GROUP III

PAPER 13

# WORK BOOK

# CORPORATE LAWS & COMPLIANCE

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory body under an Act of Parliament)
www.icmai.in

SYLLABUS - 2016

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## FINAL

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**The Institute of Cost Accountants of India**

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# CORPORATE LAWS & COMPLIANCE

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## GROUP – III

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## INDEX

# Study Note – 1

# The Companies Act, 2013

## Section A : Companies Act

1. **Answer all questions mentioned below. Mark the correct answer [only indicate (a) or (b) or (c) or (d) and give justification.**

**(i)** **State whether true or false:**

1. ‘Compromise’ is a term which implies the existence of a dispute such as relating to rights. It means settlement or adjustment of claims in dispute by mutual concessions.
2. If the members have to gave up their rights entirely, it will not be compromise [NFU Development Trust Ltd., Re (1973) 1 All E.R. 135].
3. There can be no ‘compromise’ unless there is first a dispute [Guardian Assurance Co., Re. (1917) 1 Ch. 431].

(a) 1 – T, 2 - T, 3 – T
(b) 1 –F, 2 – F, 3 – F
(c) 1 – F, 2 – T, 3 – T
(d) 1 – F, 2 – F, 3 – T

**(ii)** **State whether true or false regarding ‘power of the tribunal to enforce compromise or arrangement (section 231)’ -**

As per Section 231 (1) when the Tribunal makes an order under Section 230 sanctioning a compromise or an arrangement in respect of a company, it:

1. shall have power to supervise the implementation of the compromise or arrangement, and
2. may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

(a) 1 – T, 2 - T
(b) 1 –F, 2 – F
(c) 1 – F, 2 – T
(d) 1 – T, 2 – F

**(iii)** **Match the following:**

| Set - I | Set - II |
|---|---|
| 1. Merger or amalgamation of a company with a foreign company | I. Section 232 |
| 2. Merger and amalgamation of certain companies | II. Section 233 |
| 3. Merger and amalgamation of companies | III. Section 234 |

(a) 1 – I, 2 – II, 3 – III
(b) 1 – III, 2 – II, 3 – I
(c) 1 – II, 2 – I, 3 – III
(d) 1 – I, 2 – III, 3 – II

(iv) The majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs ______________.
(a) with two important limitations
(b) with one important limitations
(c) they don't enjoy the supreme authority
(d) without any limitations

(v) Match the following:

| Set - I | Set - II |
|---|---|
| 1. Appointment of interim administrator | I. Section 260 |
| 2. Appointment of administrator | II. Section 259 |
| 3. Powers and duties of company administrator | III. Section 256 |

(a) 1 – I, 2 – II, 3 – III
(b) 1 – III, 2 – II, 3 – I
(c) 1 – II, 2 – I, 3 – III
(d) 1 – I, 2 – III, 3 – II

(vi) Which Form will you use to submit 'application by company administrator to tribunal for sanctioning the Scheme of Revival & Rehabilitation under sec-262'?
(a) Form-P
(b) Form-Q
(c) Form-R
(d) Form-S

(vii) Which of the following is not true?
1. Chapter XX of the Companies Act, 2013 deals with Corporate Winding-Up.
2. Under Chapter XX, Part -I deals with Winding-Up by the Tribunal;
3. Under Chapter XX, Part-II deals with Voluntary Winding-Up;
4. Under Chapter XX, Part-III contains the provisions applicable to every mode of winding up;
5. Under Chapter XX, Part- IV deals with Official Liquidators.

(a) 2,3,4 &5
(b) Only 1
(c) No False statement
(d) 1 & 5

(viii) The Companies (Second Amendment) Act, 2002 provides for the setting up of a National Company Law Tribunal and Appellate Tribunal __________________ the existing Company Law Board (CLB) and Board for Industrial and Financial Reconstruction (BIFR).

(a) to replace
(b) to modify
(c) to use with
(d) to swap

(ix) Which one is correct?

As per Section 379, where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by:

(a) one or more citizens of India, or
(b) by one or more companies or bodies corporate incorporated in India, or
(c) by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXII and such other provisions of this Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

(a) a, b & c
(b) b & c
(c) a & c
(d) only a

(x) State whether true or false:

1. Effect of floating charge is covered under section 332.
2. As per above section, when a company is being wound up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up.

(a) 1 – T, 2 - T
(b) 1 –F, 2 – F
(c) 1 – F, 2 – T
(d) 1 – T, 2 – F

(xi) Match the following:

| Set - I | Set - II |
|---|---|
| 1. Chief Executive Officer | I. Section 2(24) |
| 2. Chief Financial Officer | II. Section 2(19) |
| 3. Company secretary | III. Section 2(18) |

(a) 1 – I, 2 – II, 3 – III
(b) 1 – III, 2 – II, 3 – I
(c) 1 – II, 2 – I, 3 – III
(d) 1 – I, 2 – III, 3 – II

**(xii)** **Match the following:**

| Set - I | Set - II |
|---|---|
| 1. Manager | I. Section 2(94) |
| 2. Managing director | II. Section 2(54) |
| 3. Whole-time director | III. Section 2(53) |

(a) 1 – I, 2 – II, 3 – III
(b) 1 – III, 2 – II, 3 – I
(c) 1 – II, 2 – I, 3 – III
(d) 1 – I, 2 – III, 3 – II

**(xiii)** **As per Section 203 (1), every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel —**

(a) Managing Director, or Chief Executive Officer or Manager and in their absence, a Whole-Time Director
(b) Company Secretary
(c) Chief Financial Officer
(d) All of the above

**(xiv)** **As per Section 196(3), _______________ the employment of any person as managing director, whole-time director or manager.**

(a) company shall appoint or continue
(b) no company shall appoint or continue
(c) depends on situation
(d) None of the above

**(xv)** **State whether the given statements (regarding overall maximum managerial remuneration) are true or not:**

1. As per Section197 (5), a director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board.
2. As per Section197 (6), a director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

(a) 1 – T, 2 - F
(b) 1 – F, 2 - T
(c) 1 – T, 2 - T
(d) 1 – F, 2 – F

**(xvi)** **At least one woman director is required for ___________.**

(a) every listed company;
(b) every other public company having paid–up share capital of one hundred crore rupees more
(c) every other public company having turnover of three hundred crore rupees or more
(d) all of the above

**(xvii) Match the following:**

| Set - I | Set - II |
|---|---|
| 1. Where a poll is to be taken, the Chairman of the meeting shall appoint such number of persons, as he deems necessary, to scrutinize the poll process and votes given on the poll and to report thereon to him in the manner as may be prescribed. | I. Section 109(7) |
| 2. Subject to the provisions of this section, the Chairman of the meeting shall have power to regulate the manner in which the poll shall be taken. | II. Section 109(6) |
| 3. The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken. | III. Section 109(5) |

(a) 1 – I, 2 – II, 3 – III
(b) 1 – III, 2 – II, 3 – I
(c) 1 – II, 2 – I, 3 – III
(d) 1 – I, 2 – III, 3 – II

**(xviii) Match the following:**

| Set - I | Set - II |
|---|---|
| 1. Powers and duties of company liquidator | I. Section 294 |
| 2. Books to be kept by Company Liquidator | II. Section 293 |
| 3. Audit of Company Liquidator's Accounts | III. Section 290 |

(a) 1 – I, 2 – II, 3 – III
(b) 1 – III, 2 – II, 3 – I
(c) 1 – II, 2 – I, 3 – III
(d) 1 – I, 2 – III, 3 – II

**(xix)** SICA and NCLAT both are related with revival and rehabilitation of sick industrial companies. Here, SICA stands for ______________________ and NCLAT stands for _______________.
(a) Sick Industrial Companies (Special Provisions) Act, 1985; National Company Law Appellate Tribunal
(b) Sick Industrial Companies (Special Provisions) Act, 1980; National Company Law Appellate Tribunal
(c) Sick Industrial Companies (Special Provisions) Act, 1985; National Company Legal Appellate Tribunal
(d) None of the above

**(xx)** Section 233 prescribes simplified procedure for Merger or amalgamation of ______________.
(a) two or more small companies or
(b) between a holding company and its wholly-owned subsidiary company or
(c) such other class or classes of companies as may be prescribed.
(d) all of the above

(xxi) Which of the following is the Principle of Corporate Governance?
(a) Transparency
(b) Accountability
(c) Independence
(d) All of the above

(xxii) Section ______________ of the Companies Act, 2013 imposes a _____________obligation on every company to cause minutes of all proceedings of general meetings, board meetings and other meeting and resolution passed by postal ballot.
(a) 118; statutory
(b) 119; statutory
(c) 118; statutory
(d) 118; non-statutory

(xxiii) According to Section 2 (49) of the Companies Act, 2013 '______________' means a director who is in any way, whether by himself or through any of his relatives or firm, body corporate or other association of individuals in which he or any of his relatives is a partner, director or a member, interested in a contract or arrangement, or proposed contract or arrangement, entered into or to be entered into by or on behalf of a company.
(a) Interested director
(b) Independent director
(c) Corporate director
(d) Managing director

(xxiv) According to section 197 (7), notwithstanding anything contained in any other provision of this Act but subject to the provisions of this section, an independent director shall not be entitled to any stock option and may receive remuneration by way of -
(a) sitting fees in terms of section 197 (5),
(b) reimbursement of expenses for participation in the Board and other meetings, and
(c) profit related commission as may be approved by the members.
(d) all of the above

(xxv) Section 2(54) of the Companies Act, 2013 defines a 'Managing Director' as a director who is entrusted with substantial powers of management of the affairs of the company by -
(a) virtue of the articles of a company, or
(b) an agreement with the company, or
(c) a resolution passed in its general meeting, or by its Board of Directors, and includes a director occupying the position of the managing director, by whatever name called.
(d) all of the above

**Answer:**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| i | a | vi | a | xi | b | xvi | d | xxi | d |
| ii | a | vii | c | xii | b | xvii | b | xxii | a |
| iii | b | viii | a | xiii | d | xviii | b | xxiii | a |
| iv | a | ix | a | xiv | b | xix | a | xxiv | d |
| v | b | x | a | xv | c | xx | d | xxv | d |

**2. (a) 'While a company is free to alter its articles of association the way it wants, it shall not be contrary to provisions of the act and its memorandum of association' – Discuss.**

**Answer:**

Section 14 of the Companies Act, 2013 vests companies with power to alter or add to its articles. The law with respect to alteration of articles is as follows:

(a) Alteration by special resolution: Subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution alter its articles.

(b) Alteration to include conversion of companies: Alteration of articles includes alterations having the effect of conversion of:

(1) a private company into a public company, or

(2) a public company into a private company:

Even where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, then such company shall, as from the date of such alteration, cease to be a private company:

However any such alteration having the effect of conversion of a public company into a private company, then such conversion shall not take effect except with the approval of the Tribunal and make such order as it may deem fit.

(c) Filing of alteration with the registrar: Every alteration of the articles and a copy of the order of the Tribunal approving the alteration, shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

(d) Any alteration made shall be valid: Any alteration of the articles registered as above shall, subject to the provisions of this Act, be valid as if it were originally contained in the articles.

(e) Alteration noted in every copy: Every alteration made in articles of a company shall be noted in every copy of the articles, as the case may be. If a company makes any default in complying with the stated provisions, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the articles issued without such alteration. [Section 15].

