punjab National Bank Employees Federation, AIR 1960 SC 160, the Supreme Court observed that on a plain and grammatical construction of this definition, it would be difficult to exclude a strike where workmen enter the premises of their employment and refuse to take their tools in hand and start their usual work. Refusal under common understanding not to work is a strike. If in pursuance of such common understanding, the employees enter the premises of the Bank and refuse to take their pens in their hands that would no doubt be a strike under Section 2(q).

#### ii. Go-slow

Go-slow does not amount to strike, but it is a serious case of misconduct.

In the case of Bharat Sugar Mills Ltd. v. Jai Singh, (1961) 11 LLJ 644 (647) SC, the Supreme Court explained the legality of go-slow in the following words: "Go-slow which is a picturesque description of deliberate delaying of production by workmen pretending to be engaged in the factory, is one of the most precious practices that discontented and disgruntled workmen sometimes resort to. Thus, while delaying production and thereby reducing the output, the workmen claim to have remained employed and entitled to full wages. Apart from this, 'go-slow' is likely to be much more harmful than total cessation of work by strike. During a go-slow much of the machinery is kept going on at a reduced speed which is often extremely damaging to the machinery parts. For all these reasons, 'go-slow' has always been considered a serious type of misconduct."

In another case, it was observed that slow-down is an insidious method of undermining the stability of a concern and Tribunals certainly will not countenance it. It was held that 'go slow' is serious misconduct being a covert and a more damaging breach of the contract of employment (SU Motors v. Workman 1990-11 LLJ 39). It is not a legitimate weapon in the armoury of labour. It has been regarded as a misconduct.

#### iii. Sympathetic Strike

Cessation of work in support of the demands of workmen belonging to other employers is called a sympathetic strike. This is an unjustifiable invasion of the rights of an employer who is not at all involved in the dispute. The management can take disciplinary action for the absence of workmen. However, in Ramalingam v. Indian Metallurgical Corporation, Madras, 1964-1 L.L.J. 81, it was held that such cessation of work would not amount to a strike since there is no intention to use the strike against the management.



**iv. Hunger strike**

Some workers may resort to fast on or near the place of work or residence of the employer. If it is peaceful and does not result in cessation of work, it will not constitute a strike. But if due to such an act, even those present for work, could not be given work, it would amount to strike (Pepariach Sugar Mills Ltd. v. Their Workmen).

**v. Work-to-rule**

Since there is no cessation of work, it does not constitute a strike.

**Answer 1(c)**

The legality of the strike is determined with reference to the legal provisions enumerated in the Industrial Disputes Act, 1947 and the purpose for which the strike was declared is not relevant in directing the legality. Sections 10(3), 10A(4A), 22, and 23 of the Act deals with strikes. Sections 22 and 23 impose restrictions on the commencement of a strike while Sections 10(3) and 10A(4A) prohibit its continuance.

The justifiability of the strike has no direct relation to the question of its legality and illegality. The justification of the strike as held by the Punjab & Haryana High Court in the case of Matchwell Electricals of India v. Chief Commissioner, (1962) 2 LLJ 289, is entirely unrelated to its legality or illegality. The justification of strikes has to be viewed from the stand point of fairness and reasonableness of demands made by workmen and not merely from the stand point of their exhausting all other legitimate means open to them for getting their demands fulfilled.

The Supreme Court in Gujarat Steel Tubes Ltd. v. Gujarat Steel Tubes Majdoor Sabha, AIR 1980 SC 1896 held that the justifiability of a strike is purely a question of fact. Therefore, if the strike was resorted to by the workers in support of their reasonable, fair, and bona fide demands in a peaceful manner, then the strike would be justified. Where it was resorted to by using violence or acts of sabotage or for any ulterior purpose, then the strike will be unjustified. As regards the wages to the worker's strike period are concerned, the Supreme Court in Charakulam Tea Estate v. Their Workmen, AIR 1969 SC 998 held that in case of the strike which is legal and justified, the workmen will be entitled to full wages for the strike period. A similar view was taken by the Supreme Court in Crompton Greaves Ltd. case 1978 Lab 1C 1379 (SC).

The Supreme Court in Statesman Ltd. v. Their Workman, AIR 1976 SC 758 held that if the strike is illegal or unjustified, strikers will not be entitled to wages for the strike period unless considerate circumstances constraint a different cause. A similar view was taken by the Supreme Court in Madura Coats Ltd. v. The Inspector of Factories, Madurai, AIR 1981 SC 340.

The Supreme Court has also considered the situation if the strike is followed by the lockout and vice versa, and both are unjustified, in India Marine Service Pvt. Ltd. v. Their Workman, AIR 1963 SC 528. In this case, the Court evolved the doctrine of "apportionment of blame" to solve the problem. According to this doctrine, when the workmen and the management are equally to be blamed, the Court normally awards half of the wages. This doctrine was followed by the Supreme Court in several cases. Thus, the examination of the above cases reveals that when the blame for the situation is apportioned roughly half and half between the management and workmen, the workmen are given half of the wages for the period involved.

**Answer 1(d)**

Section 7(2) of the Payment of Wages Act, 1936 provides that deductions from wages of an employed person shall be made only in accordance with the provisions of this Act, and may be of the following kinds only, namely:

- (a) fines;
- (b) deductions for absence from duty;
- (c) deductions for damage to or loss of goods expressly entrusted to the employed person for custody, or for loss of money for which he is required to account, where such damage or loss is directly attributable to his neglect or default;
- (d) deductions for house-accommodation supplied by the employer or by Government or any housing board set up under any law for the time being in force (whether the Government or the board is the employer or not) or any other authority engaged in the business of subsidizing house-accommodation which may be specified in this behalf by appropriate Government by notification in the Official Gazette;
- (e) deductions for such amenities and services supplied by the employer as the appropriate Government or any officer specified by it in this behalf may, by general or special order, authorise;
- Explanation—The word “services” in this clause does not include the supply of tools and raw materials required for the purposes of employment;
- (f) deductions for recovery of advances of whatever nature (including advances for travelling allowance or conveyance allowance), and the interest due in respect thereof, or for adjustment of overpayments of wages;
- (ff) deductions for recovery of loans made from any fund constituted for the welfare of labour in accordance with the rules approved by appropriate Government, and the interest due in respect thereof;
- (fff) deductions for recovery of loans granted for house-building or other purposes approved by appropriate Government and the interest due in respect thereof;
- (g) deductions of income-tax payable by the employed person;
- (h) deductions required to be made by order of a Court or other authority competent to make such order;
- (i) deductions for subscriptions to, and for repayment of advances from any provident fund to which the Provident Funds Act, 1925, applies or any recognized provident fund as defined in clause (38) of section 2 of the Income-tax Act, 1961, or any provident fund approved in this behalf by appropriate Government, during the continuance of such approval;
- (ii) deductions made with the written authorisation of—
- (i) the employed person; or
- (ii) the president or secretary of the registered trade union of which the employed person is a member on such conditions as may be prescribed,
- for contribution to the National Defence Fund or to any Defence Savings Scheme approved by appropriate Government;
- (j) deductions for payments to co-operative societies approved by appropriate Government or any officer specified by it in this behalf or to a scheme of insurance maintained by the Indian Post Office; and
- (k) deductions, made with the written authorisation of the person employed for payment of any premium on his life insurance policy to the Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956, or for the purchase of securities of the

- Government of India or of any appropriate Government or for being deposited in any Post Office Savings Bank in furtherance of any savings scheme of any such Government;
- (kk) deductions made, with the written authorisation of the employed person, for the payment of his contribution to any fund constituted by the employer or a trade union registered under the Trade Union Act, 1926, for the welfare of the employed persons or the members of their families, or both, and approved by appropriate Government or any officer specified by it in this behalf, during the continuance of such approval;
  - (kkk) deductions made, with the written authorisation of the employed person, for payment of the fees payable by him for the membership of any trade union registered under the Trade Unions Act, 1926;
    - (l) deductions for payment of insurance premia on Fidelity Guarantee Bonds;
    - (m) deductions for recovery of losses sustained by a railway administration on account of acceptance by the employed person of counterfeit or base coins or mutilated or forged currency notes;
    - (n) deductions for recovery of losses sustained by a railway administration on account of the failure of the employed person to invoice, to bill, to collect or to account for the appropriate charges due to that administration whether in respect of fares, freight, demurrage, wharfage and carnage or in respect of sale of food in catering establishments or in respect of sale of commodities in grain shops or otherwise;
    - (o) deductions for recovery of losses sustained by a railway administration on account of any rebates or refunds incorrectly granted by the employed person where such loss is directly attributable to his neglect or default;
    - (p) deductions, made with the written authorisation of the employed person, for contribution to the Prime Minister's National Relief Fund or to such other Fund as the Central Government may, by notification in the Official Gazette, specify;
    - (q) deductions for contributions to any insurance scheme framed by the Central Government for the benefit of its employees.

### Answer 1(e)

Section 2(vi) of the Payment of Wages Act, 1936 defines the term wages which means all remuneration (whether by way of salary allowances or otherwise) expressed in terms of money or capable of being so expressed which would if the terms of employment express or implied were fulfilled by payable to a person employed in respect of his employment or of work done in such employment and includes –

- a) any remuneration payable under any award or settlement between the parties or order of a court;
- b) any remuneration to which the person employed is entitled in respect of overtime work or holidays or any leave period;
- c) any additional remuneration payable under the terms of employment (whether called a bonus or by any other name);
- d) any sum which by reason of the termination of employment of the person employed is payable under any law, contract or instrument which provides for the payment of such sum whether with or without deductions but does not provide for the time within which the payment is to be made;

- e) any sum to which the person employed is entitled under any scheme framed under any law for the time being in force, but does not include –
- (1) any bonus (whether under a scheme of profit sharing or otherwise) which does not form part of the remuneration payable under the terms of employment or which is not payable under any award or settlement between the parties or order of a court;
  - (2) the value of any house-accommodation or of the supply of light water medical attendance or other amenity or of any service excluded from the computation of wages by a general or special order of Appropriate Government;
  - (3) any contribution paid by the employer to any pension or provident fund and the interest which may have accrued thereon;
  - (4) any travelling allowance or the value of any travelling concession;
  - (5) any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment; or
  - (6) any gratuity payable on the termination of employment in cases other than those specified in sub-clause (d).

### Responsibility for Payment of Wages

Section 3(1) of the Payment of Wages Act, 1936 provides that every employer shall be responsible for the payment to persons employed by him of all wages required to be paid under the Act. However, in the case of persons employed in factories if a person has been named as the manager of the factory; in the case of persons employed in industrial or other establishments if there is a person responsible to the employer for the supervision and control of the industrial or other establishments; in the case of persons employed upon railways if the employer is the railway administration and the railway administration has nominated a person in this behalf for the local area concerned; in the case of persons employed in the work of contractor, a person designated by such contractor who is directly under his charge; and in any other case, a person designated by the employer as a person responsible for complying with the provisions of the Act, the person so named, the person responsible to the employer, the person so nominated or the person so designated, as the case may be, shall be responsible for such payment.

Notwithstanding anything contained in sub-section (1), it shall be the responsibility of the employer to make payment of all wages required to be made under this Act in case the contractor or the person designated by the employer fails to make such payment.

It may be noted that as per section 2(ib) of the Payment of Wages Act, 1936 “employer” includes the legal representative of a deceased employer.

### Question 2

- (a) Rahul, the bus conductor fell unconscious in the bus itself at the end of the work and died subsequently. The medical evidence was very clear that the accident had no connection with the employment and it was certified that the bus conductor died due to advanced liver disease and hence no connection with the employment strain and stress in the work. The claimant (dependant) adduced no medical evidence as well. The employer refused to pay the compensation in the form of dependent benefits. Is it valid? Is the claimant entitled to any other benefits? Discuss. (3+3=6 marks)
- (b) In a matter M/s Ari Small Engineering Workshop accepted two apprentice trainees under the scheme for imparting training to artisans from rural areas. The establishment employed

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only 18 employees in their factory and hence they did not come under the definition of factory within the meaning of the Act. However, the Regional Director, ESI on finding that the two apprentices were also working in the factory computed the total number of persons working therein as 20 and held that the unit is a factory and thus asked the unit to deposit contribution under the Act. The order was challenged. Whether the apprentices appointed by the employer in factory are considered as an employee? Explain

(6 marks)

### Answer 2(a)

Section 3 of the Employees' Compensation Act, 1923 and Section 51A of the Employees' State Insurance Act, 1948 lays down that an accident arising in the course of an employee's employment is presumed, in the absence of evidence to the contrary, to have arisen out of employment. Though the provisions of the Act demand liberal interpretation, at the same time the ESI corporation is not liable to pay compensation for the dependent's benefit if the death has no connection with the employment. When the person dies due to a natural disease, it has no connection with employment. (Regional Director ESI Corporation, Trissur Vs. K Sainaba, 2005). Since the medical evidence case was very clear that the accident had no connection with employment and it was medically certified that the bus conductor died due to advanced liver disease. The stress or strain of the work will not cause such death. The claimant too did not produce any medical evidence. Therefore, the dependent benefits claim in the form of compensation was rejected. But the court awarded sickness and funeral benefits.

The employer's refusal to pay dependent benefits is valid as the death was not connected to employment. However, the claimant may still be entitled to funeral expenses under the Employees' State Insurance Act, 1948 and other statutory benefits like gratuity, provident fund, and unpaid dues, if applicable.

### Answer 2(b)

Section 2(9) of the Employees' State Insurance Act, 1948 defines the term employee which means any person employed for wages in or in connection with the work of a factory or establishment to which this Act applies and inter alia includes any person engaged as an apprentice, not being an apprentice engaged under the Apprentices Act, 1961.

In ESI Corporation v. Tata Engineering and Co., 75 it has been held by the Supreme Court that the word 'apprentice' is not defined in the Employees' State Insurance Act, 1948, nor is it specifically referred to in the definition of 'employee' by either inclusion or exclusion. The heart of the matter of apprenticeship is, therefore, the dominant object and intent to impart on the part of employer and to accept on the part of other person learning under certain agreed terms. That certain payment is made during the of the apprenticeship, by whatever name called, and that the apprentice has to be under rules of discipline do not convert that apprentice to a regular employee under the employer. Thus, the purpose of the apprenticeship is to impart learning to persons on agreed terms for a fixed period. The employer is not bound to keep them in service after the training is over. The purpose is entirely different from that of service. The stipend paid to them does not amount to wages within the meaning of this Act. Thus, they are not employees within the meaning of Section 2(9) of the Employees' State Insurance Act, 1948.

Further, it was held that the apprentices under any scheme are exempted from the operation of law relating to labour by virtue of Section 18(b) of the Apprentices Act, 1961. Hence, the apprentices cannot be taken into account for determining the coverage of the establishment under the Employees' State Insurance Act, 1948.

**Question 3**

- (a) The Management of Safal Industries engaged contract labourers in place of work done by permanent workmen. It was challenged before the Industrial Tribunal and the Tribunal held that the action of the management is invalid. The management preferred to appeal contending that the Tribunal has no jurisdiction to interfere on the appointment of contractors. Decide the validity of the appeal with reference to relevant case law.

(6 marks)

- (b) The Management of Central Machine Tool Institute, the Petitioner, challenged the validity of the registration of their employees' association as a trade union under the provisions of Trade Union Act, 1926 on the ground that the institute is purely a research and development organisation without any profit motive and therefore it is not a trade or industry for the purpose of Trade Union Act and accordingly registration of the association of the employees of the institute under the Trade Union Act, 1926 by the office of registrar of Trade Union is without any legal basis and liable to be cancelled.

Decide the following :

- (i) Whether Petitioner's Central Machine Tool Institute is an industry and its employees are workmen within the meaning of Trade Union Act, 1926 ?
- (ii) Whether the registration of the association of employees as a trade union without hearing the petitioner employer is violation of the principles of natural justice.

(3+3=6 marks)

**Answer 3(a)**

Section 10(1) of the Contract Labour (Regulation and Abolition) Act, 1970 states that notwithstanding anything contained in this Act, the appropriate Government may, after consultation with the Central Board or, as the case may be, a State Board, prohibit, by notification in the Official Gazette, employment of contract labour in any process, operation or other work in any establishment. Section 10(2) further states that before issuing any notification under sub-section (1) in relation to an establishment, the appropriate Government shall have regard to the conditions of work and benefits provided for the contract labour in that establishment and other relevant factors, such as—

- (a) whether the process, operation or other work is incidental to, or necessary for the industry, trade, business, manufacture or occupation that is carried on in the establishment;
- (b) whether it is of perennial nature, that is to say, it is of sufficient duration having regard to the nature of industry, trade, business, manufacture or occupation carried on in that establishment;
- (c) whether it is done ordinarily through, regular workmen in that establishment or an establishment similar thereto;
- (d) whether it is sufficient to employ considerable number of wholtime workmen.

Explanation. —If a question arises whether any process or operation or other work is of perennial nature, the decision of the appropriate Government thereon shall be final.

However, the Act does not prohibit employers from engaging in contract labour unless explicitly restricted by a government notification.

Hence, in the given case, the appeal of the management is valid, if it does not prohibit employers from engaging in contract labour unless explicitly restricted by a government notification. It is not

for Industrial Tribunal to decide whether the employment of the contract labour in any particular section of the industries is necessary or not. It is for the appropriate Government to approve the areas in which contract labour could be engaged or not. According to Section 1 and 10 of the Contract Labour (Regulation and Abolition) Act, 1970, it is only the appropriate government and not the tribunal or labour court has to decide whether a particular kind of work could be allocated to a contract labour or not. (Vegolis Pvt Ltd Vs Their workmen 1971 LU).

### Answer 3(b)

- (i) The Trade Union Act, 1926 has not defined the word industry. Whereas the Industry is defined under section 2(j) of the Industrial Disputes Act, 1947 which means any business, trade, undertaking, manufacture or calling of employers and includes any calling service, employment, handicraft, or industrial occupation or avocation of workmen.

The Supreme Court carried out an in-depth study of the definition of the term industry in a comprehensive manner in the case of Bangalore Water Supply and Sewerage Board v. A Rajappa, AIR 1978 SC 548, after considering various previous judicial decisions on the subject and in the process, it rejected some of them, while evolving a new concept of the term "industry". After discussing the definition from various angles, in the above case, the Supreme Court, laid down the tests to determine whether an activity is covered by the definition of "industry" or not. It is also referred to as the triple test.

The Supreme Court observed that professions, clubs, educational institutions, co-operatives, research institutes, charitable projects and other kindred adventures, if they fulfil the triple tests cannot be exempted from the scope of Section 2(j).

The industry is used indirectly in the Trade Union Act, 1926 in the definition of Trade Dispute and having regard to the context in which the said word is used in the Trade Union Act, 1926 it should be given a restricted meaning and not the same wider meaning which is specifically given in the definition of the word Industry under Industrial Disputes Act, 1947.

Notwithstanding the fact that there is no profit motive in the activities of the petitioner institute so long as it is a research institute for rendering material service to the community, its activities clearly fall within the meaning of the word Trade or Industry as used in the Trade Union Act, 1926 (State of Bombay Vs Hospital Mazdoor Sabha 1960).

The employees are therefore workmen within the meaning of section 2(g) of the Trade Union Act, 1926, and section 2(j) of the Industrial Disputes Act, 1947. These two enactments should be read in Pari Materia.

- (ii) The registration of the association of employees as a Trade Union without hearing the petitioner employer is not in violation of principles of natural justice. The word Industry as used in Section 2(g) of the Trade of Unions Act, 1926 should be wide enough to be read like how it is defined in Section 2(j) of Industrial Disputes Act, 1947. Reading the judgment in BWSSB Vs Rajappa- 1978, the workmen of central Machine tools are also workmen employed in a trade or industry for the purpose of the Trade Union Act, 1926 as well and consequently, they have the right to form a Trade Union, and get it registered under the provisions of the Trade Unions Act, 1926. Hence there is no violation of principles of natural justice.

### Question 4

The Constitution of India has provisions for ensuring occupational health and safety of workers in the form of three Articles 24, 39 (e and f) and 42. The important legislations related to occupational health, safety and welfare are the Factories Act, 1948, the Mines Act, 1952 and the Dock Workers (Safety, Health & Welfare) Act, 1986, Workmen's Compensation Act, 1923 and Building and Other

Construction Workers (Regulation of Employment and Condition of Service) Act. Among these laws, Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 came into force from 19th August, 1996 to regulate the employment and conditions of service of building and other construction workers and to provide for their safety, health and welfare.

It is further governed by the Central Rules, 1998 and each of the State has got the powers to frame their own rules for implementation of the Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996.

Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act was enacted to regulate the employment and conditions of service and to provide for safety, health and welfare measures for crores of building and other construction workers in the country. The Act is applicable to every establishment which employs 10 or more workers in any building or other construction work.

- (a) Explain the welfare measures of the workers under the Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996. (b) State the procedure for appointment of Inspecting Staff.

(6 marks each)

#### Answer 4(a)

Welfare measures of the workers under the Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 are as under:

##### 1. Drinking water (Section 32)

Section 32 provides for the obligation of the employer to make in every place where building or other construction work is in progress, effective arrangements to provide and maintain at suitable points conveniently situated for all persons employed therein, a sufficient supply of wholesome drinking water. All such points shall be legibly marked "Drinking Water" in a language understood by a majority of the persons employed in such place and no such points shall be situated within six meters of any washing place, urinals, or latrine.

##### 2. Latrines and urinals (Section 33)

In every place where building or other construction work is carried on, the employer shall provide sufficient latrine and urinal accommodation of such types as may be prescribed and they shall be so conveniently situated as may be accessible to the building workers at all times while they are in such place. Provided that it shall not be necessary to provide separate urinals in any place where less than fifty persons are employed or where the latrines are connected to a water-borne sewage system.

##### 3. Accommodation (Section 34)

It shall be the duty of the employer to provide, free of charge and within the work site or as near to it as may be possible, temporary living accommodation to all building workers employed by him for such period as the building or other construction work is in progress. Such temporary accommodation shall have separate cooking places, bathing, washing, and lavatory facilities.

As soon as may be, after the building or other construction work is over, the employer shall, at his own cost, cause removal or demolition of temporary structures so erected by him and restore the ground in good level and clean condition.

In case an employer is given any land by a Municipal Board or any other local authority for



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the purposes of providing temporary accommodation for the building workers under this section, he shall, as soon as may be after the construction work is over, return the possession of such land in the same condition in which he received the same.

#### 4. Creches (Section 35)

In every place wherein, more than fifty female building workers are ordinarily employed, there shall be provided and maintained a suitable room or rooms for the use of children under the age of six years of such female workers,

Such rooms shall -

- (e) provide adequate accommodation;
- (f) be adequately lighted and ventilated;
- (g) be maintained in a clean and sanitary condition;
- (h) be under the charge of women trained in the care of children and infants.

#### 5. First-aid (Section 36)

Every employer shall provide in all the places where building or other construction work is carried on such first-aid facilities as may be prescribed.

#### 6. Canteens, etc. (Section 37)

The appropriate Government may, by rules, require the employer -

- a) to provide and maintain in every place wherein not less than two hundred and fifty building workers are ordinarily employed, a canteen for the use of the workers;
- b) to provide such other welfare measures for the benefit of building workers as may be prescribed.

#### Answer 4(b)

##### Appointment of Inspecting Staff: -

The Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 consists of sections 42 and 43 providing for the appointment of the Director-General, Chief Inspector, and Inspectors and their powers, functions, and limitations.

##### Appointment of Director-General, Chief Inspector and Inspectors (Section 42)

##### Appointment of Director-General of Inspection:

The Central Government may, by notification, appoint a Gazetted officer of that Government to be the Director-General of inspection. He shall be responsible for laying down the standards of inspection and shall also exercise the powers of an Inspector throughout India in relation to all the establishments for which the Central Government is the appropriate Government.

##### Appointment of Chief Inspector of Inspection:

The State Government may, by notification, appoint a Gazetted Officer of that Government to be the Chief Inspector of Inspection of Building and Construction who shall be responsible for effectively carrying out the provisions of this Act in the State and shall also exercise the powers of an Inspector under this Act throughout the State in relation to establishments for which the State Government is the appropriate Government.

##### Appointment of Inspectors:

The appropriate Government may, by notification, appoint such number of its officers as it thinks

fit to be Inspectors for the purposes of this Act and may assign to them such local limits as it may think fit.

**Powers and function of Inspector:**

Every Inspector appointed under this section shall be subject to the control of the Director-General or the Chief Inspector, as the case may be, and shall exercise his powers and perform his functions under this Act subject to general control and supervision of the Director-General or the Chief Inspector.

**Deemed public servants:**

The Director-General, the Chief Inspector, and every Inspector shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code 1860.

**Question 5**

- (a) Suresh, the occupier of an industrial establishment employing 126 employees of whom some are aged below 18 but completed the age of 14 years. Two of them submitted false birth certificate just to get into the job. The employer though complied with the provisions as to the recruitment of young persons to the employment was prosecuted for the contravention of the Child and Adolescent Labour Act, 1986. Decide as to the liability of the employer with reference to the relevant case laws.

(6 marks)

- (b) Discuss the rights of employees under Occupational Safety, Health and Working Conditions Code 2020 (OSH Code).

(6 marks)

**Answer 5(a)**

According to Sections 3, 3A, and 14(1) of the Child and Adolescent Labour (Prohibition and Regulation) Act, 1986 which deals with the provisions as to prohibition of employment of children, adolescents, and penalties. If a person has not completed his/her 14 years of age, then there is a prohibition on the employment of such children. Above 14 and below 18 could be employed subject to compliance to conditions.