**(b) How would you rectify the name of memorandum?**

**Answer:**

The rectification procedure is as follows:

**(1) Central government to issue direction**
According to Section 16 of the Companies Act, 2013, the Central Government is empowered to give direction to the company to rectify its name (where the name is identical with or too nearly resembles the name by which a company in existence had been previously registered, or the name is identical with or too nearly resembling to a registered trade mark) within a period of 3 months or 6 months, as the case may be, from the issue of such direction by passing an ordinary resolution.

**(2) Notice of change to the registrar**
Where a company changes its name or obtains a new name, it shall within a period of 15 days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum.

**(3) Default in compliance with the direction**
If a company makes default in complying with any direction:

| Liable person | Penalty/punishment |
|---|---|
| Company | Fine of 1,000 rupees for every day during which the default continues. |
| Every Officer who is in default | Fine varying from 5,000 rupees to 1 lakh rupees. |

**3. Can you explain 'Doctrines of constructive notice'? Discuss the following issues relating to doctrine of constructive notice by using case law. 1. Knowledge of irregularity, 2. Negligence, 3. Act void *ab initio* and forgery and 4. Acts outside the scope of apparent authority.**

**Answer:**

Doctrines of constructive notice:
In consequences of the registration of the memorandum and articles of association of the company with the Registrar of Companies, a person dealing with the company is deemed to have constructive notice of their contents. This is because these documents are construed as 'public document' under Section 399 of the Companies Act, 2013. Accordingly if a person deals with a company in a manner incompatible with the provisions of the aforesaid documents or enters into transaction, which is ultra vires to these documents, he must do so at his peril. If someone supplies goods to a company in which it cannot deal according to its objects clause, he will not be able to recover the price from the company. Suppose the articles provide that a bill of exchange must be signed by two directors, if the bill is actually signed by one director only the

holder thereof cannot claim payment thereon. However, the doctrine of constructive notice is not positive one but a negative one like that of estoppel of which it forms parts. It operates only against the person who has been dealing with the company but not against the company itself. Consequently he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires. Thus, the doctrine is a 'cloud' for the strangers.

Case laws on 1. Knowledge of irregularity, 2. Negligence, 3. Act void *ab initio* and forgery and 4. Acts outside the scope of apparent authority which are related to doctrine of constructive notice are as follows:

1. Knowledge of irregularity: Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit t under the rule of indoor management. [T.R. PRATT (Bombay) Ltd. v. E.D. Sassoon & Co. Ltd. AIR 1936 Bom 62].

2. Negligence: Where a person dealing with a company could discover the irregularity if he had made proper inquiries, he cannot claim the benefit of the rule of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract- are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry [Anand Bihari Lel v. Dinshaw & Co and Under-Wood v. Bank of Liver Pool; A.I.R. (1942) Oudh 417].

3. Where the acts done in the name of a company are void *ab initio*, the doctrine of indoor management does not apply. The doctrine applies only to irregularities that otherwise might affect a genuine transaction. It does not apply to a forgery. A Company can never he held liable for forgeries committed by its officers. [Ruben v. Great Fingall Consolidated Co (1906) A.C. 439].

4. Acts outside the scope of apparent authority: If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound. [Kreditbank Cassel v. Schenkers Ltd (1927) 1 KB 826].

**4. (a) Write short note on 'Prohibition on Acceptance of Deposits from Public [Section 73]'.**

**Answer:**

(a) On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter.

Provided that nothing in this Sub-Section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

(b) A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfillment of the following conditions, namely:

(1) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed.

(2) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular.

(3) depositing such sum which shall not be less than fifteen per cent of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account.

(4) providing such deposit insurance in such manner and to such extent as may be prescribed.

(5) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits, and

(6) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company.

> Provided that in case where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as 'unsecured deposits' and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

(c) Every deposit accepted by a company under Sub-Section (2) shall be repaid with interest in accordance with the terms and conditions of the agreement referred to in that Sub-Section.

(d) Where a company fails to repay the deposit or part thereof or any interest thereon under Sub-Section (3) the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

(e) The deposit repayment reserve account referred to in clause (c) of Sub-Section (2) shall not be used by the company for any purpose other than repayment of deposits.

**(b) Mr. Tiwari recently acquired 80% of the equity shares of Asianol Lubricant Company Ltd in the hope of earning good dividend income. Unfortunately the existing Board of Directors have been avoiding declaration o0f dividend due to alleged inadequacy of profits. Unconvinced, Mr. Tiwari seeks permission of the company to examine the Books of Accounts, which is summarily rejected by the company. Examine and advise the provisions relating to inspection of Books of Accounts and remedy available.**

**Answer:**

The present problem relates to section 128, 206 and 212 of the Companies Act, 2013 read with Regulation 89 of Table F contained in Schedule I.

(i) As per section 128 read with Rule 4, a director of the company is entitled to inspect the books of account of the company. However, section 128 does not empower any member (irrespective of the percentage of share capital held by him) to make inspection of the books of account.

(ii) As per section 206, following persons are empowered to inspect the books of account:
   (a) Registrar of Companies
   (b) Such officer of the government as may be authorised by the Central Government in this behalf.

(iii) As per section 212, the books of account of a company shall be open to inspection of the officers of Serious Fraud Investigation Office (SFIO).

(iv) Regulation 89 of Table F reads as under:
   (i) The Board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations, the accounts and books of the company, or any of them, shall be open to the inspection of members not being directors.
   (ii) No member (not being a director) shad have any right of inspecting any account or book or document of the company except as conferred by law or authorised by the Board or by the company in general meeting.

In the given case, Mr. Tiwari has not been authorised to inspect the books of account by the Board or by the members in the general meeting, Thus, Mr. Tiwari shall not have any right to inspect the books of account even if he holds 80% of the equity shares of the company. However, Mr. Tiwari may, by using the majority voting power held by him and complying with the provisions of the Companies Act, 2013, get himself appointed as a director of Asianol Lubricant Company Ltd. and then he shall be entitled (in the capacity of director) to make the inspection of books of account.

**5. (a) Winding up of a company is the stage, whereby the company takes its last breath and now, Blackburn Private Limited of Kolkata is lying with this stage. However, Blackburn Private Limited is going to dissolve in the year of 2016 and in the course of such dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights. By considering this situation explain the modes of winding up of the company.**

**Answer:**

Here, as per Companies Act 2013, Blackburn Private Limited may be wound up in any of the following modes:

(a) By National Company Law Tribunal (the Tribunal).
(b) Voluntary winding up

The circumstances in which this company may be wound up are as follows:

**By National Company Law Tribunal (Section 271):**

Grounds on which a Company may be wound up by the Tribunal A company under Section 271(1) may be wound up by the tribunal if:

(a) if the company is unable to pay its debts.

(b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal.

(c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

(d) if the Tribunal has ordered the winding up of the company under Chapter XIX(i.e., Revival and Rehabilitation of Sick Companies).

(e) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.

(f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years, or

(g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

**Voluntary winding up (Section 304):**

As per Section 304 (1), a company may be wound up voluntarily:

(a) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period for its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company should be dissolved, or

(b) if the company passes a special resolution that the company be wound up voluntarily.

**(b) Can you illustrate the power of tribunal to assess damages against delinquent directors etc. with some case laws?**

**Answer:**

1. In the matter of Ajay G Podar v. Official Liquidator of JS & WM & Ors. (2008) 85 CLA 398 (SC), Hon'ble Supreme Court has held that section 543(2) of the Companies Act, 1956 [Section 340 under the Companies Act, 2013] deals with the limitation of applications/claims including misfeasance proceedings and prescribes five (5) years period of limitation from the date of the winding up order for filing an application under section 543 (1). However, section 458A of the Companies Act, 1956 [Section 358 under the Companies Act, 2013] provides for the concept of computation of the limitation period. Section 458A being a non obstante clause exclude the period starting from commencement of winding up proceedings till the date on which winding up order is passed and a

period of one (1) year thereafter. In view of the above, misfeasance proceedings filed by the OL are well within limitation period.

2. In L.K. Prabhu v. S.M. Ameerul Millath (2002) 40 SCL 385 (Ker HC), it was held that application under Section 543 (for damages for misapplication or misfeasance) [Section 340 under the Companies Act, 2013] is maintainable against Official Liquidator also, as 'liquidator' includes 'Official Liquidator'. Moreover he is 'Officer' of the company as defined in Section 2(30), even if not specifically mentioned in the definition. However there should be prima facie case against him and there is substance in the allegations. If Official Liquidator has acted in good faith, he is entitled to protection under Section 635A [Section 456 under the Companies Act, 2013].

3. In Official Liquidator v. Ashok Kumar, (1976) 46 Comp. Cas. 575 (Pat), it was held that a director who has not been duly elected and has taken his qualification shares shall be liable if he has acted as such. In other words, where a director continued to act de facto without being validly elected, he shall be liable for misfeasance.

4. The extent of liability of the Legal Representative: In the case of death of the director, it was held by the Supreme Court that the proceedings commenced against the delinquent director of a liquidated company can be continued against his legal representatives and the amount declared to be due in such misfeasance proceeding can be realized from the estate of the deceased on the hands of his legal representatives. The Court further held that the legal representatives would not, however, be liable for any sum beyond the value of the estate of the deceased in their hands [Official Liquidator, Supreme Bank Ltd. V.P.A. Tendolkar (1973) 43 Comp. (Case 382)] and [Official Liquidator vs. Parthasarthy Sinha (1983) 53. Comp. Case (SC) (3c)].

**6. (a) Discuss the impact of the Companies Act, 2013 on Corporate Governance in India.**

**Answer:**

The term "Governance" refers to the process of governing, whether undertaken by government, market or network, whether over a family, tribe formal or informal organization or territory whether through general laws, norms or power. It involves the process of interaction and decision making. The term "Governance" when applied to a business organization, it is defined as combination of processes established and executed by Board of Directors that are reflected in the organization structure and how it is managed and led toward achieving goals. The term "Corporate Governance" gained much importance when accounting fraud of high profile companies were observed in the business world and the reason was due to lack of adequate governance mechanism.

Undoubtedly, the impact of the Companies Act, 2013 on some important areas of corporate governance has already been experienced and measured. However, those important broad areas may be mentioned by the following figure:

- Board Composition
- Independent Directors
- Woman Director
- Duties of Directors
- Committees of The Board
- Board Meetings and Processes
- Others

**Figure: important areas of corporate governance affected by the Companies Act, 2013**

The Companies Act, 2013 contemplates structural and fundamental changes in the way companies would be governed in India and incorporates various lessons that have been learnt from the corporate scams of the recent years that highlighted the role and importance of good governance in organizations. Significant corporate governance reforms, primarily aimed at improving the board oversight process, have been proposed in the Companies Act, 2013; for instance it has proposed, for the first time in Company Law, the concept of an Independent Director and all listed companies are required to appoint independent directors with at least one third of the Board of such companies comprising of independent directors.

The Companies Act, 2013 takes the concept of board independence to another level altogether. The definition of an Independent Director has been considerably tightened and the definition now defines positive attributes of independence and also requires every Independent Director to declare that he or she meets the criteria of independence. In order to ensure that Independent Directors maintain their independence and do not become too familiar with the management and promoters, minimum tenure requirements have been prescribed. The initial term for an independent director is for five years, following which further appointment of the director would require a special resolution of the shareholders. However, the total tenure for an independent director is not allowed to exceed two consecutive terms.