In the instant case, it becomes irrelevant whether an employer is aware of or unaware of the misrepresentation made by the child as to his age, he will be absolutely liable for the contravention of Section 3 of the Child and Adolescent Labour (Prohibition and Regulation) Act, 1986. Even when he was sent for medical examination by the certifying surgeon, the employer could not escape from liability. He will be liable for punishment of up to 2 years imprisonment with less than 6 months and a fine of not less than rupees twenty thousand which may extend to rupees fifty thousand or with both.

In the matter of M.C. Mehta vs State of Tamil Nadu and Others judgement dated December 10, 1996, the Hon'ble Supreme Court issued directions to the State Government regarding welfare of child labour and held that the offending employer must be asked to pay compensation for every child employed in contravention of the provisions of the Act. The employer is also liable to pay penalty, which could be deposited in a fund to be known as Child Labour Rehabilitation-cum-Welfare Fund. The liability of the employer would not cease even if he would desire to disengage the child presently employed.

**Answer 5(b)**

The Occupational Safety, Health and Working Conditions Code 2019 has been introduced in the

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Parliament on 23rd July, 2019. Occupational Safety, Health and Working Conditions (OSH) Code 2020 provides that every employee must have the following rights.

- Right to be informed about health and safety at work.
- Right to bring to the notice of the employer any likelihood of the injury or death or danger to health of employees at work place and simultaneously to bring it to the notice of the Inspector.
- Right to remedial action from employer.
- If the employer is not satisfied with existence of eminent danger as apprehended by employees, he/she can refer the matter to the inspector cum facilitator for appropriate actions.
- Right to be administered with the facilities on working conditions.

#### Question 6

- (a) India's first legislation of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 (''POSH Act'') was enacted by the Ministry of Women and Child Development, India in 2013 after 16 years of the Supreme Court judgment in the case of Vishaka and Ors. v. State of Rajasthan and Ors. (1997 (7) SCC 323).

Sexual harassment of a woman in workplace is of serious concern to humanity on the whole. It cannot be construed to be in a narrow sense, as it may include sexual advances and other verbal or physical harassment of a sexual nature. The victims of sexual harassment face psychological and health effects like stress, depression, anxiety, shame, guilt and so on.

The Supreme Court stated that the Vishaka Guidelines had to be implemented in form, substance and spirit in order to help bring gender parity by ensuring women can work with dignity, decency and due respect. It noted that the Vishaka Guidelines require both employers and other responsible persons or institutions to observe them and to help prevent sexual harassment of women.

Further, the Court held that a number of states were falling short in this regard and reiterated that there is an obligation to prevent all forms of violence. It stated that "lip service, hollow statements and inert and inadequate laws with sloppy enforcement are not enough for true and genuine upliftment of our half most precious population - the women".

In view of the above decision of the Court, highlight the importance of Medha Kotwal Lele and Ors. V. Union of India judgement.

(6 marks)

- (b) Factories Act, 1948 is an act to consolidate and amend the law regulating Labour in factories. The main objective of the Act is to ensure adequate safety measures but also to promote health and welfare of the workers employed in factories as well as to prevent haphazard growth of factories. This Act is legislated to lay guidelines on working conditions in factories including leaves, working hours, holidays, etc. It also ensures health, safety and welfare measures of workers in factories.

This Act also focused on hazardous process by industries and the level of chemical substances permissible in work environment. The Act contains provisions regarding hazardous process, constitution of Site Appraisal Committee, compulsory disclosure of Information, appointing competent person in handling hazardous substances, etc. On the basis of above facts, answer the following :

- (a) Define "Workers" with reference to Landmark Case of Birdh Chand Sharma v. First Civil Judge Nagpur (AIR 1961 SC 644).
- (b) Explain the term "Manufacturing Process" with relevant case laws.

(3+3=6 marks)

#### Answer 6(a)

In Medha Kotwal Lele & Ors. v. Union of India & Ors. case a letter written by Medha Kotwal who is the coordinator of Aalochana, a centre of documentation and research on women and women's rights groups highlighted a number of individual cases of sexual harassment stating that the Vishaka Guidelines were not being effectively implemented.

Converting the letter into a writ petition, the Supreme Court took cognizance and undertook monitoring of the implementation of the Vishaka Guidelines across the country by directing State Governments to file affidavits emphasizing the steps taken by them to implement the Vishaka Guidelines. The result showed a poor performance by a majority of the states.

Thus, SC issued further orders to national organisations such as the Bar Council of India, to respect and implement the Vishakha Guidelines in spirit. In its judgment, the Supreme Court observed that "the implementation of the Vishaka Guidelines has to be not only in form but also in substance and spirit so as to make available safe and secure environment for women at workplace in every aspect and thereby enabling working women to work with dignity, decency and due respect."

Similarly, the Medical Council of India, Council of Architecture, Institute of Chartered Accountants, Institute of Company Secretaries and other statutory Institutes were required to ensure that the organisations, bodies, associations, institutions and persons registered/affiliated with them follow the Vishaka Guidelines.

Not being satisfied with the implementation of the Vishaka Guidelines, it directed States to put in place sufficient mechanisms to ensure effective implementation of the Vishaka Guidelines. Finally, the Supreme Court asserted that in case of non-compliance or non-adherence of the Vishaka Guidelines, it would be open to the aggrieved persons to approach the respective High Courts.

#### Answer 6(b)

- (a) According to section 2(l) of the Factories Act, 1948 "Worker" means a person employed, directly or by or through any agency (including a contractor) with or without the knowledge of the principal employer, whether for remuneration or not, in any manufacturing process, or in any other kind of work incidental to, or connected with, the manufacturing process, or the subject of the manufacturing process but does not include any member of the armed forces of the Union.

In Birdh Chand Sharma v. First Civil Judge, Nagpur, [AIR 1961 SC 644] where the respondents prepared bidis at the factory and they were not at liberty to work at their homes. They worked within certain hours which were the factory hours. They were, however, not bound to work for the entire period and they could go whenever they like. Their attendance was noted in the factory. They could come and go away at any time they liked. However, no worker was allowed to work after midday even though the factory was closed at 7 p.m. and no worker was allowed to continue work after 7 p.m. There were standing orders in the factory and, according to these orders, a worker who remained absent for eight days presumably without leave could be removed. The payment was made on a piece rate according to the quantum of work done, but the management had the right to reject such bidis that did not come up to the proper standard. On these facts the Supreme Court held that respondents were workers under section 2 (l) of the Factories Act, 1948.

**(b) Manufacturing Process**

The definition of the manufacturing process is exhaustive. Under the present definition even transporting, washing, cleaning, oiling, and packing which do not involve any transformation as such which is necessary to constitute a manufacturing process in its generic sense, are nonetheless treated as a manufacturing process.

The definition is artificially projected beyond the scope of the natural meaning of what the words might convey thus covering a very wide range of activities.

Madras High Court in the case of *In re. Seshadrinatha Sarma*, 1966 (2) LLJ 235 held that to constitute a manufacture there should not be essentially some kind of transformation of substance and the article need not become commercially as another and different article from that at which it begins its existence so long as there has been an indisputable transformation of substance by the use of machinery and transformed substance is commercially marketable. Division Bench of A.P. High Court held that to determine where certain premises is factory, it is necessary that it should carry on manufacturing process and it does not require that the process should end in a substance being manufactured.

The following processes have been held to be manufacturing processes:

- (1) Sun Cured tobacco leaves are subjected to processes of moistening, stripping, breaking up, adaption, and packing, with a view to transport to the company's main factory for their use in manufacturing cigarettes (*V.P. Gopala Rao v. Public Prosecutor*, AIR 1970 S.C. 66).
- (2) The operation of peeling, washing, etc., of prawns for putting them in cold storage is a process with a view to the sale or use or disposal of the prawns (*R.E. DSouza v. Krishnan Nair*, 1968 F.J.R. 469).
- (3) Process carried out in salt works in converting seawater into salt. In *Ardeshir V. Bombay State* (AIR 1962 SC 29] the process carried out in the salt works comes within the definition of manufacturing process' in Section 2 (k) in as much as salt can be said to have been manufactured from sea water by the process of treatment and adaptation of seawater into salt.
- (4) The Making of Bidies. [*State of Bombay v. Ali.Saheb kashim Tamboli*,(1995)2LLJ 182].

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*Padhai Kar Befikar*

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## INSOLVENCY – LAW AND PRACTICE

### MODULE 3 ELECTIVE PAPER 9.5

*Time allowed : 3 hours*

*Maximum marks : 100*

**NOTE :** Answer All Questions.

#### Questions 1

**COB Bank** filed an application under Section 7 of the Insolvency and Bankruptcy Code, 2016 (IBC) for initiating a Corporate Insolvency Resolution Process (CIRP) against the Corporate Debtor, **M/s. Gupta Infra Private Limited (GIPL)**. The said application was admitted by the Adjudicating Authority (AA) during October, 2018 and a Resolution Professional (RP) was appointed as an Interim Resolution Professional (IRP).

Following is the financial position of GIPL as on the date of commencement of the CIRP :

Liabilities	Amount in ₹ Crores	Assets	Amount in ₹ Crores
Share Capital – Equity	100.00	Fixed Assets – Land and Building	115.00
Share Capital – Redeemable Preference Shares	75.00	Fixed Assets – Plant and Machinery	165.00
Share Capital – Convertible Preference Shares	25.00	Other Fixed Assets	70.00
Debentures (Unsecured fully convertible)	50.00	Investments in Subsidiaries	50.00
Long Term Borrowings – Fully Secured	300.00	Inventories	150.00
Short Term Borrowings – Unsecured	75.00	Receivables	110.00
Loan from Related Parties	25.00	Cash and Bank Balances	15.00
Payables	65.00	Other Current Assets	25.00
Provisions	35.00	Accumulated Losses	100.00
Deferred Tax Liabilities	15.00		
Other Current Liabilities	35.00		
<b>Total Liabilities</b>	<b>800.00</b>	<b>Total Assets</b>	<b>800.00</b>

**Other Additional information provided by the Corporate Debtor :**

[Amounts stated in the table above can be treated as claims made by each of the parties in their respective category].

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**Other Current Liabilities include :**

₹ In Crores

Workmen Wages Payable for 36 months	9.00
Salary Payable for 20 months	100.00
PF Liabilities	3.80
Sales Tax/Commercial Taxes Due *	4.80
Other Statutory Dues	2.40

\* On the sales tax and commercial taxes due, the Commercial Tax Authorities have already attached one of the immovable properties of the Corporate Debtor valued at ₹ 3.50 crores.

Fixed Assets includes buildings occupied on long term lease for a period of 75 years obtained from the **State Industrial Development Authority (SIDA)** for ₹ 5 Crores. SIDA has also submitted their claim with the RP stating that their premium amount along with interest and penal interest is due for since last 7 years. SIDA has filed its claim as a Financial Creditor. Whereas, the Resolution Professional has requested SIDA to submit its claim as an Operational Creditor. (This amount is included in Other Current Liabilities).

Further, it was informed by the Resolution Professional that the Corporate Debtor, M/s. Gupta Infra Private Limited, who initiated a CIRP against one of its Operational Creditor, namely C-Digital Arts Private Ltd for ₹ 6 Crores and going forward, the National Company Law Tribunal (NCLT) has already ordered for initiation of Corporate Insolvency Resolution Process (CIRP). However, one of the suspended Director on the Board of C-Digital Arts Private Limited filed an appeal before the National Company Law Appellate Tribunal (NCLAT) stating that there was no notice given as required under **Section 8** of the Insolvency and Bankruptcy Code, 2016 read with **Rule 5** of the insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 which entails that for initiation of insolvency resolution process by an Operational Creditor, a demand notice has to be served by the unpaid Operational Debtor on the Corporate Creditor. Nevertheless, the aforesaid suspended director he has not denied the debts due. This matter is pending before NCLAT for disposal.

Investments includes investment in **Foreign Subsidiary of ₹ 30 Crores** and in an **Indian Subsidiary of ₹ 18 Crores** and **Investment in shares amounting to ₹ 2 Crores** in another company incorporated and **registered with charitable objects and not for profit.**

Inventories and Receivables realisable only for 80% of its value.

Loan from related parties is from wife and son of one Director of GIPL.

Other Current Assets includes ₹ 10 Crores paid to **National Highway Authority of India (NHAI)** towards **a bid amount for a road project.**

Other Current Assets includes ₹ 2 Crores of assets of third party held **under Trust.** Machinery, the carrying value of which is ₹ 1.50 crores belonging to an Indian Subsidiary is lying in one of the Units of the Corporate Debtor.

A Machinery which was acquired for dispatching to the Foreign Subsidiary is also lying in the factory premises of the Corporate Debtor having a carrying value of ₹ 3 crores.

Cranes worth ₹ 5 Crores belonging to a proprietorship concern of one of the Director is also lying the Factory premises of the Corporate Debtor.



CIRP costs payable including all expenses is ₹ 2 Crores.

The Security Interest charged for COB Bank is 91.25% and SID Bank is 8.75%. (both the financial creditors have not relinquished their security interest).

During the CIRP, in one of the Meeting of the '**Committee of Creditors**' (CoC), Resolution Plans were discussed. Revised Resolution Plans were submitted by the prospective Resolution Applicants. Resolution Plan was put to e-Vote and by majority of 94.79%, the Resolution Plan of 'GIPL' was approved.

The Resolution plan proposes for utilisation of all assets including the assets under lease. Further, the Resolution Professional has sent a letter to the Commercial Taxes Authorities to release the property attached by them and on the contrary, the Authorities informed that the Department will get their portion as per the proposed Resolution Plan.

One of the Financial Creditor (SID Bank) sent an objection with respect to the distribution of the proceeds of the resolution plan under the Resolution Plan.

SID Bank also filed seeking direction to the Resolution Professional to distribute the proceeds of the Resolution Plan and made the following prayers :

"It is most respectfully prayed that :

1. The present application may kindly be allowed and the directions be issued to the Respondent No. 1 to modify/clarify the distribution to dissenting members as per the Resolution Plan and distribute the proceeds of the resolution plan to the Applicant SID Bank, for an amount of ₹ 8.97 Crores in priority in accordance with provisions of IBC, 2016 in the interest of justice and equity.
2. Interim stay be granted on distribution of the resolution plan amount by the Resolution Professional to the Committee of Creditors till the present application is decided."

The case of the Appellant, namely SID Bank in the Application was that, as per the security interest of the Appellant, the Appellant is entitled to 8.75% i.e. the amount of ₹ 8.97 Crores and as per voting share as approved by the CoC, the Appellant is entitled to 5.21% i.e., ₹ 5.34 Crores. The case of the Appellant SID Bank set up in the Application is that he is entitled for his distribution of plan amount as per value of the security interest of the Appellant.

The Application was objected by the Resolution Professional. The Adjudicating Authority, by its Order, upheld the decision of the CoC for distribution of proceeds of the Resolution Plan as per the voting share. The Appellant, aggrieved by the said Order, has come up with the Appeal to the National Company Law Appellate Tribunal (NCLAT).

**In the light of the above case study inputs and referring to the decisions of applicable case laws with reasons and the provisions of Insolvency and Bankruptcy Code, 2016 (IBC, 2016) and the Regulations made thereunder, answer the following questions :**

- (i) Explain in the light of the decided case laws, whether the claim made by SID Bank regarding distribution proceeds of the resolution plan based on the security interest is correct and whether SID Bank will succeed in its appeal with NCLAT ?

(6 marks)

- (ii) In the given case study, it is stated that though the Corporate Debtor has succeeded in initiating the CIRP against one of its Operational Creditor, namely C-Digital Arts Pvt Ltd, nevertheless, an appeal has been preferred before the NCLAT by one of the suspended director on the Board of the aforesaid Operational Creditor contending that notice as required under IBC, 2016 was not served by the Corporate Debtor. Referring to the applicable case laws, state

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whether the Corporate Debtor will succeed in the appeal filed by a suspended Director of the Operational Creditor ?

(5 marks)

(iii) Explain whether the claim of the Resolution Professional to require the State Industrial Development Authority (SIDA) to revise its claim as an Operational Creditor is correct ? Support your answer in the light of the decided case laws in this regard.

(6 marks)

(iv) Explain whether the RP can file an application under IBC, 2016 for initiating Corporate Insolvency Resolution Process against National Highway Authority of India (NHAI) for recovery of bid amount ?

(3 marks)

(v) Explain whether the RP can file an application under IBC, 2016 for initiating Corporate Insolvency Resolution Process against the Subsidiary of the Corporate Debtor which is incorporated as Company not for profit ?

(4 marks)

(vi) In case, if liquidation is ordered in the given case study, state the order of priority with the amount that can be claimed by each of the parties. (Treat both COB Bank and SID Bank as Secured Creditors).

(8 marks)

(vii) Whether the RP can file an application before the National Company Law Tribunal for claims (as amount payable) against the three subsidiaries of Corporate Debtor ?

(4 marks)

(viii) In case, if liquidation is ordered in the given case, state whether the following shall be included in the liquidation estate :

- (i) ₹ 2 Crores of assets of third party held under Trust.
- (ii) Machinery, the carrying value of which is ₹ 1.50 crores belonging to an Indian Subsidiary lying in one of the Units of the Corporate Debtor.
- (iii) A Machinery which was acquired for dispatching to the Foreign Subsidiary lying in the factory premises of the Corporate Debtor having a carrying value of ₹ 3 crores.
- (iv) Cranes worth ₹ 5 Crores belonging to a proprietorship concern of one of the Director lying in the Factory premises of the Corporate Debtor.

(1×4=4 marks)

**Answer 1(i)**

The facts of the question similar to the case of *Small Industries Development Bank of India (SIDBI) v. Vivek Raheja, RP, Gupta Exim (India) Pvt. Ltd. and Ors. decided September 16, 2022* where in National Company Law Appellate Tribunal held as follows:

Section 53 (1) (b)(ii) of the Insolvency and Bankruptcy Code (the Code) uses expression "debts owed to a secured creditor" which is the basis for distribution in the order of priority as provided in Section 53(1)(ii). The debt owed to a secured creditor is a debt which is relatable to his claim as admitted in the CIRP Process. The claim/debt of a secured financial creditor which is admitted in CIRP Process is a fixed amount determined in the CIRP process as reflected in the Information

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Memorandum prepared by the Resolution Professional. The debt owed to a secured creditor is not the value of security of a secured creditor. Section 53(1) does not contemplate distribution as per value of security of a secured creditor. The submission of the Appellant that he is entitled to distribution of the proceeds of the plan value as per value of security possessed by him is not in accordance with the legislative scheme as delineated in Section 53(1) of the Code.

The above issue has also been decided by this Appellate Tribunal in *Union Bank of India Vs. Resolution Professional of M/s Kudos Chemie Ltd. & Ors.* In the above case also, the Financial Creditor of the Corporate Debtor has filed an application seeking direction to distribute the resolution plan amount as per value of the security of the Appellant. The CoC has decided to distribute the amount as per amount accepted by the Resolution Professional. The CoC decision was challenged before the Adjudicating Authority who rejected the Application against which the Appeal was filed. The views of the Adjudicating Authority for distribution of plan amount as per voting share found approval by this Tribunal. When we look into above statement of objects and reasons, it is made clear that financial creditors who do not vote in favour of the resolution plan shall receive an amount that is not less than the liquidation value of their debt. The above statement of objects and reasons also makes it clear that the entitlement of dissenting financial creditor is to receive liquidation value of their debt and not the distribution as per their security value as is sought to be contended by the Learned Counsel for the Appellant before us.

The statement of objects and reasons by which amendments in Section 30(2)(b) has been made makes it clear that entitlement of dissenting financial creditor is the liquidation value of their debt which also clearly negate the submissions raised by the Learned Counsel for the Appellant before us. Learned Sr. Counsel appearing for Respondent No. 1-Resolution Professional refuting the submissions of Learned Counsel for the Appellant submits that manner of distribution of the proceeds of the plan value is in accordance with Section 30 (2) (b) of the Code. The Appellant is entitled for distribution as per value of the debt of the Appellant. There is no entitlement to claim distribution on the basis of value of security interest of the Appellant according to the provisions of Section 30(2)(b) of the Code. None of the submissions raised by the Learned Counsel for the Appellant has any substance. In result, the Appeal is dismissed.

In view of the aforesaid decisions of NCLAT, the SID Bank in the given case will not succeed in its appeal.

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

The facts of the question similar to the case of *Digvijay Kathiwada v. Haren Sanghvi & Associates and Ors.* decided on December 06, 2023 National Company Law Appellate Tribunal, in this case the Appellant/Corporate Debtor has contended that the Adjudicating Authority in this case has erroneously commenced the insolvency process under Section 9 of IBC though the Appellant/Corporate Debtor was not served any notice upon them under Section 8 of IBC. It has also been asserted that the Operational Creditor has failed to adduce valid proof of delivery of demand notice. The explanation offered by the Operational Creditor is that Section 8 demand notice dated 04.11.2019 was addressed to the Corporate Debtor but on account of clerical error the proof that was attached was the notice copy which had been endorsed to the Operational Creditor by the legal counsel of the Operational Creditor. The Appellant has vehemently contended that these grounds cited by the Advocate for the Operational Creditor on failure to give proof of service of Section 8 notices on the Corporate Debtor are flimsy and lack credulity.

Moreover, we also notice that admittedly the Section 8 notice was sent to the corporate office and not to the registered office of the Corporate Debtor. There is no doubt in our minds that in terms of the statutory construct of the IBC, an application for initiation of corporate insolvency resolution process can be filed by Operational Creditor only after expiry of period of 10 days from the date

of delivery of the Section 8 demand notice on the Corporate Debtor. If we look at the impugned order, it has held at paragraph 19 that the Corporate Debtor was served with a notice dated 04.11.2019 which notice was not responded to by the Corporate Debtor.

However, there is no specific finding recorded on whether the notice was actually served on the Corporate Debtor, a factum which has been seriously contested by the Corporate Debtor. Further it is the case of the Appellant that the proof of service claimed by the Operational Creditor was wrong proof of service. In the facts of the present case, where the delivery of the Section 8 notice has itself been questioned by the Corporate Debtor there arises a need to verify as to whether the statutory provisions of IBC code have been duly complied with.

In view of the mandatory provision under Section 8 of IBC read with Rule 5 of Insolvency and Bankruptcy, (Application to Adjudicating Authority) Rules, 2016 which entails that for initiation of insolvency resolution by an Operational Creditor a demand notice has to be served by the unpaid Operational Debtor on the Corporate Debtor, we feel that the contention of the Appellant deserves due consideration. Having given thoughtful consideration to the submissions made on behalf of the Appellant and having examined the material available on record with reference to the applicable mandatory statutory provisions of the IBC, we are clearly of the view that the order of the Adjudicating Authority is silent on the actual delivery of the Section 8 notice which is a bone of contention between the two parties. We are of the considered opinion that this aspect needs to be appropriately examined and hence remand the matter back to the Adjudicating Authority to consider the Section 9 application afresh with particular reference to actual and proper delivery of the demand notice on the Corporate Debtor. In result, the appeal is allowed. The impugned order dated 13.05.2023 is set aside. The orders passed by the Adjudicating Authority initiating CIRP against the Corporate Debtor and appointing interim Resolution Professional and all other orders pursuant to the impugned order are declared illegal and set aside. The interim Resolution Professional shall be paid the actual expenses incurred and nominal fees by the Operational Creditor on production of invoices.

Accordingly, the Corporate Debtor will lose in appeal against the appeal filed by suspended Director of its operational creditor.

### Answer 1(iii)

The facts of the question similar to the case of *New Okhla Industrial Development Authority vs. Anand Sonbhadra* decided by Supreme Court of India on 17-May-2022, in which the Apex Court had a detailed analysis on the following aspects under the IBC:

- a. Claim: The golden thread that runs through the word 'claim', is the right to payment. The right to payment may arise from a judgement. It may or may not be fixed. It may be disputed or undisputed, legal or equitable, secured or unsecured, but what is indispensable is that there must be a right to payment. Similarly, in cases of breach of contract, under any law in force, if it gives rise to a right to payment, irrespective of whether it is reduced to a judgment or fixed or matured or unmatured, disputed or undisputed, secured or unsecured, as long as there is a right to payment, a claim arises. When there is a claim and, in regard to such a claim, there is a liability or obligation, which is due from any person, it gives rise to a debt.
- b. Debt: A debt is a liability or an obligation in respect of a right to payment. Irrespective of whether there is adjudication of the breach, if there is a breach of contract, it may give rise to a debt. A debt includes a financial debt and an operational debt. It is after defining the word 'debt' with reference to the existence of a right to payment in the broadest terms, as defined in the term 'claim' and including the word 'financial debt' within the expression 'debt', the word financial debt, in turn, is elaborately defined in Section 5(8).

- c. Relation between Debt & Claim: A perusal of definition of the word 'debt', no doubt, reveals that it is closely intertwined with the definition of the word 'claim' in Section 3(6). The word 'transaction' is conspicuous by its absence in the definition of both the word 'claim' and the word 'debt'. 'Debt' means a liability or obligation, which relates to a claim. The claim or right to payment or remedy for breach of contract occasioning a right to payment must be due from any person. Now, if it is due from any person, it must be due to someone who would then be the creditor.
- d. Transaction: 'Transaction', as defined in Section 3 (33) Insolvency and Bankruptcy Code, would, undoubtedly, include an agreement or arrangement in writing or the transfer of funds. The transfer of funds may take place from a corporate debtor. A transfer can also take place when there is transfer of funds to the debtor. A transfer may include a transfer of assets in writing again from or to the corporate debtor.