The Companies Act, 2013 expressly disallows Independent Directors from obtaining stock options in companies to protect their independence. The new guidelines which set out the role, functions and duties of Independent Directors and their appointment, resignation and evaluation introduce greater clarity in their role; however, in certain places they are prescriptive in nature and could end up making the role of Independent Directors quite onerous. In order to balance the extensive nature of functions and obligations imposed on Independent Directors, the Companies Act, 2013 seeks to limit their liability to matters directly relatable to them and limits their liability to 'only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently'. The Act also requires that all resolutions in a meeting convened with a shorter notice should be ratified by at least one independent director which gives them an element of veto power. Various other clauses such as those on directors' responsibility statements, statement of social responsibilities, and the directors' responsibilities over financial controls, fraud, etc, will create a more transparent system through better disclosures. The Act also contemplates that any undue gain made by a director by abusing his position will be disgorged and returned to the company together with monetary fines.

**(b) 'A Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence.' – Explain this statement.**

**Answer:**

According to Section 35 of the 1956 Act, a Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Acts have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act. The Certificate of Incorporation is conclusive evidence that everything is in order as regards registration and that the company has come in to existence from the earliest moment of the day of incorporation stated therein with rights & liabilities of a natural person, competent to enter into contracts [Jubilee Cotton Mills Ltd. v. Lewis (1924) A.C. 958.]. The validity of the registration cannot be questioned after the issue of the certificate.

It is for the purpose of incorporation that the certificate was made conclusive by the legislature and the certificate cannot legalise the illegal object contained in the Memorandum. Where the object of the company is unlawful, it has been held that the certificate of registration is not conclusive for this purpose [Performing Right Society Ltd. v. London Theatre of Varieties (1992) 2 KB 433].
Even if the two signatures to a Memorandum were written by one person, or were forged, the certificate would be conclusive that the company was duly incorporated. So too, if the signatories were all minors, the certificate would still be conclusive [Hammod v. Prentice Bros (1920) 1 Ch. 201 and Bowman v. Secular Society Ltd. 1917 AC 406,438].

Section 35 of the 1956 Act has not been incorporated bodily in the 2013 Act and the same shall be watched with interest as to how the Courts would interpret the absence of such a provision.

**(c) RL Solutions Pvt. Ltd. redeemed its preference shares 5 years ago. Some of the shares are still unpaid. It credited the unpaid amount into its Investor Education Protection Fund". Was it a contravention of the provisions of Companies Act, 2013?**

**Answer:**

The credits that may be made into the Investor Education Protection Fund as per provisions of Section 125 of Companies Act, 2013 are as under:

(i) Amount in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956.
(ii) Amount in the Unpaid Dividend Account of the companies transferred to the Fund under section 124, and interest accrued thereon
(iii) Application money received by the companies for allotment of any securities and due for refund and remaining unpaid for a period of 7 years, and interest accrued thereon
(iv) Matured deposits remaining unpaid for a period of 7 years, and interest accrued thereon
(v) Matured debentures remaining unpaid for a period of 7 years, and interest accrued thereon
(vi) Redemption amount of preference shares remaining unpaid for a period of 7 years
(vii) Grants by the Central Government after due appropriation made by the Parliament
(viii) Donations given to the Fund by the Central Government, any State Government, companies or any other institution
(ix) Interest or other income received out of the investments made from the Fund
(x) Sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation and remaining unpaid for a period of 7 years.
(xi) Amount in the General Revenue Account of the Central Government which had been transferred to that account under section 205A(5) of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999
(xii) Amount received under section 38(4)
(xiii) Such other amount as may be prescribed.

Since, only 5 years has passed and not 7 years, hence it is a contravention of the provisions.

**7. (a) 'OPC is enabling entrepreneur(s) carrying on the business in the Sole Proprietor form of business to enter into a corporate framework.' – Discuss.**

**Answer:**

This is very true that through One Person Company (OPC) a businessman can enter into a Corporate Framework from the Sole Proprietor form of business. The concept of OPC is new to this era of the corporate world. In very simple sense, In OPC, a single person could constitute a company. The new Companies Act, 2013 has done away with redundant provisions of the previous Companies Act, 1956, and provides for a new entity in the form of OPC, while empowering the Central Government to provide a simpler compliance regime for small companies. The introduction of OPC in the legal system is a move that would encourage corporatisation of micro-businesses and entrepreneurship. Whereas a Sole Proprietorship firm is also one person business but there are no legal formalities. A Sole

Proprietorship means an entity which is run and owned by one individual and where there is no distinction between the owner and the business.

The Companies Act, 2013 classifies companies on the basis of their number of members into OPC, private company and public company. A private company requires a minimum of two members. In other words, an OPC is a kind of private company having only one member. **As per section 2(62) of the Companies Act, 2013**, "One Person Company" means a company which has only one person as a member. **Section 3(1) (c) of the Companies Act, 2013** lays down that a company may be formed for any lawful purpose by one person. In other words, one person company is a kind of private company. An OPC shall have a minimum of one director. Therefore, an OPC will be registered as a private company with one member and one director. By virtue of section 3(2), an OPC may be formed either as a company limited by shares or a company limited by guarantee; or an unlimited liability company.

Also we can mention that, according to Section 2 (62) of the Companies Act, 2013 'One Person Company' means a company which has only one person as a member. A company formed under one person company may be either:

a) A company limited by shares, or
b) company limited by guarantee, or
c) An unlimited company.

OPC is a hybrid of Sole-Proprietor and Company form of business, and has been provided with concessional/relaxed requirements under the act.

**(b) Jagannath Limited is an unlisted public company having a paid up capital of twenty crore rupees as on 31st March, 2017 and a turnover of one hundred fifty crore rupees during the year ended 31st March, 2017. The total number of directors is thirteen.**

**Referring to the provisions of the companies act, 2013 answer the following:**

**(i) State the minimum number of independent directors that the company should appoint.**

**(ii) How many independent directors are to be appointed in case Raja Limited is a listed company?**

**Answer:**

The given problem relates to section 149(4) of the Companies Act, 2013 read with Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

(i) As per Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class (es) of companies shall have at least 2 directors as independent directors:
    (a) Public Companies having paid up share capital of 10 crore or more.
    (b) Public Companies having turnover of 100 crore or more.
    (c) Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore.

However, the following classes of unlisted public companies shall not be required to have any independent director:

(a) A joint venture

(b) A wholly owned subsidiary

**(c) The Board of Directors of Yatrik Athletic Club of Behala, Kolkata (a not-for-profit company) desires to prepare the books of accounts on cash basis. Can it be done without the approval of members or the Central Government?**

**Answer:**

The present problem relates to section 128 of the Companies Act, 2013. As per the section, the books of accounts shall be prepared on accrual basis. Section 128 does not provide any exemption permitting a company to p[reaper the books of accounts on any basis other than accrual basis.

Further, the requirement to prepare the books of accounts on accrual basis is applicable on all companies, whether public or private, whether having share capital or not, whether a company is a government company or non-profit company.

Further, section 128 does not empower the members or the Central Government to permit a company to prepare the books of accounts on any basis other than accrual basis. Thus the books of Accounts of Yatrik Athletic Club cannot be prepared on cash basis. If the books are prepared on cash basis, it would amount to contravention of Section 128.

**8. (a) Discuss the provisions regarding to vacation of office of director.**

**Answer:**

The provisions regarding to vacation of office of director are contained in section 167 of the Companies Act, 2013, which are as follows:

**As per section167 (1),** the office of a director shall become vacant in case -

(a) he incurs any of the disqualifications specified in section 164;

(b) he absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board;

(c) he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;

(d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184;

(e) he becomes disqualified by an order of a court or the Tribunal;

(f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months:

Provided that the office shall be vacated by the director even if he has filed an appeal against the order of such court;

(g) he is removed in pursuance of the provisions of this Act;

(h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

**As per Section167 (2),** if a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in subsection (1), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

**As per Section167(3**), where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

**As per Section167(4**), a private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified in sub-section (1).

**As per Companies (Amendment) Act, 2017**

In section 167 of the principal Act, in sub-section (*1*),—

(*i*) in clause (*a*), the following proviso shall be inserted, namely:—

"Provided that where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies, other than the company which is in default under that sub-section.";

(*ii*) in clause (*f*), for the proviso the following proviso shall be substituted, namely,—

"Provided that the office shall not be vacated by the director in case of orders referred to in clauses (*e*) and (*f*)—

(*i*) for thirty days from the date of conviction or order of disqualification;

(*ii*) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or

(*iii*) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of.".

**(b) Give a brief idea on 'Cost Audit under section 148'.**

**Answer:**

According to Section, the Central Government may specify audit of items of cost in respect of certain companies. These provisions are detailed below:

(a) Notwithstanding anything contained in the provisions related to audit and auditor (Chapter X), the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept under Section 128 by that class of companies in Form CRA-1 as per Rule 5(1) of the Companies (Cost Records and Audit) Rules, 2014.

(b) The Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(c) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered aforesaid and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(d) The cost audit shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed [Section 148(3)].

**9. Write short notes on any four following:**

**(a) Indoor Management**
**(b) Memorandum of Producer Company (Section 581F)**
**(c) Nidhi**
**(d) The Principle of Non-interference (Rule in Foss v. Harbottle)**
**(e) Oppression**

**Answer:**

**(a) Indoor Management**

The doctrine of indoor management has been recognized in the case of Royal British Bank v. Turquand (1856) 6 E&B 327 All ER Rep (435), While an ordinary person dealing with a company is bound to assume that the requisite compliance or delegation of powers to the person dealing on behalf of the company has been made, he need not probe beyond what is ostensible and evident from the actions. For that reason, it is also known as Turquand's rule. In other words we can say that, the role of doctrine of indoor management is opposed to of the role of doctrine of constructive notice. The doctrine of constructive notice protects company against outsiders whereas the doctrine of indoor management protects outsiders against the actions of company. This doctrine also is a possible safeguard against the possibility of abusing the doctrine of constructive notice.

**(b) Memorandum of Producer Company (Section 581F)**

The memorandum of association of every Producer Company should contain the following:

(a) the name of the company with 'Producer Company Limited' as the last words of the name of such Company.

(b) the State in which the registered office of the Producer Company is to situate.

(c) the main objects of the Producer Company shall be one or more of the objects specified in Section 581B.

(d) the names and addresses of the persons who have subscribed to the memorandum.

(e) the amount of share capital with which the Producer Company is to be registered and division thereof into shares of a fixed amount.

(f) the names, addresses and occupations of the subscribers being producers, who shall act as the first directors in accordance with Sub-Section (2) of Section 58IJ.

(g) that the liability of its member is limited.

(h) opposite to the subscriber's name the number of shares each subscriber takes:

(i) in case the objects of the Producer Company are not confined to one State, the States to whose territories the objects extend.