Section 5(8) of the Insolvency and Bankruptcy Code defines 'financial debt' as meaning 'a debt along with interest, if any, which is disbursed against the consideration of time value of money'. Thereafter, Clauses (a) to (i) deal with transactions which are included as financial debt. It is, thereafter, that Clause (f) provides that a financial debt includes any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing. Disbursement is essential: What is relevant is to attract Section 5(8), on its plain terms, is disbursement. While, it may be true that the word 'transaction' includes transfer of assets, funds or goods and services from or to the corporate debtor, in the context of the principal provisions of Section 5(8) of the IBC, we are of the view that to import the definition of 'transaction' in Section 2(33), involving the need to expand the word 'disbursement', to include a promise to pay money by a debtor to the creditor, will be uncalled for straining of the provisions. 'Disbursement', within the meaning of Section 5 (8), is the payment of money, which flows to the debtor.

Disbursement is essential: The essential requirements to attract Section 5(8) are that there must be a debt along with interest, if any, which is disbursed against consideration for the time value of money. There can be no dispute that there is a debt in this case. Even the respondents would contend that it is actually a debt but an operational debt under Section 5(21). That interest is payable in connection with the debt, cannot be disputed, having regard to the terms of the lease deed. It is another matter that liability to pay interest is not an essential feature to attract Section 5(8).

The next requirement is that there be disbursement.

Disbursement is an indispensable requirement to constitute a debt, a financial debt, within the meaning of Section 5(8) and that disbursement must be from the creditor to debtor. The Court is of the view that, in the lease in question, there has been no disbursement of any debt (loan) or any sums by the appellant to the lessee. The appellant would, therefore, not be a financial creditor within the ambit of Section 5(8).

Accordingly, in the given case, State Industrial Development Authority is operational creditor and the Resolution Professional is right in asking it to file claim as Operational Creditor.

#### Answer 1(iv)

Under Insolvency and Bankruptcy Code Corporate Insolvency Resolution Process (CIRP) can be initiated only against Corporate Persons.

IBC defines "Corporate Person" means a company as defined in clause (20) of section 2 of the Companies Act, 2013, a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008, or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider [Section 3(7)].

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National Highway Authority of India (NHAI) is a statutory body which functions as an extended limb of the Central Government and performs Governmental functions which obviously cannot be taken over by an RP, or by any other corporate body nor can NHAI ultimately be wound up under the Code. For all these reasons, it is not possible to either read in, or read down the definition of 'corporate person' in section 3 (7) of the Code to include NHAI. (*Hindustan Construction Company Ltd. & Anr. Vs. Union of India & Ors. [WP (Civil) No. 1074 of 2019 with other Civil Appeals] SC judgement dated 27.11.2019*).

Thus, Resolution Professional cannot file an application under Insolvency and Bankruptcy Code, 2016 against NHAI for recovery of bid amount.

### Answer 1(v)

The facts of the question similar to the case of *M/s. Educomp Infrastructure & School Management Limited (Applicant/ Operational Creditor) Vs M/s. Millenium Education Foundation (Respondents/ Corporate Debtor) decided by The National Company Law Tribunal, New Delhi Bench, Court-V, Company Petition No. (IB)-245(ND)/2022 dated 4th July, 2023*.

In this case, the operational creditor stated that the proceedings under the IBC are maintainable against the Companies incorporated with charitable objects and Not for Profit companies. Also, Section 3 (8) of the Insolvency and Bankruptcy Code provides that a "corporate debtor" means a "corporate person" who owes a debt to any person and as per Section 3 (7) of the IBC provides that "corporate person" means a company as defined in clause (20) of section 2 of the Companies Act, 2013. To support the contention, the applicant had placed reliance on coordinate Bench of NCLT, Mumbai Judgement dated 10.06.2020 in C.P.(IB)/3976/2018; *Bee Athletic Private Limited vs. DSK Shivajians Football Club Private Limited*; and coordinate Bench NCLT, Kolkata Judgement dated 13.03.2020 in C.P. (IB)/2084/2019; *Avani Oxford Owners Association versus Oxford Facilities Management*. NCLT in its order stated that the contention of the Corporate Debtor that the proceedings under Insolvency and Bankruptcy Code, 2016 are not maintainable against the Corporate Debtor as the Corporate Debtor is a company registered under Section 8 of the Companies Act, 2013 is to be examined in the light of the provisions of the IBC, 2016 and Regulations. On a reading of Section 3(7) of the Insolvency and Bankruptcy Code, 2016 that defines a "corporate person", it is amply clear that the definition under Section 3 (7) inter alia, includes a "company" under Section 2(20) of Companies Act" 2013. Section 2(20) of the Companies Act, 2013 defines "Company" as a company incorporated under the Companies Act, 2013 or under any previous company law. Further, Section 2 (a) of the Insolvency and Bankruptcy Code provides that the provisions of the Code, 2016 shall apply to, "any company incorporated under the Companies Act 2013 (18 of 2013) or under any previous company law for the applicability of the Insolvency and Bankruptcy Code, 2016". Accordingly, the Insolvency and Bankruptcy Code, 2016 does not create a difference based on the objectives or nature of the company. Thus, clearly, Section 8 Companies are also covered under the Code, 2016 as a "Corporate Person" and therefore, Corporate Insolvency Resolution Process can be initiated against the Corporate Debtor herein.

Based on decided cases, it is clear that application for initiating CIRP under Insolvency and Bankruptcy Code can be filed against a Company registered with an objective of not for profit and such Company falls under the definition of corporate person.

### Answer 1(vi)

In the given case, following is the order of priority:

Order of Priority	Category of Persons	Amount
1	Insolvency process cost and liquidator fee	Rs. 2 Crores

2	(i) Workmen dues (24 months preceding the liquidation commencement date) pari passu with Secured creditor who has relinquished security Pari passu with  (ii) Secured creditor who has relinquished security	(i) Rs 6 Crores (0.25 Crores per month for 24 Months) Pari passu with  (ii)Rs. 300 Crores both COB Bank and SID Bank
3	Employees' wages and unpaid dues (12 months preceding the liquidation commencement date)	Rs 6 Crores (0.50 Crores per month for 12Months)  (Note: Salary payable shall be 10 Crores as total of other current liabilities including SIDA loan (5 Cores) is 35 Crores)
4	Financial debts owed to Unsecured Creditors (all parties in the Category Ranking Equally)	(i) Rs. 75 Crores – Short term borrowings (ii)Rs. 50 Crores–Debentures (unsecured fully convertible)  (iii) Rs. 65 Crores – Payables  (v) Rs. 25 Crores – Loan from Related Parties
5	Central or State Government dues Pari passu with Secured creditor who has enforced security interest	(i) (a) Rs. 3.80 Crores -PF Liabilities (b) Rs. 4.80 Crores- Sales Tax and Commercial Tax dues (c) Rs. 2.40 Crores Other Statutory dues. Nil
6	Remaining debts and dues (ranking equally)	(i) Rs. 3 Crores (0.25 Crores per month for 12 Months) – Workmen dues (ii) Rs. 4 Crores (0.50 Crores per month for 8 months) – Employee dues. (iii) Rs. 5 Crores. SIDA dues payable (iv) 30 Crore (other current liabilities excluding SIDA dues)
7	Preference Shareholders	(i) Rs. 75 Crores - Redeemable Pref. Shareholders  (ii) Rs. 25 Crores. – Convertible Preference Shareholders.
8	Equity Shareholders	Rs. 100 Crores – Equity Shareholders.

*\*Unsecured debentures are to be treated as debt if they are optionally convertible and hence payable at 4<sup>th</sup> rank while if they are compulsorily convertible then they are to be treated as Equity on the principle of "Repayment of Principal" test as held by Supreme Court in IFCI Limited v. Sutanu Sinha ("IFCI Limited"). Therefore, same shall be applicable in case of Preference Shareholders also. But Question is silent whether debentures and preference shares are optionally convertible or compulsorily convertible. Therefore, appropriate marks may be given accordingly).*



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### Answer 1(vii)

Section 60(5) of the Insolvency and Bankruptcy Code, 2016 provides as follows:

Notwithstanding anything to the contrary contained in any other law for the time being in force, the National Company Law Tribunal shall have jurisdiction to entertain or dispose of-

- (a) any application or proceeding by or against the corporate debtor or corporate person;
- (b) any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and
- (c) any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under this Code.

As per the above provisions, claims against only subsidiaries situated in India fall in the jurisdiction of NCLT. Accordingly, the RP can file application for claims against Indian Subsidiary Company including Company registered not for profit.

However, he cannot file application for claims with NCLT against the foreign Subsidiary.

### Answer 1(viii)

Includability of assets in the liquidation estate:

- (i) Rs. 2 Crores of assets of third party held under Trust Not includable as it does not belong to Corporate Debtor. *(Sub-section 4 of Section 36 of IBC,2016, provides that the following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation: - (a) 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) Machinery worth Rs. 1.50 Crores belonging to Indian Subsidiary is lying in one of the Units of Corporate Debtor Not includable as it does not belong to Corporate Debtor. *(Section 36(4) of IBC,2016, provides that the following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation: - (d) assets of any Indian or foreign subsidiary of the corporate debtor)*
- (iii) Machinery acquired for dispatching to Foreign Subsidiary is also lying in the factory premises worth Rs. 3 Crores. Not includable as it does not belong to Corporate Debtor *(Section 36(4) of IBC,2016, provides that the following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation: - (d) assets of any Indian or foreign subsidiary of the corporate debtor)*
- (iv) Cranes worth Rs. 5 Crores belonging a proprietorship concern of one of the Director is also lying in the Factory.

Not includable as it does not belong to Corporate Debtor.

*(Section 36(4) of IBC,2016, provides that the following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation: - (a) assets owned by a third party which are in possession of the corporate debtor)*

### Question 2

- (a) **HG & Co, a Partnership firm** is currently facing the brunt of cash liquidity and is suffering to repay its debts. This has eventually resulted in initiating an Insolvency Resolution Process against the said partnership firm wherein H and G are partners of the firm.

Following is the financial position of the HG & Co as at 31st March, 2024.

Liabilities	Amount (₹)	Assets	Amount (₹)
Partners' Fixed Capital	1,00,000	Vehicles (Two Tempo Vans)	13,00,000
UIB Bank – Working Capital Loan (Secured by 2 Tempos owned by the Firm)	10,00,000	Stocks (but only 50% is realizable)	6,00,000
Unsecured Overdraft from UIB Bank	5,00,000	Sundry Debtors (but only 75% is realizable)	4,00,000
Trade payables (10 Creditors)	10,00,000	Partners' Current Account	3,00,000

Following is the additional information :

- (i) Out of list of Creditors submitted by the Resolution Professional, one of the creditors is **GH Works Private Limited** from whom ₹ 3,50,000 is due. It is observed that Mr. G holds 30% shareholding and H holds 25% shareholding in GH Works Private Limited.
- (ii) In the said list prepared by the Resolution Professional, the name of one of the creditors, **K** for ₹ 1,00,000, has not been included in the list of Creditors as the proof of claim was not provided.
- (iii) 2 Tempos owned by the Firms is provided as security for the working capital loan obtained by the Firm.
- (iv) As per the list prepared by the Resolution Professional, ₹ 24,00,000 is the total debt payable to 10 Creditors including UIB Bank which has provided working capital loan and unsecured overdraft.

The Resolution Professional has prepared a repayment plan with the following

“Terms”.

- (a) Continuation of business operations of HG & Co by the Resolution Professional in his name.
- (b) Sale of Stocks for the repayment to the creditors.

In the light of the above information, answer the following questions stating the relevant provisions of the IBC, 2016.

- (a) Discuss whether the ‘Terms’ as prepared by the Resolution Professional as above is valid in law ?
- (b) Whether the creditor ‘K’ and GH Works Private Limited can vote in the meeting of Committee of Creditors ?
- (c) What are the voting rights of UIB Bank in relation to the repayment plan ?

(2×3=6 marks)

- (b) **Huve Private Limited** filed an application under Section 9 of the Insolvency and Bankruptcy Code, 2016 against **M/s. Rohit Feeds Limited (Corporate Debtor)** before the Adjudicating Authority (AA).

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The AA passed an order admitting the said application and as a result of which, the Corporate Insolvency Resolution Process (CIRP) of the Corporate Debtor commenced and subsequently after proper hearing of the case, the AA passed an order for liquidation of the Corporate Debtor. **Aman** was appointed as the Liquidator to oversee the CIRP.

Aman by an e-mail dated **1st March 2022**, forwarded a sale notice towards sale of the assets of the Corporate Debtor. As no one bided in the auction sale, the transaction for sale did not materialize. Aman forwarded a **similar notice dated 8th April, 2022** for an e-auction sale of the assets of the Corporate Debtor which was scheduled to happen on **10th May, 2022**.

**M/s. Adam Feeds Private Limited (Bidder)**, bided in terms of the sale notice and the Bidder paid the earnest money deposit (EMD) of ₹ 5 crore in respect of the subject property of the Corporate Debtor.

As Adam Feeds Private Limited was the only sole bidder in the e-auction held on 10th May, 2022, the Bidder received an e-auction certificate from Aman certifying that it had won the auction for the assets of the Corporate Debtor put up for auction sale.

But, on very next day, the Bidder received another e-mail from Aman informing that he had cancelled the e-auction held on 10th May, 2022 under the Disclaimer Clause in the 'E-Auction Process Information Document' and also with a view to expect a better price. Aman, did not however assign any brief reasons to cancel an auction which was otherwise valid and there were no statutory infirmities in the bidding or the bidding was collusive in nature or there was an element of fraud in the bidding process.

The Bidder was further informed that a fresh e-auction would be conducted for the subject property. Aggrieved by the action of Aman, the Bidder filed an application before the AA under Section 60 of the IBC, 2016 and related provisions of the Code and the AA disposed of the said application by directing the Liquidator (Aman) to send a communication to the Bidder requiring him to deposit the balance sale consideration within the time specified in the e-auction notice. Accordingly, the Bidder deposited the balance consideration money as per the order of the AA.

As the entire sum was paid, Aman issued a sale certificate on **15th September, 2022** in respect of the subject property in favour of the Bidder.

While the Liquidator, Aman accepted the order of the AA, one of the financial creditors, namely M/s. BN Bank filed an appeal before the National Company Law Appellate Tribunal under Section 61 of the Code against the order of the AA.

The appeal was contested by the Bidder. However, NCLAT allowed the appeal and set aside the order of the AA. Consequently, the steps taken pursuant to the said order of AA were also reversed. The Liquidator, Aman was given a liberty to initiate fresh process of auction in accordance with the provisions of the Code. Aggrieved by the order NCLAT, the auction purchaser (Bidder) has preferred the present appeal before the Supreme Court of India.

In the light of the above inputs, explain whether the auction can be cancelled by the Liquidator exercising unfettered discretion and without furnishing adequate reasons in the hope of expecting higher bids? Whether Adam Feeds Private Limited, the successful bidder will succeed in their appeal? Provide your answer in the light of the relevant Schedule of the IBBI Liquidation Regulations?

(6 marks)

**Answer 2(a)**

- (a) Section 105(2) of the Insolvency and Bankruptcy Code, 2016 provides that the repayment plan may authorize or require the Resolution Professional to:
- carry on the debtor's business or trade on his behalf or in his name; or
  - realize the assets of the debtor; or
  - administer or dispose of any funds of the debtor.

Accordingly, continuing of business operations of HG & Co by the Resolution Professional in his name is not correct and Resolution Professional can carry on the business of the debtor only on behalf of the Debtor and not in his name. Sale of Stocks for the repayment to the Creditors is allowed as the stock is an asset which can be realized.

- (b) According to section 109 of the Code a creditor shall not be entitled to vote in respect of a debt for an unliquidated amount. A credit Insolvency and Bankruptcy Code, 2016 or shall not be entitled to vote in a meeting of the creditors, if the name of creditor is not mentioned in the list of creditors prepared under Section 104 of the Code, or creditor is an associate of the debtor.

In the given case:

- 'K' cannot vote as his name not mentioned in the list of creditors.
- GH Works Private Limited cannot vote as they are an 'Associate' of the debtor.

- (c) Section 110 of the Insolvency and Bankruptcy Code, 2016 provides that the secured creditors shall be entitled to participate and vote in the meetings of the creditors. A secured creditor participating in the meetings of the creditors and voting in relation to the repayment plan shall forfeit his right to enforce the security during the period of the repayment plan in accordance with the terms of the repayment plan. Where a secured creditor does not forfeit his right to enforce security, such secured creditor shall submit an affidavit to the resolution professional at the meeting of the creditors stating:

- that the right to vote exercised by the secured creditor is only in respect of the unsecured part of the debt; and
- the estimated value of the unsecured part of the debt.

If UIB Bank does not forfeit its right to enforce security, it can vote only for Unsecured Overdraft of Rs. 5 Lacs.

**Answer 2(b)**

The facts of the case are similar to *Eva Agro Feeds Pvt. Ltd. v. Punjab National Bank and Anr.* decided on September 06, 2023 by the Supreme Court of India. Issues Before Hon'ble Supreme Court:

Whether NCLAT was right in cancelling the e- auction held on 20.07.2021 and directing the liquidator to initiate fresh auction for CD's assets?

Findings & Observations of the Hon'ble Supreme Court:

- Hon'ble Supreme Court while setting aside the order of NCLAT, restored the order passed by AA. Supreme Court upheld the view of AA that liquidator was not justified in cancelling the e auction held on 20.07.2021 without assigning any reason and there were no objective materials before the liquidator to cancel the auction process and to opt for another round of auction. While examining the clause 3 (k) of the E-Auction Process Information Document,

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Supreme Court observed that it only declares that the liquidator has absolute right to accept or reject any or all bids or adjourn/postpone/cancel the E-auction etc., at any stage without assigning any reason therefor. It held that, “E-Auction Process Information Document is neither an agreement nor an offer by the Liquidator to the prospective bidders or any other person.”

- Para 1(11A) of Schedule-I of the IBBI Liquidation Process Regulations says that where the Liquidator rejects the highest bid in an auction process, he shall intimate the reasons for such rejection to the highest bidder and mention it in the next progress report. While it is true that para 1 (11A) came to be inserted in Schedule 1 to the Regulations with effect from 30.09.2021, it does not imply that an auction sale or the highest bid prior to the aforesaid date could be cancelled by the Liquidator exercising unfettered discretion and without furnishing any reason. It is trite law that furnishing of reasons is an important aspect rather a check on the arbitrary exercise of power. Furnishing of reasons presupposes application of mind to the relevant factors and consideration by the concerned authority before passing an order. Absence of reasons may be a good reason to draw inference that the decision-making process was arbitrary. Therefore, what para 1(11A) has done is to give statutory recognition to the requirement for furnishing reasons, if the Liquidator wishes to reject the bid of the highest bidder. Furnishing of reasons, which is an integral facet of the principles of natural justice, is embedded in a provision or action, whereby the highest bid is rejected by the Liquidator. Thus, what para 1 (11A) has done is to give statutory recognition to this well-established principle. It has made explicit what was implicit.

- Therefore, if we read the provisions of Schedule-I, more particularly paras 1 (11) to (13) thereof, in a conjoint manner a view may reasonably be taken that ordinarily the highest bid may be accepted by the Liquidator unless there are statutory infirmities in the bidding or the bidding is collusive in nature or there is an element of fraud in the bidding process.

The necessary corollary that follows therefrom is that there can be no absolute or unfettered discretion on the part of the Liquidator to cancel an auction which is otherwise valid. As it is in an administrative framework governed by the rule of law there can be no absolute or unfettered discretion of the Liquidator.

- Further, upon a thorough analysis of all the provisions concerning the Liquidator it is evident that the Liquidator is vested with a host of duties, functions and powers to oversee the liquidation process in which he is not to act in any adversarial manner while ensuring that the auction process is carried out in accordance with law and to the benefit of all the stakeholders. Merely because the Liquidator has the discretion of carrying out multiple auction it does not necessarily imply that he would abandon or cancel a valid auction fetching a reasonable price and opt for another round of auction process with the expectation of a better price. Tribunal had rightly held that there were no objective materials before the Liquidator to cancel the auction process and to opt for another round of auction.

Based on the above decision once auction satisfies all conditions, Liquidator without reasons cannot reject and conduct further auction in expectation of higher bids. Hence, the in the given case successful bidder will succeed in its appeal with Supreme Court.

### Question 3

- (a) **Krishna**, a Legal Advisor, engages in providing of professional services, such as the submission of petitions before Tribunals and Courts. **Gopika, the spouse of Krishna**, holds the Designation of Registered Insolvency Professional (IP) with the IBBI. In his capacity as a Legal Advisor, Krishna has submitted numerous applications concerning the admission of Corporate Debtors before NCLT, while Mrs. Gopika, functioning as an Insolvency Professional, undertakes the Role of an

Insolvency Professional in all matters undertaken by her husband in his professional capacity. Gopika, within a span of 6 months from commencing her role as an Insolvency Professional, accepted a total of 15 Assignments, lacking any previous experience in this field. During the assessment of a petition for the initiation of CIRP, NCLT remarked on the excessively high fees charged by Gopika for her services as an Insolvency Resolution Professional. Gopika entered into an agreement with the applicant to not only serve as an Interim Resolution Professional but also as a Resolution Professional across all the 15 assignments she had undertaken.

With reference to the above-mentioned facts, answer whether Gopika is right in accepting the Assignments when it was her Husband who proposed her name? Discuss with the relevant provisions of the 'Code of Conduct' issued by IBBI in this regard.

(6 marks)

- (b) **'Best Food'** was a restaurant located at a leased premises in Mumbai. It had a great reputation, award-winning chefs and tastefully designed interiors. Much of its business came from executive lunches and dinners. Following the opening of **'Heavens'**, another excellent restaurant in the nearby vicinity, business losses were incurred by Best Food and eventually Best Food became insolvent.

All efforts towards reducing the rent or to sell the business were unsuccessful. Suppliers of food, beverages and utilities were unpaid for supplies provided in the previous 45-60 days, amounting to around ₹ 90,000. There were rental arrears for one month amounting to ₹ 50,000 towards landlord Gopal (the landlord had received advance rent for three months, lease deed provided for one-month rent as security and two month's rent as advance).

Best Food also had a secured creditor, **'IBS Bank'**. The bank indicated that it did not wish to appoint a receiver/file for insolvency as the accounts were regularly maintained. Best Food was managed by Mr. Ramesh, as a sole proprietor. He employed a staff of 10 people, including a chef, an assistant chef, six waiters and two housekeeping staff. The salaries due to these employees were paid in half since the past three months.

**In light of the above, answer the following questions with reference to the provisions of the Insolvency and Bankruptcy Code, 2016.**

- (i) Whether Best Food can apply for fresh start process? Provide answer citing reasons.
- (ii) In priority of payment of debts, state who will be paid before the wages and unpaid dues of employees of the bankrupt? How the priority is decided under the IBC 2016?

(3×2=6 marks)

### Answer 3(a)

The facts of the case are similar in case of Order No. IIIPI/DC/06/2019-20 dated 30th May 2019

In the matter of Mr. Sanjay Kumar Ruia (Respondent) under Clause 15(2) of the Disciplinary Policy of IIIPI read with Clause 24(1)(c) of IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, (2016), In the CIRP of S.N. Plumbing Private Limited:

The Disciplinary Committee, therefore, observed that Mr. Ruia appointed his spouse as IRP, which is a clear case of conflict of interest. Committee noted that being Professional, there is a clear case of Conflict of Interest and it would have been better if the Respondent could have submitted his in-ability to proceed with rather appointing relative (spouse) on a position which could hamper his independence, which is clear case of contravention of the provisions of sections 20, 23, 208(2)(a) of the Code regulations 7(2)(a) and (h) of the IPR and clauses 1, 2, 3, 5, 9, 10, 12, 14 and 25 of the Code of Conduct thereof.

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Committee on the allegation of charging exorbitant fee was of the opinion that IBC bestows massive responsibility on the IRP and it would not be an exaggeration to say that the same is the most important pillar in the entire process. Clause 25 of the Code of Conduct for Insolvency Professionals under the IBBI (Insolvency Professionals) Regulations, 2016 require that an insolvency professional must provide services for remuneration which is charged in a transparent manner, and is a reasonable reflection of the work necessarily and properly undertaken. He shall not accept any fees or charges which is not reasonable. Therefore, contentions of the respondent that the fee quoted by him was a reasonable reflection of his work is not acceptable and thereby contravened the provisions of sections 20, 208(2)(a) of the Code regulations 7(2)(a) and (h) of the IPR and clauses 1, 2, 3, 5, 10, 14 and 25 of the Code of Conduct thereof.

Going by the above order of Disciplinary Committee, it could be said that Gopika, in the given question, is not right in accepting the assignment when it was her husband who proposed her name. An insolvency professional must provide services for remuneration which is charged in a transparent manner, is reasonable reflection of the work necessarily and properly undertaken, and is not inconsistent with the applicable regulations.

An Insolvency professional shall disclose the fee payable to him, the fee payable to the insolvency professional entity, and the fee payable to professionals engaged by him to the insolvency professional agency of which he is a professional member and the agency shall publish such disclosure on its website. An Insolvency professional must refrain from accepting too many assignments, if he is unlikely to be able to devote adequate time to each of his assignments.

### **Alternate Answer 3(a)**

#### *Independence and Impartiality:*

The Code of Conduct requires the IP to maintain complete independence in professional relationships. It is not correct on part of Mrs. Gopika to accept assignments which affect her independence.

An insolvency professional must maintain complete independence in his professional relationship and should conduct the Insolvency resolution, liquidation or bankruptcy process, as the case may be, independent of external influences.

An insolvency professional shall not take up an assignment under the Code if he, any of his relatives, any of the partners or directors of the insolvency professional entity of which he is a partner or director, or the insolvency professional entity of which he is a partner or director is not independent, in terms of the regulations related to the processes under the code, in relation to the Corporate Person / Debtor and its related parties.

An insolvency professional shall ensure disclosure of the relationship, if any, of the other professionals engaged by it with itself, the corporate debtor, the financial creditor, the interim finance provider, if any, and the prospective resolution applicant, to the insolvency professional agency of which he is a member, within the time specified as per the Code.