**(c) Nidhi**

"Nidhi" is a Hindi word, which means finance or fund. Nidhis are popular in the Southern part of the country and in fact the Government has recognized the importance of nidhi companies as an instrument of savings of communities coming together for mutual help and making available products like loans and cash credit at the location of the member and make such credit also available on easy attempts. So, A nidhi company, is one that belongs to the non-banking Indian finance sector and is recognized under section 406 of the **Companies Act, 2013**. Their core business is borrowing and lending money between their members. They are also known as **Permanent Fund**, Benefit Funds, Mutual Benefit Funds and Mutual Benefit Company. The examples of Nidhi Company are Hindupur Mutual Benefit Permanent, Shri Navarathna Benefit Fund Limited etc.

Nidhi companies is governed by Nidhi Rules, 2014. They are incorporated in the nature of Public Limited company and hence, they have to comply with two set of norms, one of Public limited company as per Companies Act, 2013 and another is for Nidhi rules, 2014. No RBI approval is necessary to register the company, as RBI has specifically exempted this category of NBFC in India to comply its core provisions such as registration with RBI etc. Every Nidhi shall, within a period of one year from the commencement must ensure that it has not less than 200 members.

**(d) The Principle of Non-interference (Rule in Foss v. Harbottle)**

In case of differences amongst the members the issue is decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority. The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of Foss v. Harbottle 67 E.R. 189. (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

**(e) Oppression**

The words 'Oppression' and 'mismanagement' are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense. The meaning of the term 'oppression' as explained by Lord Cooper in the Scottish case of Elder v. elder & Western Ltd. [(1952) Scottish Cases 49], which has been cited with approval by Wanchoo. J (afterwards C.J.) of the Supreme Court in Shanti Prasad v. Kalinga Tubes [(1965) 1 Comp L.J. 193 at 204], is as under:

'The essence of the matter seems to be that the conduct complained of should at the lowest, involve a visible departure from the standards of fair dealing, on which every shareholders who entrusts his money to the company is entitled to rely.'

## Study Note – 2

## SEBI Laws and Regulations

**Fill in the blanks:**

1. **Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within____________ from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order.**
   **(A) 30 days**
   **(B) 45 days**
   **(C) 60 days**
   **(D) 90 days**

2. **As per clause 49 of the listing agreement, no person can be an independent director of more than listed companies. If any person is serving as a whole time director in any listed company, then he/she shall not be the independent director of more than ______listed companies.**
   **(A) seven, five**
   **(B) seven, three**
   **(C) five, three**
   **(D) five, two**

3. **The Company is required to obtain a certificate regarding compliance of corporate governance from as enumerated in this clause and annex this certificate with the director's report sent annually to the shareholders of the Company. The same certificate is to be sent to the stock exchanges along with the annual report.**
   **(A) independent director**
   **(B) chairman of the board**
   **(C) practicing company secretaries**
   **(D) practicing chartered accountants**

4. **In case of an initial public offer, minimum contribution of the promoters of the issuer should not be less than of the post issue capital.**
   **(A) 5%**
   **(B) 10%**
   **(C) 15%**
   **(D) 20%**

**Answer:**

| Question No. | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| Answer: | C | B | C | D |

**1. Briefly discuss the power and functions of the Securities Exchange Board of India.**

**Answer:**

Chapter IV of the SEBI Act, 1992 deals with the powers and function of the Securities Exchange Board of India. The functions of the securities Exchange Board of India has been dealt in Section 11. Sub-Section (1) of Section 11 declares that it shall be the duty of the Securities Exchange Board of India:

(a) to protect the interest of investors in securities, and
(b) to promote the development of and
(c) to regulate the securities market by such measures as the Board thinks fit and
(d) for matters connected therewith and incidental thereto.

The Board is mainly entrusted with two main functions, namely:
(A) Regulatory functions and (B) Developmental functions.

**A) Regulatory functions**

The Board is responsible for:

1) regulating the business in stock exchanges and any other securities markets.
2) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner.
3) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf.
4) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.
5) promoting and regulating self-regulatory organizations.
6) prohibiting fraudulent and unfair trade practices relating to securities markets.
7) promoting investors' education and training of intermediaries of securities markets.
8) prohibiting insider trading in securities.
9) regulating substantial acquisition of shares and take-over of companies.
10) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market intermediaries and self- regulatory organisations in the securities market.
11) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board.
12) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government.
13) levying fees or other charges for carrying out the purposes of this Section.
14) conducting research for the above purposes.

15) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions
16) performing such other functions as may be prescribed.

**B) Developmental Functions**

1) Promoting investors' education. 2) Training of intermediaries. 3) Conducting research and publishing information useful to all market participants. 4) Promotion of fair practices. 5) Promotion of self regulatory organizations.

Beside these above mentioned functions, the Board may take measures to undertake inspection of any book or register or any other document or record of any listed public company which intends to get its securities listed on any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

**2. Explain the term 'Insider Trading'.**

**Answer:**

Securities and Exchange Board of India has prohibited insider trading, substantial acquisition of securities or control. Insider trading can be defined as securities trading by insiders based on material non-public information in violation of a fiduciary or similar duty of trust and confidence to the company issuing the security to the company's shareholders or to the source of information. The main benefit of the insider trading goes to the insider. An insider can be the directors, officers, shareholders holding substantial number of shares, persons who are not employed by the corporation but receive confidential information from a corporation while providing services to the corporation like professional advisors, lawyers, investment bankers. In other words, the knowledge of unpublished price sensitive information in hands of persons connected to the companies which put them in an advantageous position over others who lack it, such information can be used to make gains by buying shares a cheaper rate anticipating that it might rise and it can be used to insulate themselves against losses by selling shares before the prices fall down, such kind of transaction entered into by persons having access to any unpublished information is called Insider Trading.

Consequently, SEBI banned insider trading and laid down the SEBI (Prohibition of Insider Trading) Regulation 1992. With a view to do away with the lacunae and inadequacies of the 1992 Regulations, SEBI has revamped the entire framework governing insider trading in India. Recently, SEBI (Prohibition of Insider Trading) Regulations, 2015 were notified vide notification dated 15th January, 2015. The regulations came into effect from May 15th, 2015.

**3. What are the principles under Clause 49 of the listing agreement?**

**Answer:**

Principles under Clause 49 of the listing agreement:

A. Rights of Shareholders

Listing Agreement enumerates the following rights of the shareholders which must be met by the Company:

1) Shareholder's must be sufficiently informed about the fundamental corporate changes and must get a right to participate in it.
2) They must have an opportunity to participate and vote in general shareholder's meetings.
3) They should have a right to place items on the agenda of the meeting (general), propose resolutions etc.
4) The shareholders must have the opportunity to exercise ownership rights. Minority protection from the abusive action of the majority must be protected.
5) Further, the Company must adequately and timely inform the shareholders about the general meetings, capital structures and arrangements, rights attached to shares or class of shares they seek to invest in.
6) The Company must design ways to avoid Insider trading and abusive self dealing.
7) Finally, there must be equitable treatment of all shareholders.

B. Role of Stakeholders in Corporate Governance

This Section provides for the need of recognition of the rights of stakeholder and encourages cooperation between stakeholders and company. The stakeholders must be effectively recognized and respected. A mechanism must be created to protect their rights from abuse or violation. Further, they must be timely and adequately informed about every process relating to Corporate Governance.

C. Disclosure and Transparency

Disclosures must be made regarding proper compliance of prescribed standards of accounting, financial and non-financial disclosure. Maintenance of records containing minutes of the meeting must be done, specifically recording dissenting opinions.

D. Duties/Responsibilities of the Board

One of the key responsibilities of the Board is to observe transparency and disclose every material fact or report which is required to be disclosed. Other key functions include monitoring the effectiveness of the Company's governance practice, setting performance objectives, aligning board remuneration and other key executive with the interests of the Company and shareholders etc.

**4. Write short note on: (i) Whistle Blower Policy (ii) Audit Committee**

Answer:

**(i) Whistle Blower Policy**:

One of the most important and mandatory provision under the listing agreement is the Whistle Blower Policy. Under this provision, the Company is required to establish a vigil mechanism to report unethical behaviour or any sort of violation of the company's code of conduct, any actual or suspected fraud. The website of the Company along with the Board report must disclose the establishment of such mechanism. The mechanism should provide for safeguards against victimization of the personnel availing it.

**(ii) Audit Committee:**

The Board of this committee must have minimum three members out of which at least two third must be independent directors. Further, all the members must be financially literate and one member must be an expert in accounting or related financial management. The Chairman of the Audit Committee must be an Independent Directors, who must be present at the Annual General Meeting to answer shareholder's query. The Audit Committee must meet four times in a year with a gap of not more than four months in between two meetings. The quorum must be two members or one third of the total members whichever is greater, but minimum two independent directors must be present. The powers of the Committee extend to investigate any activity within its reference, seek information from employee, obtaining outside professional advice and secure attendance of expert outsiders in the relevant area. Under the Listing Agreement, the Audit Committee has been empowered with several duties or roles. Some of which are recommendation on the appointment, remuneration of auditors, approving the payment to statutory auditors, review annual financial statement of the company along with the Auditor's reports, review quarterly financial statements before submission to the Board for approval, review the independence and performance of the auditors.

**5. What are the essential conditions for Initial Public Offer?**

**Answer:**

Conditions for Initial Public Offer:

(a) An issuer may make an initial public offer (an offer of equity shares and convertible debentures by an unlisted issuer to the public for subscription and includes an offer for sale of specified securities to the public by an existing holder of such securities in an unlisted issuer) if:

(1) The issuer has net tangible assets of at least ₹ 3 crores in each of the preceding 3 years (of 12 months each) of which not more than 50% are held in monetary assets. If more than 50% of the net tangible assets are held in monetary assets, then the issuer has to make firm commitment to utilize such excess monetary assets in its business or project.

(2) it has a minimum average pre-tax operating profit of ₹ fifteen crore, calculated on a restated and consolidated basis, during the three most profitable years out of the immediately preceding five years.

(3) The issuer company has a net worth of at least ₹ 1 crores in each of the preceding 3 full years (of 12 months each).

(4) The aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed 5 times its pre-issue net worth as per the audited balance sheet of the preceding financial year.

(5) In case of change of name by the issuer company within last one year, at least 50% of the revenue for the preceding one year should have been earned by the company from the activity indicated by the new name.

(b) Any issuer not satisfying any of the conditions stipulated above may make an initial public offer if:

   (1) The issue is made through the book building process and the issuer undertakes to allot at least 75% of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make allotment to the qualified institutional buyers.

(c) An issuer may make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing.

(d) An issuer cannot make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.

(e) No issuer can make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person any option to receive equity shares after the initial public offer. However, this is not applicable to:
   (1) a public issue made during the currency of convertible debt instruments which were issued through an earlier initial public offer, if the conversion price of such convertible debt instruments was determined and disclosed in the prospectus of the earlier issue of convertible debt instruments.
   (2) outstanding options granted to employees pursuant to an employee stock option scheme framed in accordance with the relevant Guidance Note or Accounting Standards, if any, issued by the Institute of Chartered Accountants of India in this regard.
   (3) Fully paid-up outstanding securities which are required to be converted on or before the date of filing of the red herring prospectus (in case of book built issues) or the prospectus (in case of fixed price issues), as the case may be.

(d) in case the issuer opts for the alternate method of book building, the issuer may offer specified securities to its employees at a price lower than the floor price. However, the difference between the floor price and the price at which equity shares and convertible securities are offered to employees should not be more than 10% of the floor price.