#### *Remuneration and Costs:*

IBBI is empowered by the Insolvency and Bankruptcy Code, 2016 to issue a show cause notice even without a complaint made against IP if it has reasonable grounds to believe IP has contravened any provisions. An insolvency professional must provide services for remuneration which is charged in a transparent manner, is reasonable reflection of the work necessarily and properly undertaken, and is not inconsistent with the applicable regulations. An Insolvency professional shall disclose the fee payable to him, the fee payable to the insolvency professional entity, and the fee payable to professionals engaged by him to the insolvency professional agency of which he is a professional



member and the agency shall publish such disclosure on its website. An Insolvency professional must refrain from accepting too many assignments, if he is unlikely to be able to devote adequate time to each of his assignments. Thus, it was not right of Gopika to accept the assignments when it was her husband who proposed her name.

### Answer 3(b)(i)

Section 80(2)(c) of the Insolvency and Bankruptcy Code, 2016 provides a Fresh Start Process for individuals under which they will be eligible for a debt waiver of up to INR 35,000. The individual will be eligible for the waiver subject to certain limits prescribed under the Code.

Section 80 of the Insolvency and Bankruptcy Code, 2016 provides that a debtor who is unable to pay his debt and fulfils the conditions as mentioned in sub-section (2) of section 80 shall be entitled to make an application to the Debt Recovery Tribunal (DRT) for a fresh start process for discharge of his qualifying debt provided the aggregate value of the qualifying debts does not exceed thirty-five thousand rupees.

Section 79(19) of the Insolvency and Bankruptcy Code, 2016 defines the meaning of Qualifying Debt. It 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:

- an excluded debt;
- a debt to the extent it is secured; and
- any debt which has been incurred three months prior to the date of the application for fresh start process.

As the amounts due by Best Food do not fall under the definition of Qualifying Debt, Best Foods cannot apply for fresh start process.

### Answer 3(b)(ii)

The first priority of payment shall be for the costs and expenses incurred by the bankruptcy trustee for the bankruptcy process in full.

The Workmen's dues for the period of twenty-four months preceding the bankruptcy commencement date in pari passu with the debts owed to the secured creditors comes next in priority.

Reason: Section 178(1) of the Insolvency and Bankruptcy Code, 2016 prescribes the priority of payments of debts as under:

Notwithstanding anything to the contrary contained in any law enacted by the Parliament or the State Legislature for the time being in force, in the distribution of the final dividend, the following debts shall be paid in priority to all other debts:

- (a) firstly, the costs and expenses incurred by the bankruptcy trustee for the bankruptcy process in full;
- (b) secondly:
  - i. the workmen's dues for the period of twenty-four months preceding the bankruptcy commencement date; and
  - ii. debts owed to secured creditors.
- (c) thirdly, wages and any unpaid dues owed to employees, other than workmen, of the bankrupt for the period of twelve months preceding the bankruptcy commencement date;

- (d) fourthly, any amount due to the Central Government and the State Government including the amount to be received on account of Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the bankruptcy commencement date;
- (e) lastly, all other debts and dues owed by the bankrupt including unsecured debts.

**Question 4**

- (a) One of the Operational Debtor of **Q Sea Industries Limited (Corporate Debtor)** has filed an application for initiating Corporate Insolvency Resolution Process (CIRP) before the Adjudicating Authority and CIRP was ordered by the Adjudicating Authority. Corporate Debtor has also availed various credit facilities from three Banks. Out of which **BOA Bank** is one of the financial creditors to whom immovable properties of one manufacturing Unit was exclusively provided as a security. One of the properties of that Unit is located in the State of Jammu and Kashmir. At the time of formation of Committee of Creditors, BOA Bank has opted out of Committee of Creditors as it has exclusive charge on immovable properties of one of the Units of the Corporate Debtor. Hence, the BOA Bank has decided to proceed under SARFAESI Act, 2002 and the Rules made thereunder. Accordingly, it has appointed one Authorized Officer to carry out the recovery process. The Authorized Officer served 21 clear days' notice to the Corporate Debtor for the sale of secured immovable assets of the Unit and also uploaded the detailed terms and conditions of the sale on the website of the BOA Bank in the appropriate page as per the Rules.

**Following are the details provided with respect to the sale of the properties :**

- (i) The description of the immovable properties of the Unit of Corporate Debtor.
- (ii) The secured debt for recovery of which the properties to be sold.
- (iii) Time of public auction.
- (iv) Deposit of earnest money as per the policy of the BOA Bank and as per Rules.
- (v) Other important terms and conditions including the value and nature of the properties.

Referring to the applicable Act and Rules framed thereunder, answer whether the Authorized Officer has followed appropriate Rules in serving notice, website display and also state what are the special provisions to be followed for sale of properties located in the state of Jammu and Kashmir ?

(6 marks)

- (b) **SMS Enterprises Private Limited (Operational Creditor)** has filed the present petition under Section 9 of the Insolvency and Bankruptcy Code, 2016 with a prayer to initiate the CIRP against **Kaj Tiles Private Limited** (Hereinafter referred as 'Kaj Tiles').

The Applicant Operational Creditor has claimed the alleged debt on account of the accumulated stocks due to discontinuance/prevention of the supply of goods to the dealers of the Operational Creditor, which it had been doing pursuant to the **Distributorship Agreement** executed between the Kaj Tiles and SMS Enterprises (through its proprietor Mittu).

As per Kaj Tiles, the said Distributorship Agreement clearly prohibited Mittu (SMS Enterprises) from transferring or assigning the same or any part thereof without the prior written consent in terms one of the clauses of the Distributorship Agreement. The Applicant Operational Creditor, in its rejoinder has admitted that the proprietorship was transferred into a Private Limited Company by virtue of an "Amalgamation Agreement" entered between

M/s SMS Enterprises (Proprietorship Concern) and M/s SMS Enterprises Private Limited and the aforesaid Distributorship Agreement never prohibited the transfer of business or assigning of actionable claims. The Petitioner Operational Creditor being a Company is pursuing debt on behalf of the proprietorship firm.

In the light of the above case study inputs, answer the following questions :

- (i) Whether SMS Enterprises Private Limited can file an application in compliance with the relevant provisions of the IBC, 2016 in terms of the Distributorship Agreement entered by SMS Enterprises ?
- (ii) Whether "Amalgamation Agreement" entered between M/s SMS Enterprises (Proprietorship Concern) and M/s SMS Enterprises Private Limited is tenable and valid as per the applicable law ?

(3×2=6 marks)

#### Answer 4(a)

Rule 8 of Security Interest (Enforcement) Rules, 2002 which deals with Sale of Immovable Secured Assets under SARFAESI Act. It provides that the authorised officer shall serve to the borrower a notice of thirty days for sale of the immovable secured assets. Every notice of sale shall be affixed on a conspicuous part of the immovable property and the authorised officer shall upload the detailed terms and conditions of the sale, on the web- site of the secured creditor, which shall include:

- (a) the description of the immovable property to be sold, including the details of the encumbrances known to the secured creditor;
- (b) the secured debt for recovery of which the property is to be sold;
- (c) reserve price of the immovable secured assets below which the property may not be sold;
- (d) time and place of public auction or the time after which sale by any other mode shall be completed;
- (e) deposit of earnest money as may be stipulated by the secured creditor;
- (f) any other terms and conditions, which the authorized officer considers it necessary for a purchaser to know the nature and value of the property.

However, the Authorised officer has given notice only for 21 days instead of 30 days as stated in the Rules. Further following details are missing in the website disclosure:

- the details of the encumbrances known to the secured creditor;
- reserve price of the immovable secured assets below which the property may not be sold;
- place of public auction or the time after which sale by any other mode shall be completed

Accordingly, the notice and publication has not complied with the Rules and may be challenged.

In case of sale of immovable property in the State of Jammu and Kashmir, the provisions of Jammu and Kashmir Transfer of Property Act, 1977 shall apply to the person who acquires such property in the State.

#### Alternate Answer to Above Paragraph

After the abrogation of Article 370 & 35A of the Constitution of India and enactment of Jammu and Kashmir Reorganisation Act, 2019, sale of immovable property in the Union Territory of Jammu and Kashmir, the provisions of Jammu and Kashmir Transfer of Property Act, 1977 shall not applicable to the person who acquires such property in the State.

**Answer 4(b)(i)**

The Case given in the question is similar to the case decided by National Company Law Tribunal, New Delhi Bench (Court-II) in *SVS Marketing Sanitaryware Pvt. Ltd. (Applicant & Operational Creditor) v. Kajaria Bathware Pvt. Ltd. (Respondent)* decided on December 01, 2023. In the aforesaid case, NCLT viewed that the respondent had supplied the Goods and the Applicant had made payments towards the Goods as Distributor of the Respondent. The chain of transaction ends here itself. Moreover, the invoice itself stipulates that "Goods once supplied would not be exchanged or taken back." Further, the letter on which the Applicant has relied is an un-dated one and no particulars are available as to when, and how the letter was sent.

Even otherwise, once agreeing to purchase the goods and subsequently, denying the purchase will not constitute an "Operational Debt" since there is neither any flow of goods/services nor any payment of consideration from one party to another in this chain. Hence, we find that there is no existence of any operational debt or default committed by the Respondent towards the so-called unpaid stock. Since no operational debt and default have been proved with respect to unsold stock, the question of going into the "stock interest" component does not arise.

In considered view of NCLT, if the goods have been supplied by the Applicant to its dealers, and if they had not paid the Applicant in time, the Applicant cannot shift the burden of the alleged default by dealers to the Respondent and claim the same as an Operational Debt. At the most, the claim of the Applicant against the Respondent in respect of causing bad debts could be of compensatory in nature, subject to such a Clause existing in the Distributorship Agreement, but it cannot be claimed as an Operational Debt.

NCLT examined the various components of the claim of the Applicant and find that there is no operational debt subsisting for which CIRP be initiated against the Respondent. Hence, the Application is misconceived and is accordingly, dismissed. Based on the above SMS Enterprises Private Limited cannot file an application with NCLT as an Operational Creditor.

**Answer 4(b)(ii)**

Since the Sole Proprietorship Firm has no separate legal entity of its own, and it is known only through its Proprietor who is a member/shareholder in the Applicant Company (SMS Enterprises), the provision of Section 230 of the Companies Act 2013 can be resorted to by Mr. Mittu and the SMS Enterprises Pvt. Ltd., for the purpose of "Compromise and Arrangement" by filing an appropriate Petition before NCLT by following the due procedure prescribed by law.

However, as regards "Merger or Amalgamation" under Section 232 of the Companies Act 2013, the parties that are eligible to seek Merger or Amalgamation can file an application before NCLT, but this does not mean that the Amalgamation can take place between "a Proprietorship Firm" and "a Company" as Section 232(a) of the Companies Act 2013 specifically deals with the Merger and Amalgamation of two or more companies only. Thus, neither the "Sole Proprietorship Firm" nor "its individual Proprietor" is a "Company" in terms of Section 2 (20) of the Companies Act 2013.

Hence, the Merger and Amalgamation of a "Sole Proprietorship Firm" and "a Company" is not possible under Section 232 of the Companies Act 2013.

Hence, we find that an amalgamation of "a Sole Proprietorship Firm" with Company" is not permissible under the law. As per the above decision 'Amalgamation Agreement' entered in the give case is not tenable in the eyes of law.

**Question 5**

- (a) **Gold Crown Flat Buyers Association** (herein after referred to as '**Flat Buyers Association**') is a registered Association of Residential Flat Buyers in respect of the flats promoted and constructed by **Gold Crown Developers Private Limited** (herein after referred as the "Developer

Company") in the city of Pune. Besides the location of the project being in the heart of the city, planned and developed with a host of amenities including compliance with Vasthu Sashtra, many home buyers invested in the Project and eventually formed the aforesaid association.

Unfortunately, the Developer Company was not able to complete the project due to various reasons and crossed various timelines fixed by them. Despite various attempts made by the Flat Buyers Association requesting the Management of the Company for earliest completion of the project, it was all in vain and the project got further delayed.

In view of the above situation, as most of members expressed their dissatisfaction over the delay, the Flat Buyers Association filed a complaint before the **National Consumer Disputes Redressal Commission (the National Commission)**. After hearing the parties of their submissions, an order was made by the **National Commission** directing the Developer Company to complete the project in all respects and handover the possession of the allotted flats to the members of the Association of the homebuyers within the time specified.

In the meantime, one of the Operational Creditors of the Developer Company, filed an application under Section 9 of the IBC, 2016 and the said application was admitted by the Honourable NCLT.

The National Commission, by its order, held that a decree cannot be executed against the Developer Company in view of the operation of Moratorium granted under Section 14 of the IBC, 2016. The National Commission also observed that in view of the moratorium against the Developer Company, it would not be appropriate to proceed in the same execution against the Directors and Officers of the Company. Also, there was no finding recorded by the National Commission that in view of the provisions of the IBC, 2016, moratorium will apply to the directors and officers of the company.