**6. Write short note on: Book Building**

**Answer:**

Book Building means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be in accordance with the SEBI (ICDR) Regulations 2009.

(a) In an issue made through the book building process, the allocation in the net offer to public category is made as follows:
   (1) Not less than 35 % to retail individual investors.
   (2) Not less than 15 % to non institutional investors i.e. investors other than retail individual investors and qualified institutional buyers.
   (3) Not more than 50% to Qualified Institutional Buyers; 5 % of which would be allocated to mutual funds.

Provided that in addition to five per cent allocation available in terms of clause (3), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

In an issue made through the book building process the allocation in the net offer to public category shall be as follows:

(1) not more than ten per cent to retail individual investors;
(2) not more than fifteen per cent to non-institutional investors;
(3) not less than seventy five per cent to qualified institutional buyers, five per cent of which shall be allocated to mutual funds.

Provided further that in addition to five per cent allocation available, mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

In an issue made through the book building process, the issuer may allocate up to 60% of the portion available for allocation to qualified institutional buyers to an anchor investor in accordance with the conditions specified in ICDR Regulations 2009.

(b) In an issue made other than through the book building process, allocation in the net offer to public category will be made as follows:
(1) minimum 50% to retail individual investors, and
(2) remaining to individual applicants other than retail individual investors and other investors including corporate bodies or institutions, irrespective of the number of equity shares and convertible securities applied for.
(3) the unsubscribed portion in either of the categories specified above (point 1 and 2) may be allocated to applicants in the other category.

If the retail individual investor category is entitled to more than 50% on proportionate basis, the retail individual investors will be allocated that higher percentage.

**7. Define the term 'Securities'.**

**Answer:**

Securities include,

(1) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or body corporate.
(2) derivative.
(3) units or any other instrument issued by any collective investment scheme to the investors in such schemes.
(4) security receipt as defined in clause (zg) of Section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
(5) units or any other such instrument issued to the investors under any mutual fund scheme.

It has been explained that "securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938 (4 of 1938);]

(6) any certificate of instrument (by whatever name called) issued to an investor by any issuer being a special purpose distinct entity which possess any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.
(7) government securities.
(8) such other instruments as may be declared by the Central Government to be securities, and
(9) rights or interests in securities.

**8. What are the different types of Listing?**

**Answer:**

Listing of securities falls under 5 groups:

(1) Initial listing: If the shares or securities are to be listed for the first time by a company on a stock exchange is called initial listing.
(2) Listing for Public Issue: When a company whose shares are listed on a stock exchange comes out with a public issue of securities, it has to list such issue with the stock exchange.
(3) Listing for Rights Issue: When companies whose securities are listed on the stock exchange issue further securities to existing share holders on rights basis, it has to list such rights issues on the concerned stock exchange.
(4) Listing of Bonus Shares: Companies issuing shares as a result of capitalization of profits through bonus issue shall list such issues also on the concerned stock exchange.
(5) Listing for merger or amalgamation: When new shares are issued by an amalgamated company to the share holders of the amalgamating company, such shares are also required to be listed on the concerned stock exchange.

**9. State what are the benefits of Listing?**

**Answer:**

The following benefits are available when securities are listed by a company in the stock exchange:

(a) public image of the company is enhanced.
(b) the liquidity of the security is ensured making it easy to buy and sell the securities in the stock exchange.
(c) tax concessions are made available both to the investors and the companies.
(d) listing procedure compels company management to disclose important information to the investors enabling them to make crucial decisions with regard to holding or disposing of such securities.
(e) Shares of listed companies command better credibility as they could be offered as security for loans from Banks and FIs.

**10. What are the penalties for failure to furnish information and return under Securities Contracts (Regulation) Act, 1956?**

**Answer:**

Under Section 26 of Securities Contracts (Regulation) Act, 1956, any person, who is required under this Act or any rules made there under:

1) to furnish any information, document, books, returns or report to a recognised stock exchange, fails to furnish the same within the time specified therefore in the listing agreement or conditions or bye-laws of the recognised stock exchange, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees for each such failure.
2) to maintain books of account or records, as per the listing agreement or conditions, or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

## Study Note – 3

## The Competition Act, 2002

**Fill in the blanks:**

1. **Any person aggrieved by any order of Appellate Tribunal, may file an appeal to the Hon'ble Supreme Court within______days, from the date of receipt of the order of Appellate Tribunal.**
   **(A) 30 days**
   **(B) 45days**
   **(C) 60 days**
   **(D) 90 days**

2. **Unfair competition means adoption of practices such as**
   **(A) Allocation of markets**
   **(B) Deliberate reduction in output in order to increase prices,**
   **(C) Predatory pricing**
   **(D) All of the above**

3. **The Commission also has the power to impose a fine which may extend to ______of the total turnover or the assets of the combination, whichever is higher, for failure to give notice to the Commission of the combination.**
   **(A) 2%**
   **(B) 1%**
   **(C) 0.5%**
   **(D) 3%**

4. **The Chairperson and every other Member of Competition Commission of India shall hold office for a term of years from the date on which he enters upon his office and shall be eligible for re-appointment.**
   **(A) one**
   **(B) two**
   **(C) five**
   **(D) three**

**Answer:**

| Question No. | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| Answer | C | D | B | C |

**1. What are the objectives of the Competition Act, 2002?**

**Answer:**

Keeping in view of the economic development of the country, the Competition Act, 2002 was laid down to provide for an establishment of a Commission seeks to achieve the following objectives:

(a) to prevent practices having adverse effect on competition.
(b) to promote and sustain competition in markets.
(c) to protect the interests of consumers.
(d) to ensure freedom of trade carried on by other participants in markets in India and for matters connected therewith or incidental thereto.

The objectives of the Act are sought to be achieved through the instrumentality of the Competition Commission of India (CCI) which has been established by the Central Government with effect from 14$^{th}$ October, 2003.

**2. Discuss the Duties of Commission.**

**Answer:**

In terms of Section 18 of the Competition Act, 2002, it shall be the duty of the Commission to eliminate practices having adverse effect on competition, to promote and sustain competition in markets in India, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets in India. The Commission may for the purpose of discharging its duties or performing its functions under this Act, enter into any memorandum or arrangement, with the prior approval of the Central Government, with any agency of any foreign country.

**3. State the Powers of the Commission.**

**Answer:**

Powers and Functions of the Commission

(a) Appreciable Adverse effect: The Commission has the power to determine whether an agreement has an appreciable adverse effect on competition or not
(b) Dominant position of enterprise: The Commission has the power to inquire whether an enterprise enjoys a dominant position or not
(c) Relevant Market: The Commission has the power to determine whether a market constitutes a "relevant market", due regard to "relevant geographic market" and "relevant product market" for the purposes of this Act or not.

**4. What is the procedure for inquiry under the Competition Act, 2002?**

**Answer:**

(a) Section 26 prescribes the detailed procedure for any inquiry initiated *suo motu* by the Commission and various complaints and references referred to in Section 19 of the Act.

The procedure is as follows:

(1) On receipt of a reference from the Central Government or a State Government or a statutory authority or on its own knowledge or information received under Section 19, if the Commission is of the opinion that there exists a prima facie case, it shall direct the Director General to cause an investigation to be made into the matter. If the subject matter of information received is, in the opinion of the Commission, substantially the same as or has been covered by any previous information received, then the new information may be clubbed with the previous information.

(2) Where on receipt of a reference from the Central Government or a State Government or a statutory authority or information received under Section 19, the Commission is of the opinion that there exists no prima facie case, it shall close the matter forthwith and pass such orders as it deems fit and send a copy of its order to the Central Government or the State Government or the statutory authority or the parties concerned, as the case may be.

(3) The Director General shall, on receipt of direction submit a report on his findings within such period as may be specified by the Commission.

(4) The Commission may forward a copy of the report to the parties concerned. In case the investigation is caused to be made based on reference received from the Central Government or the State Government or the statutory authority, the Commission shall forward a copy of the report to the Central Government or the State Government or the statutory authority, as the case may be.

(5) If the report of the Director General recommends that there is no contravention of the provisions of this Act, the Commission shall invite objections or suggestions from the Central Government or the State Government or the statutory authority or the parties concerned, as the case may be, on such report of the Director General.

(6) If, after consideration of the objections and suggestions if any, the Commission agrees with the recommendation of the Director General, it shall close the matter forthwith and pass such orders as it deems fit and communicate its order to the Central Government or the State Government or the statutory authority or the parties concerned, as the case may be.

(7) If, after consideration of the objections or suggestions if any, the Commission is of the opinion that further investigations is called for, it may direct further investigation in the matter by the Director General or cause further inquiry to be made by in the matter or itself proceed with further inquiry in the matter in accordance with the provisions of this Act.

(8) If the report of the Director General recommends that there is contravention of any of the provisions of this Act, and the Commission is of the opinion that further inquiry is called for, it shall inquire into such contravention in accordance with the provisions of this Act. Orders by Commission after inquiry into agreements or abuse of dominant position (Section 27)

(b) Where after inquiry the Commission finds that any agreement referred to in Section 3 or action of an enterprise in a dominant position, is in contravention of Section 3 or Section 4, as the case may be, it may pass all or any of the following orders, namely:

(1) direct any enterprise or association of enterprises or person or association of persons, as the case may be, involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position, as the case may be.
(2) impose such penalty, as it may deem fit which shall be not more than ten per cent of the average of the turnover for the last three preceding financial years, upon each of such person or enterprises which are parties to such agreements or abuse. Provided that in case any agreement referred to in Section 3 has been entered into by a cartel, the Commission may impose upon each producer, seller, distributor, trader or service provider included in that cartel, a penalty of up to three times of its profit for each year of the continuance of such agreement or ten per cent of its turnover for each year of the continuance of such agreement, whichever is higher.
(3) direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission.
(4) direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, if any.
(6) pass such other order or issue such directions as it may deem fit. While passing orders under this Section, if the Commission comes to a finding, that an enterprise in contravention to Section 3 or Section 4 of the Act is a member of a group as defined in clause (b) of the Explanation to Section 5 of the Act, and other members of such a group are also responsible for, or have contributed to, such a contravention, then it may pass orders, under this Section, against such members of the group. (Section 27)
(7) If, after consideration of the objections or suggestions if any, the Commission is of the opinion that further investigations is called for, it may direct further investigation in the matter by the Director General or cause further inquiry to be made by in the matter or itself proceed with further inquiry in the matter in accordance with the provisions of this Act.
(8) If the report of the Director General recommends that there is contravention of any of the provisions of this Act, and the Commission is of the opinion that further inquiry is called for, it shall inquire into such contravention in accordance with the provisions of this Act. Orders by Commission after inquiry into agreements or abuse of dominant position (Section 27)

**5. Discuss about the acts taking place outside India but having an effect on competition in India.**

**Answer:**

The Commission shall, notwithstanding that:
(a) an agreement referred to in Section 3 has been entered into outside India. or
(b) any party to such agreement is outside India. or
(c) any enterprise abusing the dominant position is outside India. or

(d) a combination has taken place outside India. or

(e) any party to combination is outside India. or

(f) any other matter or practice or action arising out of such agreement or dominant position or combination is outside India.

have power to inquire in accordance with the provisions contained in Sections 19, 20, 26, 29 and 30 of the Act into such agreement or abuse of dominant position or combination if such agreement or dominant position or combination has, or is likely to have, an appreciable adverse effect on competition in the relevant market in India and pass such orders as it may deem fit in accordance with the provisions of this Act.

**6. Write short notes on: (i) Cartel (ii) Combination**

**Answer:**

(i) **Cartel:** According to Section 2(c) Cartel includes an association of producers, sellers or distributors, traders or service providers who, by agreement amongst themselves, limit control or attempt to control the production, distribution, sale or price of or, trade in goods or provision of services.

The nature of a cartel is to raise price above competitive levels, resulting in injury to consumers and to the economy. For the consumers, cartelisation results in higher prices, poor quality and less or no choice for goods or/and services. An international cartel is said to exist, when not all of the enterprises in a cartel are based in the same country or when the cartel affects markets of more than one country. An import cartel comprises enterprises (including an association of enterprises) that get together for the purpose of imports into the country.

**(ii) Combinations:** Broadly, combination under the Act means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has direct or indirect control over another enterprise engaged in competing businesses, and mergers and amalgamations between or amongst enterprises when the combining parties exceed the thresholds set in the Act. The thresholds are specified in the Act in terms of assets or turnover in India and abroad. The words combination and merger are used interchangeably in this booklet. Entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India is prohibited and such combination shall be void.

## Study Note – 4

## Foreign Exchange Management Act, 1999

**Fill in the blanks:**

1. **The External Commercial Borrowings Framework enables permitted resident entities to borrow from recognized nonresident entities in the forms of:**
   **(A) Loans including bank loans.**
   **(B) Suppliers' credit.**
   **(C) Foreign Currency Convertible Bonds (FCCBs).**
   **(D) All of the above**

2. **Which one of the following is not a Current account transaction?**
   **(A)Imports payables**
   **(B) Exports receivables**
   **(C)Dividend**
   **(D) External Commercial Borrowings**

**Answer:**

| Question No | 1 | 2 |
|---|---|---|
| Answer | D | D |

1. **What is the objective of the Foreign Exchange Management Act, 1999?**

   **Answer:**

   Foreign exchange means 'foreign currency' and includes deposits, credits and balances payable in any foreign currency and secondly drafts, travelers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency.

   The objective of Foreign Exchange Management Act (FEMA) is to facilitate external trade and payments and to promote the orderly development and maintain a healthy foreign exchange market in India.

2. **Define Current account transaction.**

   **Answer:**

   Current account transaction: 'current account transaction' means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes:
   (1) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business.
   (2) payments due as interest on loans and as net income from investments.

(3) remittances for living expenses of parents, spouse and children residing abroad, and
(4) expenses in connection with foreign travel, education and medical care of parents, spouse and children.

Whereas, 'capital account transaction' means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in sub-section (3) of section 6.

**3. What is Foreign Institutional Investor (FII) and Foreign Portfolio Investor (FPI)?**

**Answer:**

'Foreign Institutional Investor'(FII) means an entity established or incorporated outside India which proposes to make investment in India and which is registered as a FII in accordance with the Securities and Exchange Board of India (SEBI) (Foreign Institutional Investor) Regulations 1995.

'Foreign Portfolio Investor'(FPI) means a person registered in accordance with the provisions of Securities and Exchange Board of India (SEBI) (Foreign Portfolio Investors) Regulations, 2014, as amended from time to time.

**4. Define 'Person resident in India' as per Foreign Exchange Management Act, 1999.**

**Answer:**

Under section 2(v) of Foreign Exchange Management Act (FEMA) 'person resident in India' means:
(a) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include:
  (1) a person who has gone out of India or who stays outside India, in either case:
    a) for or on taking up employment outside India, or
    b) for carrying on outside India a business or vocation outside India, or for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period.

  (2) a person who has come to or stays in India, in either case, otherwise than:
    a) for or on taking up employment in India, or
    b) for carrying on in India a business or vocation in India, or
    c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period.

(b) any person or body corporate registered or incorporated in India.

(c) an office, branch or agency in India owned or controlled by a person resident outside India.

(d) an office, branch or agency outside India owned or controlled by a person resident in India.

**5. Discuss the provision regarding the holding of foreign exchange.**

**Answer:**

According to Section 4 of Foreign Exchange Management Act, 1999, except as provided in this Act, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

This section restricts a resident in India from acquiring, holding, owing, possessing or transferring in any manner foreign exchange, foreign security or any immovable property situated outside India. However the acquisition such immovable property outside India on lease for a period not exceeding five years is permissible provided such transactions are not specifically prohibited.

In terms of regulations relating to acquisition and transfer of immovable property outside India, such acquisition by a person resident in India would require prior approval of Reserve Bank except in the following cases:
(a) Property held outside India by a foreign citizen resident in India.
(b) Property acquired by a person on or before 8th July, 1947 and held with the permission of Reserve Bank.
(c) Property acquired by way of gift or inheritance from persons referred to in above.
(d) Property purchased out of funds held in RFC account.

**6. What are the different forms of business that may be conducted by a Foreign Company in India?**

**Answer:**

A foreign company planning to set up business operations in India may:
(a) Incorporate a company under the Companies Act, 1956 (now Companies Act 2013), as a Joint Venture or a Wholly Owned Subsidiary.
(b) Set up a Liaison Office/Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000.

**7. What is Foreign Direct Investment in India? What is the procedure for receiving Foreign Direct Investment (FDI) in an Indian company?**

**Answer:**

Foreign Direct Investment (FDI) is a category of cross border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) i.e., resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long term relationship with the direct investment enterprise to ensure the significant degree of influence by the direct investor in the management of the direct investment enterprise. The objectives of direct investment are different from those of portfolio investment whereby investors do not generally expect to influence the management of the enterprise.

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy which is formulated and announced by the Government of India. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, issues a Consolidated FDI Policy on an yearly basis elaborating the policy and the process in respect of FDI in India. The latest Consolidated FDI Policy is governed by the provisions of the Foreign Exchange Management Act (FEMA), 1999.

FEMA Regulations which prescribe amongst other things the mode of investments i.e. issue or acquisition of shares / convertible debentures and preference shares, manner of receipt of funds, pricing guidelines and reporting of the investments to the Reserve Bank.

An essential requirement for receiving foreign direct investment is the compliance with the KYC (Know your customer) requirement specified by the Reserve Bank of India. As and when the negotiations take place for foreign investment, the overseas investor should be apprised of the need to receive the KYC certification through the Banking channels. An Indian company may receive Foreign Direct Investment (FDI) under the two routes as given under:

(a) **Automatic Route**

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities / sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

(b) **Government Route**

FDI in activities not covered under the automatic route requires prior approval of the Government which is considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Application can be made in the prescribed Form. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

The Indian company having received FDI either under the Automatic route or the Government route is required to comply with provisions of the FDI policy including reporting the FDI to the Reserve Bank of India.

**8. What are the prohibited sectors for FDI in India?**

**Answer:**

FDI is prohibited in:

(1) Lottery Business including Government / private lottery, online lotteries, etc.
(2) Gambling and betting including casinos etc.

(3) Chit funds.
(4) Nidhi company.
(5) Trading in Transferable Development Rights (TDRs).
(6) Housing and Real Estate Business or Construction of Farm Houses 'Real estate business' shall not include development of townships, construction of residential / commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.
(7) Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.
(8) Activities / sectors not open to private sector investment e.g.,
    a) Atomic Energy and
    b) Railway operations (other than permitted activities).

Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities.

# Study Note – 5

# Laws Related to Banking Sector

## Section – A

**(1) Multiple choice questions:**

**(A)** Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act popularly known as SARFAESI Act was enacted in which of the following year:

(i) 21st Day of June 2002
(ii) 30th Day of May 2002
(iii) 21st Day of July 2002
(iv) 21st Day of April 2002

**(B)** Reserve Bank has the power under __________ of the Securitisation Act to cancel the Certificate of Registration issued by it to any ARC:

(i) Section 5
(ii) Section 8
(iii) Section 4
(iv) Section 12

**(C)** The Three Stages of Money Laundering are:

(i) Layering, Placement, Refining
(ii) Placement, Refining, Integration
(iii) Layering, Placement, Integration
(iv) Layering, Refining, Integration

**(D)** Who shall be responsible for furnishing information on modification and satisfaction of security interest:

(i) Asset Reconstruction Company or secured creditor
(ii) Only secured creditor
(iii) Only the asset reconstruction company
(iv) Borrower or secured creditor

**(E)** Before which for a can an asset reconstruction company file an application for enforcement of its security interest:

(i) Debt Recovery Tribunal
(ii) High Court
(iii) District Court
(iv) National Company Law Tribunal

**(F) Which of the following is the usage of shell companies?**

- **i. To create the appearance of legitimate transaction through false invoice and financial statements.**
- **ii. To take loan against securities acquired from black money and paying tax on profit.**
- **iii. Both (i) and (ii)**
- **iv. None of the above**

**(G) What is the stamp duty to be paid in respect of any document executed by any banker financial institution for issuing a debenture or bond.**

- **(i) One rupee for every ₹ 100 or part thereof.**
- **(ii) One rupee for every ₹ 1000 or part thereof.**
- **(iii) It shall be exempted from stamp duty.**
- **(iv) It depends from State to State.**

**(H) An Example of smurfing:**

- **(i) Wiring money to the foreign country**
- **(ii) A drug dealer asking a stranger to buy a money order with drug money.**
- **(iii) A broker buying pesos with US Dollars**
- **(iv) None of the above.**

**(I) Which of the following is not a security interest:**

- **(i) Any mortgage, charge, hypothecation, assignment or any right, title or interest of any kind, on tangible asset, retained by the secured creditor as an owner of the property, given on hire or financial lease or conditional sale or under any other contract.**
- **(ii) Such right, title or interest in any intangible asset or assignment or licence of such intangible asset which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation incurred or any credit provided to enable the borrower to acquire the intangible asset or licence of intangible asset**
- **(iii) A lien on any goods, money or security given by or under the Indian Contracts Act, 1872 or the Sale of Goods Act, 1930 or any other law for the time being in force**
- **(iv) Lien of goods, pledge of movables, security interest of less than ₹ One Lakh**

**Answers:**

(A) (i) 21st Day of June 2002
(B) (iii) Section 4
(C) (iii) Layering, Placement, Integration
(D) (i) Asset Reconstruction Company or secured creditor
(E) (i) Debt Recovery Tribunal
(F) (iii) Both (i) and (ii)
(G) (iii) It shall be exempted from stamp duty
(H) (i) Wiring money to the foreign country
(I) (iii) A lien on any goods, money or security given by or under the Indian Contracts Act, 1872 or the Sale of Goods Act, 1930 or any other law for the time being in force

## Section – B

**Answer the following questions:**

**(2) (a) What is the meaning of security interest as per SARFAESI Act?**

**(b) Can SARFAESI proceedings be initiated against the guarantor to the credit facility? Can proceedings against the guarantor be initiated first and then against the borrower?**

**Answer:**

**2. (a)** The term "security interest" has been defined in section 2(zf) of the SARFAESI Act, 2002, as amended by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016 (Amendment Act).