Aggrieved by the Order of the National Commission, the Flat Buyers Association filed an appeal before the Honourable Supreme Court of India with an understanding that just because there is a moratorium against the company, it cannot be said that no proceedings can be initiated against the opposite party for execution, provided they are otherwise liable to abide by and comply with the order, which is passed against the company.

In the light of the provisions of the IBC, 2016 and the decided case laws state whether the Flat Buyers Association will succeed in their appeal who are aggrieved by the order of the National Commission with respect to Directors and Officers of Corporate Debtor to take protection of the moratorium ?

(6 marks)

- (b) **Sundar, a Director of Sun Star Limited** has approached with following financial summary of the company as at 31st March, 2023 and requested to clarify his doubts in connection with voluntary liquidation process under the Insolvency and Bankruptcy Code, 2016 (IBC).

Liabilities	Amount ₹ in Crores	Assets	Amount ₹ in Crores
Share Capital	2.00	Stocks at current price	1.25
Bank – Term Loan	2.25	Receivables (fully realizable)	0.60
Other Creditors	0.75	Other realizable Current assets	0.65
		Cash and Bank Balances	2.50

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Sundar, further informed that the Board of Directors of the Company felt that due to rapid changes in technology, their business has become commercially unviable and the Board wants to proceed to voluntarily liquidate the Company.

In the light of the above inputs, Sundar has put forward the following questions to you for stating the correct legal position with reference to the provisions of the IBC, 2016, so that he can inform his Board colleagues to take an informed decision :

- (i) Whether the Company can carry on its business even after the commencement of Voluntary Liquidation ?
- (ii) Whether approval from the creditors is required for proceeding with Voluntary Liquidation ? If yes, whether prior approval is required from the Bankers ?
- (iii) Based on above financial position, state within how many days, the liquidation process can be completed ?
- (iv) Before commencement of liquidation, if the Company closes its Bank Loans and other Creditors, whether there will be any change in completion timelines ?
- (v) Whether Sundar's brother, who is an Insolvency Professional registered with IBBI can be appointed as a Liquidator ?
- (vi) Whether the Company can destroy all the Statutory Registers including the Minutes Book of Board and General Meetings once the liquidation is completed ?

(1×6=6 marks)

#### Answer 5(a)

The Case given in the question is similar to the case of *Ansal Crown Heights Flat Buyers Association (Regd.) v. Ansal Crown Infrabuild Pvt. Ltd. and Ors. decided on January 17, 2024*, Supreme Court held that 'we may note here that the National Commission has not made any adjudication on the question whether the opposite party Nos. 2 to 9 (the respondent Nos. 2 to 9) in the execution application were under an obligation to abide by the directions issued against the company. This issue has not been considered at all by the National Commission. There is no finding recorded by the National Commission that in view of any particular provision of the IBC, moratorium will apply to the directors/officers of the company.

Hon'ble Supreme Court approved the view taken in the case of *P. Mohanraj & Ors. v. Shah Brothers Ispat Pvt. Ltd.* that notwithstanding moratorium, the liability, if any, of the directors/officers will continue. The Hon'ble Court, therefore, permitted the appellants to expressly proceed against the promoters of the company though there was a moratorium under Section 14 of the IBC affecting the company. Only because there is a moratorium under Section 14 of the IBC against the company, it cannot be said that no proceedings can be initiated against the opposite party Nos. 2 to 9 (the respondent Nos. 2 to 9) for execution, provided that they are otherwise liable to abide by and comply with the order, which is passed against the company.

The protection of the moratorium will not be available to the directors/officers of the company.

The Hon'ble Court set aside the impugned judgments and orders and remitted the execution application to the National Commission. The execution will continue against the opposite party Nos. 2 to 9 (the respondent Nos. 2 to 9) in the execution application.

Accordingly, in the given case, Flat Buyers Association will succeed in their appeal.

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**Answer 5(b)(i)**

As per Regulation 4 of IBBI (Voluntary Liquidation) Regulations, 2017 the corporate person shall from the liquidation commencement date cease to carry on its business except as far as required for the beneficial winding up of its business. Accordingly, the Company shall not carry-on business after commencement of Voluntary Liquidation.

**Answer 5(b)(ii)**

The proviso appended to section 59(3) of the Insolvency and Bankruptcy Code, 2016 lays down that if the company owes any debt to any person, creditors representing two thirds in value of the debt of the company shall approve the resolution passed under sub-clause

(c) within seven days of such resolution.

Accordingly, prior approval of Creditors is not required; however, the approval has to be obtained within 7 days of passing the Shareholders resolution.

**Answer 5(b)(iii)**

In the given case the Company has secured as well as unsecured Creditors. Assuming that the Creditors gives approval, the Voluntary liquidation has to be completed with 270 days from the commencement as per amended Regulations. (Regulation 37 of the IBBI (Voluntary Liquidation) Regulations, 2017, dealing with completion of liquidation states that (1) the liquidator shall endeavour to complete the liquidation process of the corporate person and submit the Final Report under regulation 38 within: - (a) two hundred and seventy days from the liquidation commencement date where the creditors have approved the resolution under clause (c) of subsection (3) of section 59 or clause (c) of sub-regulation (1) of regulation 3.)

**Answer 5(b)(iv)**

If the Corporate Debtor does not have any Creditors, then the Voluntary liquidation has to be completed within 90 days from the commencement as per the amended regulations. (According to the Regulation 37 of the IBBI (Voluntary Liquidation Process) Regulations, 2017, (1) The liquidator shall endeavour to complete the liquidation process of the corporate person and submit the Final Report under regulation 38 within (b) ninety days from the liquidation commencement date in all other cases not covered by (a) }

**Answer 5(b)(v)**

As per the Insolvency and Bankruptcy Code, 2016 and Liquidation Regulations, the Liquidator shall not be related to the corporate person which includes relative of director and hence, brother of Director cannot be appointed as Liquidator. (Regulation 6 of the IBBI (Voluntary Liquidation Process) Regulations, 2017, (1) An insolvency professional shall be eligible to be appointed as a liquidator if he, Explanation: (b) is not a related party of the corporate person; Section 5 (24) of the Code defines "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;)

**Answer 5(b)(vi)**

As per Regulation 41 of the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017, the liquidator shall preserve a physical or an electronic copy of the reports, registers and books of account referred to in regulations 8 and 10 for at least eight years after the dissolution of the corporate person, either with himself or with an information utility and (b) a physical copy of records for a minimum period of three years; from the date of dissolution of the corporate person, before the Board, the Adjudicating Authority, Appellate Authority or any Court, whichever is later.



**Question 6**

- (a) **Blue Dolphin Limited (Corporate Debtor)** is under Liquidation as per the provisions of Insolvency and Bankruptcy Code, 2016. The Corporate Debtor has only one secured creditor namely in BQ Bank. In one of the meetings of **Stakeholders Consultation Committee**, the Liquidator of the Corporate Debtor informed the BQ Bank that the secured properties of the Corporate Debtor may not be sufficient to satisfy the amount of loan lent to the Blue Dolphin Limited. In view of the above situation, BQ Bank, at its internal meeting, discussed and decided to recover the balance amount through exercising the provisions of SARFEASI Act, 2002 on movable, secured assets of the Corporate Guarantors who were additionally secured to the BQ Bank by the Corporate Debtor.

**Black Dolphin Private Limited** has given its movable property in its Unit 'A' as additional security for credit facilities available by Corporate Debtor. The BQ Bank has entrusted the job of recovery through movable properties of Black Dolphin Private Limited to Ishan, a newly appointed Recovery Officer. Ishan being your close friend has approached you to clarify his doubts on enforcement of security interest as per the SARFAESI Act, 2002 and the Rules made thereunder.

Ishan has put forth following queries to clarify his doubts on the provisions of SARFAESI Act and Rules made thereunder :

- What procedures are to be followed for the possession of movable property of the Guarantor/Borrower ?
- Once the possession is taken, on what methods such assets can be sold ?
- Upon sale, state the procedure to be followed for recovery and completion of sale ?

(2×3=6 marks)

- (b) **Suj Infra Private Limited (Corporate Debtor)** was under Liquidation. Bank of Bharat is the sole member of the **Stakeholders Consultation Committee (SCC)**. One of the Agenda at the SCC was to replace the present Liquidator Rahul with Ashwin.

All the SCC Meeting, Bank of Bharat requested that the present Liquidator is not empanelled with the Bank of Bharat as a Liquidator and hence requested to replace the liquidator-Rahul with Ashwin who is empanelled with the Bank of Bharat. The item was discussed at the SCC meeting and SCC has passed resolution with 100% voting.

The application to change the Liquidator of Suj Infra Private Limited as per SCC decision was filed under Section 60(5) of the Insolvency Bankruptcy Code, 2016 and the Bankruptcy Board of India (Liquidation Process) Regulations, 2016, read with Rule 11 and 32 of National Company Law Tribunal Rules, 2016.

Referring to the applicable provisions of the Insolvency and Bankruptcy Code and decided case laws, if any, state whether there is any differences in the provisions of IBBI Regulations with respect to changing of Resolution Professional and changing of Liquidator and also state whether the Bank of Bharat will succeed in its application filed with Adjudicating Authority for changing the Liquidator ?

(6 marks)

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

According to section 13(2) of the SARFAESI Act, where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or

any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4) which includes (a) taking possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

Rule 4 of the Security Interest (Enforcement) Rules, 2002 provides that where the possession of the secured assets to be taken by the secured creditor are movable property in possession of the borrower, the authorized officer shall take possession of such movable property in the presence of two witnesses after a Panchnama drawn and signed by the witnesses as nearly as possible in Appendix I to The Security Interest (Enforcement) Rules, 2002.

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

Rule 6 of the Security Interest (Enforcement) Rules, 2002 provides that the authorized officer may sell the movable secured assets taken possession under sub-rule (1) of rule 4 of the Security Interest (Enforcement) Rules, 2002 in one or more lots by adopting any of the following methods to secure maximum sale price for the assets, to be so sold –

- obtaining quotations from parties dealing in the secured assets or otherwise interested in buying such assets; or
- inviting tenders from the public; or
- holding public auction including through e-auction mode; or
- by private treaty.

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

Rule 7 of the Security Interest (Enforcement) Rules, 2002 provides that where movable secured assets are sold, sale price of each lot shall be paid as per the terms of the public notice or on the terms as may be settled between the parties, as the case may be and in the event of default of payment, the movable secured assets shall be liable to be ordered for sale again.

On payment of sale price, the authorized officer shall issue a certificate of sale in the prescribed form as given in Appendix III to The Security Interest (Enforcement) Rules, 2002 specifying the movable secured assets sold, price paid and the name of the purchaser and thereafter the sale shall become absolute. The certificate of sale so issued shall be prima facie evidence of title of the purchaser.

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

Present case is similar to the case of *State Bank of India v. Mr. Ramakant Gupta, Liquidator* decided by the National Company Law Tribunal on January 17, 2024. In this case, the State Bank of India has preferred the present application on behalf of SCC for replacement of the present liquidator who is Respondent herein only with the reason that the present Liquidator is not on the panel of the State Bank of India. It is essential to emphasize that in accordance with the statutory mandate outlined in Regulation 31A of the IBBI (Liquidation Process) Regulations, 2016, a mandatory Written Consent Form, as stipulated in Form AA of Schedule II, is a prerequisite for the proposed liquidator's appointment. In addition to the requisite 66% voting percentage to pass the resolution, this form must be submitted before the Adjudicating Authority for the purpose of replacing the liquidator. It is noteworthy that such written consent has been attached in the present application.

Moreover, during its 2nd Meeting, the SCC had approved the agenda of replacement of the

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Liquidator with 100% voting without giving any reasons for the replacement of the Liquidator. Regulation 31A (11) of the IBBI (Liquidation) specifically states that the Liquidator can be replaced by the SCC after recording the reasons in the minutes of the SCC.

It is noticed that there exists a marked difference for change of Resolution Professional and change of Liquidator. During CIRP, the COC has the wisdom to replace the RP if there is majority of more than 66% without assigning any specific reason for such replacement as such option is available as a matter of right. In the Liquidation process, the SCC has to record specific reason for replacement of the Liquidator.

Nowhere in the instant application, the Applicant had recorded any reason, neither the applicant is levelling any allegations nor incompetency on part of the liquidator who is performing his duties in the manner it should be performed. In our view, wisdom or right for change of liquidator is not available to SCC in the Liquidation process. Recording the above, we reject the present application as we hold that no cogent reasons for replacement of the Liquidator are provided in the present application. The applicant bank had stated only single reason to replace the present Liquidator, i.e., that the Liquidator is not on the panel of the State Bank of India. In our view, it cannot be a valid and reasonable reason to change or to replace the Liquidator. The Liquidator is directed to complete the liquidation process expeditiously as per law. Accordingly, with these observations, the present application is dismissed and is disposed off.

As per the aforesaid decision, the Bank of Bharat will not succeed in its decision in changing the Liquidator.

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Lecture Kart

*Padhai Kar Befikar*

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