Broadly, it includes the following:

a. Where the property is tangible in nature:

i. Right title or interest those created for security;

ii. Mortgage created under section 58 of the Transfer of Property Act, 1881 conferring the right to the lender to sell the property on default;

iii. Charge created on immovable property under section 100 of the Transfer of Property Act, 1881;

iv. Hypothecation created on movable property – defined in section 2(1)(n) of the SARFAESI Act, 2002 and includes all forms of security interest created on movable properties except by virtue of which the possession is taken by the creditor, i.e., pledge;

v. Assignment of rights created for the purpose of creating a security and not for the purpose of transferring.

vi. Right or interest created by way of financial lease, hire purchase or conditional sale – Though from legal point of view, these are ownership interests, however, for the purpose of SARFAESI Act, these have been recognised as security interests.

**(b)** SARFAESI Act defines the term borrower in section 2(f) in the following manner –
"borrower" means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance;

As stated in the law quoted above, the term borrower includes anyone who has extended guarantee for a financial assistance. Therefore, enforcement proceedings under the SARFAESI Act can be initiated against the guarantors as well. Note, however, that SARFAESI is available only for enforcement of security interest. That is, if the guarantor has granted a security interest, the same may be enforced under SARFAESI.
Yes.

There is no specific provision in the Act which requires the secured lender to proceed first against the principal borrower and then against the guarantor.

**3. How does Money Laundering take place? What has been the international response to tackle Money Laundering?**

**Answer:**

Usually, the process of Money Laundering goes through the following three stages :

(a) Placement:- The Money Launderer, who is holding the money generated from criminal activities, introduces the illegal funds into the financial system. This might be done by breaking up large amount of cash into less conspicuous smaller sums which are deposited directly into a Bank Account or by purchasing a series of instruments such as Cheques, Bank Drafts etc., which are then collected and deposited into one or more accounts at another location.

(b) Layering:- The second stage of Money Laundering is layering. In this stage, the Money Launderer typically engages in a series of continuous conversions or movements of funds, within the financial or banking system by way of numerous accounts, so as to hide their true origin and to distance them from their criminal source. The Money Launderer may use various channels for movement of funds, like a series of Bank Accounts, sometimes spread across the globe, especially in those jurisdictions which do not co–operate in anti Money Laundering investigations.

(c) Integration:- Having successfully processed his criminal profits through the first two stages of Money Laundering, the Launderer then moves to this third stage in which the funds reach the legitimate economy, after getting inseparably mixed with the legitimate money earned through legal sources of income. The Money Launder might then choose to invest the funds into real estate, business ventures & luxury assets, etc. so that he can enjoy the laundered money, without any fear of law enforcement agencies.

The above three steps may not always follow each other. At times, illegal money may be mixed with legitimate money, even prior to placement in the financial system. In certain cash rich businesses, like Casinos (Gambling) and Real Estate, the proceeds of crime may be invested without entering the mainstream financial system at all.

In response to mounting concern over money laundering, the Financial Action Task Force on money laundering (FATF) was established by the G-7 Summit in Paris in 1989 to develop a co-ordinated international response. One of the first tasks of the FATF was to develop Recommendations which set out the measures national governments should take to implement effective anti-money laundering programmes.

**(4) (a) Can the following classes of creditors vote in the resolution for enforcement of security interest –**

- **i. Secured creditor holding first charge**
- **ii. Secured creditor holding second charge**
- **iii. Secured creditor holding sub-servient charge**
- **iv. Unsecured creditor**
- **v. Trade creditor**

**(b) Whether a lender can avail the benefits of SARFAESI Act in the following circumstances –**

- **i. An insolvency application has been launched against the borrower**
- **ii. The borrower is under BIFR**
- **iii. A winding up petition has been made against the borrower**
- **iv. A criminal proceeding has been launched by the lender against the borrower**

**Answer:**

**4. (a)** SARFAESI Act is applicable only where the creditor is a secured creditor, therefore, only secured creditors can vote in the resolution for enforcement of security interest. Further, the Act does not provide for any difference between first charge holders and subsequent charge holders. Based on this discussion, let us understand which classes of creditors can vote –

- i. Secured creditor holding first charge - Yes
- ii. Secured creditor holding second charge - Yes
- iii. Secured creditor holding sub-servient charge - Yes
- iv. Unsecured creditor - No
- v. Trade creditor - No

**(b) i.** Where an insolvency application is launched against the borrower, a secured lender shall not be able to exercise its powers under the SARFAESI Act during the first moratorium granted by the Adjudicating Authority under section 14(1)(c) of the Insolvency and Bankruptcy Code, 2016 for a period of 180 days from the date of admission of the application, which is extendable for another period of 90 days

**ii.** Where the borrower in question is under BIFR, the secured lender can still proceed against the borrower under the SARFAESI Act, 2002 after obtaining leave of the said authority. Since, the SARFAESI Act deals with enforcement of security interest on specific properties, therefore, enforcement action under this Act shall override BIFR proceedings. The same can be validated from reading of section 35 of the Act, which provides that the provisions of SARFAESI Act will override all such laws, for the time being in force, having inconsistencies with this Act.

**iii.** Yes. If the lender decides not to relinquish the security interest on the property at the time of winding up of the borrower company, the lender will be able to retain the proceeds recovered from the enforcement proceedings after depositing the workmen dues with the liquidator in terms of second proviso to section 13(9) of the SARFAESI Act.

**iv.** In a criminal proceeding the suit is launched by the state against the defendant whereas the SARFAESI Act empower the secured lenders to enforce security interests by non-judicial means, the proceedings of the two are completely different from each other. Therefore, there is no bar in pursuing both simultaneously.

**5. What is Money Laundering? What steps have been taken by the Government of India to tackle the menace of Money Laundering?**

**Answer:**

The goal of a large number of criminal activities is to generate profit for an individual or a group. Money laundering is the processing of these criminal proceeds to disguise their illegal origin.

Illegal arms sales, smuggling, and other organised crime, including drug trafficking and prostitution rings, can generate huge amount of money. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to "legitimise" the ill-gotten gains through money laundering. The money so generated is tainted and is in the nature of `dirty money'. Money Laundering is the process of conversion of such proceeds of crime, the `dirty money', to make it appear Legitimate Money.

<u>Steps taken by Indian Government to tackle the menace of Money Laundering are:</u>
Government of India is committed to tackle the menace of Money Laundering and has always been part of the global efforts in this direction. India is signatory to the following UN Conventions, which deal with Anti Money Laundering / Countering the Financing of Terrorism:

1. International Convention for the Suppression of the Financing of Terrorism (1999)
2. UN Convention against Transnational Organized Crime (2000)
3. UN Convention against Corruption (2003)

In pursuance to the political Declaration adopted by the special session of the United Nations General Assembly (UNGASS) held on 8 to 10 June 1998 (of which India is one of the signatories) calling upon member states to adopt Anti Money Laundering Legislation & Programme, the Parliament has enacted a special law called the `Prevention of Money Laundering Act, 2002' (PMLA 2002). This Act has been substantially amended, by way of enlarging its scope, in 2009 (w.e.f. 1.6.2009), by enactment of Prevention of Money Laundering (Amendment) Act, 2009.

**6. Write Short Notes on:**

**i) Powers available to the Investigating Officers under the Prevention of Money Laundering Act**

**Answer: (i)**
The Investigating Officers have the powers :-
(a) To conduct survey of a place (Section 16)

(b) To conduct search of building, place, vessel, vehicle or aircraft & seize records & property (Section 17)
(c) To conduct personal search (Section 18)
(d) To summon and record the statements of persons concerned (Sec. 50);
(e) To arrest persons accused of committing the offence of Money Laundering (Section 19).
(f) To provisionally attach any property suspected to be derived from the proceeds of crime (Section 5)

**ii) 'scheduled offence' under the Prevention of Money Laundering Act**

**Answer (ii)**

The offences listed in the Schedule to the Prevention of Money Laundering Act, 2002 are scheduled offences in terms of Section 2(1)(y) of the Act. With the amendment of the Act in 2009, a large number of offences have been included in the Schedule of the Act. The scheduled offences are divided into three parts – Part A, Part B, & Part C.

In Part A, certain serious offences such as those connected with waging war against the Nation, circulation of Fake Indian Currency Notes, offences relating to Narcotic Drugs, etc. have been included, wherein no monetary limit for initiating action under PMLA has been prescribed.

In relation to offences under Part 'B' of the schedule, the value involved should be ₹ 30 Lakhs or More.

Part `C' of the Schedule deals with trans-border crimes, and is a vital step in tackling Money Laundering across international boundaries.

**iii) Rights of persons being searched during search under Prevention of Money Laundering Act.**

**Answer (iii)**

The rights of persons being searched during search Prevention of Money Laundering Act are as follows:

(i) Where an authority is about to search any person, he shall, if such person so requires, take such person within twenty-four hours to the nearest Gazetted Officer, superior in rank to him, or a Magistrate.
(ii) If the requisition is made, the author-ity shall not detain the person for more than twenty-four hours prior to taking him before the Gazetted Officer, superior in rank to him, or the Magistrate referred to in that sub-section.
(iii) The Gazetted Officer or the Magistrate before whom any such person is brought shall, if he sees no reasonable ground for search, forthwith discharge such person but otherwise shall direct that search be made.
(iv) Search shall be made in the presence of two or more persons.
(v) No female shall be searched by anyone except a female. (Section 18)

# Study Note – 6

# Laws Related to Insurance Sector

## Section – A

**Fill in the blanks:**

1. **Multiple choice questions**
   (i) **The amount credited to The Insurance Regulatory and Development Authority Fund shall consist of :**
      a. **all Government grants, fees and charges received by the Authority;**
      b. **all sums received by the Authority from such other source as may be decided upon by the Central Government;**
      c. **the percentage of prescribed premium income received from the insurer;**
      d. **all of the above**
   (ii) **IRDA shall, within _____________ after the close of each financial year, submit to the Central Government a report giving a true and full account of its activities including the activities for promotion and development of the insurance business during the previous financial year.**
      a. **nine months**
      b. **three months**
      c. **one month**
      d. **six months**
   (iii) **The headquarter of IRDA is located in the city of ___________**
      a. **New Delhi**
      b. **Hyderabad**
      c. **Telangana**
      d. **Mumbai**
   (iv) **The principle of _____________ ensures that an insured does not profit by insuring with multiple insurers.**
      a. **Subrogation**
      b. **Contribution**
      c. **Co-insurance**
      d. **Indemnity**
   (v) **An actuary is expected to:**
      a. **Make an exact forecast of the future liabilities of policies**
      b. **Make a reasonable forecast of the future liabilities of policies**
      c. **Calculate the premium required to cover a risk on a long-term basis**
      d. **Find the probability of an insured event to happen in non-life policies**

**Answers:**

| Question No. | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Answer: | d | a | c | b | b |

## Section – B

**Answer the following questions:**

**2. a) Explain the provisions of the Insurance Act, 1948 related to the requirement of capital of insurance companies.**

**b) Explain the principle of insurable interest.**

**Answer:**

**2. a)** According to Section 6 (1) of the Insurance Act, 1948 no insurer not being an insurer as defined in sub-clause (d) of clause (9) of section 2, carrying on the business of life insurance, general insurance, health insurance or re-insurance in India or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be registered unless he has,—

(i) a paid-up equity capital of rupees one hundred crore, in case of a person carrying on the business of life insurance or general insurance; or

(ii) a paid-up equity capital of rupees one hundred crore, in case of a person carrying on exclusively the business of health insurance; or

(iii) a paid-up equity capital of rupees two hundred crore, in case of a person carrying on exclusively the business as a re-insurer:

Provided that the insurer, may enhance the paid-up equity capital, as provided in this section in accordance with the provisions of the Companies Act, 2013, the Securities and Exchange Board of India Act, 1992 and the rules, regulations or directions issued thereunder or any other law for the time being in force:

Provided further that in determining the paid-up equity capital, any preliminary expenses incurred in the formation and registration of any insurer as may be specified by the regulations made under this Act, shall be excluded.

Section 6 (2) of the Act also specifies that no insurer, as defined in sub-clause (d) of clause (9) of section 2, shall be registered unless he has net owned funds of not less than rupees five thousand crore."

**b)** The principle of insurable interest states that the person getting insured must have insurable interest in the object of insurance. A person has an insurable interest when the physical existence of the insured object gives him some gain but its non-existence will give him a loss. In simple words, the insured person must suffer some financial loss by the damage of the insured object.

**For example:** The owner of a taxicab has insurable interest in the taxicab because he is getting income from it. But, if he sells it, he will not have an insurable interest left in that taxicab. From this example, we can conclude that, ownership plays a very crucial role in evaluating insurable interest. Every person has an insurable interest in his own life. A merchant has insurable interest in his business of trading. Similarly, a creditor has insurable interest in his debtor.

**3. a) State the powers and functions of IRDA.**

**Answer:**

**3. a)** Under Section 14 of the IRDA Act, IRDA the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include, -

(a) Issue of Certificate of Registration to insurance companies, renew, modify, withdraw, suspend or cancel the certificate of registration
(b) Protection of interests of policyholders in matters concerning assignment of policies, nomination, insurable interest, claim settlement, surrender value and other terms and conditions of insurance contract
(c) Specification of requisite qualifications, practical training and code of conduct for insurance agents and intermediaries
(d) Specification of code of conduct for surveyors and loss assessors
(e) Promoting efficiency in the conduct of insurance business
(f) Promoting and regulating professional organizations connected with insurance and reinsurance business
(g) Levying fees and other charges for carrying out the purposes of the Act
(h) Calling for information from or undertaking inspection of insurance companies, intermediaries and other oganisations connected with insurance business
(i) Control and regulation of rates, advantages, terms and conditions that may be offered by general insurance companies
(j) Specifying the form and manner in which books of account shall be maintained by insurance companies and intermediaries
(k) Regulation of investments of funds by insurance companies
(l) Regulation of maintenance of margin of solvency
(m) Adjudication of disputes between insurers and insurance intermediaries
(n) Supervising the functioning of Tariff Advisory Committee
(o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations
(p) Specifying the percentage of insurance business to be undertaken by insurers in rural or social sectors
(q) Such other powers as may be prescribed

**4. a) Highlight the provisions of the IRDA Act relating to maintenance of accounts by IRDA and auditing of the same.**

**b) State the prohibitions on the Insurance companies in granting loans or advances.**

**Answer:**

**4. a)** As per Section 17 of the IRDA Act, the following are the provisions relating to maintenance of accounts by IRDA and auditing of the same:

(1) IRDA shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.

(2) The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.

(3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Authority shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books of account, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.

(4) The accounts of the Authority as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit-report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

**4. b)** According to Section 29 of the Insurance Act, 1938 the prohibitions on the Insurance companies in granting loans or advances are:

(1) No insurer shall grant loans or temporary advances either on hypothecation of property or on personal security or otherwise, except loans on life insurance policies issued by him within their surrender value, to any director, manager, actuary, auditor or officer of the insurer, if a company or to any other company or firm in which any such director, manager, actuary or officer holds the position of a director, manager, actuary, officer or partner: Provided that nothing contained in this sub-section shall apply to such loans, made by an insurer to a banking company, as may be specified by the Authority: Provided further that nothing in this section shall prohibit a company from granting such loans or advances to a subsidiary company or to any other company of which the company granting the loan or advance is a subsidiary company if the previous approval of the Authority is obtained for such loan or advance.

(2) The provisions of section 185 of the Companies Act, 2013 shall not apply to a loan granted to a director of an insurer being a company, if the loan is one granted on the security of a policy on which the insurer bears the risk and the policy was issued to the director on his own life, and the loan is within the surrender value of the policy.

(3) Subject to the provisions of sub-section (1), no insurer shall grant—

(a) any loans or temporary advances either on hypothecation of property or on personal security or otherwise, except such loans as may be specified by the regulations including the loans sanctioned as part of their salary package to the full-time employees of the insurer as per the scheme duly approved by its Board of Directors;

(b) temporary advances to any insurance agent to facilitate the carrying out of his functions as such except in cases where such advances do not exceed in the aggregate the renewal commission earned by him during the immediately preceding year.

(4) Where any event occurs giving rise to circumstances, the existence of which at the time of grant of any subsisting loan or advance would have made such grant a contravention of this section, such loan or advance shall, notwithstanding anything in any contract to the contrary, be repaid within three months from the occurrence of such event.

(5) In case of default in complying with the provisions of sub-section (4), the director, manager, auditor, actuary, officer or insurance agent concerned shall, without prejudice to any other penalty which he may incur, cease to hold office under, or to act for, the insurer granting the loan on the expiry of three months."

**5. Write Short Notes on:**

**(i) Insurance Advisory Committee**

**(ii) Principle of Uberrimae fidei**

**(iii) Constitution of Insurance Regulatory and Development Authority**

**(iv) Principle of Causa Proxima**

**Answer:**

**5. i)** IRDA may, establish a Committee to be known as the Insurance Advisory Committee which shall consist of not more than twenty-five members excluding ex-officio members to represent the interests of commerce, industry, transport, agriculture, surveyors, agents, intermediaries, organisations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector. The Chairperson and the members of the Authority shall be the ex officio Chairperson and ex officio members of the Insurance Advisory Committee. The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to the making of the regulations.

**ii)** **Principle of Uberrimae fidei** (a Latin phrase), or in simple English words, the Principle of Utmost Good Faith, is a very basic and first primary principle of insurance. According to this principle, the insurance contract must be signed by both parties (i.e. insurer and insured) in an absolute good faith or belief or trust. The person getting insured must willingly disclose and surrender to the insurer his complete true information regarding the subject matter of insurance. The insurer's liability gets void (i.e. legally revoked or cancelled) if any facts, about the subject matter of insurance are either omitted, hidden, falsified or presented in a wrong manner by the insured. The principle of Uberrimae fidei applies to all types of insurance contracts.

**iii)** **The Insurance Regulatory and Development Authority Act** has established the Insurance Regulatory and Development Authority ("IRDA" or "Authority") as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies. The members of the IRDA are appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration etc. The Authority consists of a chairperson, not more than five whole-time members and not more than four part-time members.

The Chairperson and every other whole-time member of IRDA appointed shall hold office for a term of five years years from the date on which he enters upon his office and shall be eligible for reappointment. However, Chairperson shall not hold office after he or she attains the age of 65 years while whole time members shall not hold after he or she attains the age of 62 years. A part-time member shall hold office for a term not exceeding five years from the date on which he enters upon his office.

Central Government may remove any member from office if he or she is adjudged insolvent or is physically or mentally incapacitated or has been convicted of an offence involving moral turpitude or has acquired financial or other interests or has abused his position. Chairperson and the whole time members shall not for a period of two years from the date of cessation of office in IRDA, hold office as an employee with Central Government or any State Government or with any company in the insurance sector.

**iv)** **Principle of Causa Proxima** (a Latin phrase), or in simple English words, the Principle of Proximate (i.e. Nearest) Cause, means when a loss is caused by more than one causes, the proximate or the nearest or the closest cause should be taken into consideration to decide the liability of the insurer. The principle states that to find out whether the insurer is liable for the loss or not, the proximate (closest) and not the remote (farthest) must be looked into.

**For example:** A cargo ship's base was punctured due to rats and so sea water entered and cargo was damaged. Here there are two causes for the damage of the cargo ship - (i) The cargo ship getting punctured because of rats, and (ii) The sea water entering ship through puncture. The risk of sea water is insured but the first cause is not. The nearest cause of damage is sea water which is insured and therefore the insurer must pay the compensation.

However, in case of life insurance, the principle of Causa Proxima does not apply. Whatever may be the reason of death (whether a natural death or an unnatural death) the insurer is liable to pay the amount of insurance.

# Study Note – 7

# Corporate Governance

## Section – A

**Answer all questions mentioned below. Make the correct answer with proper justification.**

1. **Mr. B. Krishna, the CEO and Promoter of Alpha Ltd had decided to keep the size of the board 12 which will be chaired by his brother-in-law Mr. N. Srinivasan who is also happened to be the President-Sales. What should be the minimum number of outside independent director to be appointed in the board?**
   a. 3,
   b. 4,
   c. 6,
   d. 12

2. **The size of the Audit Committee of Gama Ltd is 6 out of which 3 are Independent Directors. What should be the quorum for a meeting of the committee?**
   a. 1,
   b. 2,
   c. 3,
   d. 6.

3. **Which Corporate Governance model proposes dual board structure with representation from financial institutions?**
   a. Anglo-Saxon Model
   b. German Model
   c. Japanese Model
   d. Indian Model

4. **As per Clause 49 of listing rules formation of which board committees are mandatory and recommendatory respectively?**
   a. Audit Committee,
   b. Nomination and Remuneration Committee,
   c. Stakeholder Relationship Committee,
   d. Corporate Social Responsibility Committee

5. **Which Corporate Governance model proposes dual board structure with representation from labour union?**
   a. Anglo-Saxon Model
   b. German Model
   c. Japanese Model
   d. Indian Model

6. **What is the range of directorship for private companies operating in India as per Companies Act, 2013?**
   a. 2 to 15
   b. 3 to 12
   c. 3 to 15
   d. 1 to 15

7. **Which Corporate Governance model proposes unitary board structure?**
   a. Anglo-Saxon Model
   b. German Model
   c. Japanese Model
   d. Indian Model

8. **In order to ensure the representation of minority shareholders in the Company which revolutionary step has been undertaken in the Companies Act, 2013?**
   a. Resident Directorship,
   b. Proxy Voting,
   c. Small Shareholders Directorship,
   d. Minority Directorship.

9. **Which board committee is responsible to appraise directors' performance annually**
   a. Audit Committee,
   b. Nomination and Remuneration Committee,
   c. Stakeholder Relationship Committee,
   d. Corporate Social Responsibility Committee

10. **What is the range of directorship for public companies operating in India as per Companies Act, 2013?**
    a. 2 to 15
    b. 3 to 12
    c. 3 to 15
    d. 1 to 15

11. **As per Companies Act, 2013 Public Companies having paid up share capital of 10crore rupees or more or turnover of 100crore rupees or more or aggregate outstanding loans, debentures and deposits, exceeding 50crore rupees must have at least ---------------Directors.**
    a. 1,
    b. 2,
    c. 3,
    d. 4.

12. **According to Sec 149(11)of Companies Act, 2013 no independent director should hold office for more than-------- consecutive terms with a cooling off period of ------years.**
    a. Two and two
    b. Two and three
    c. Two and four
    d. Two and five

13. According to Sec 165 (1)of Companies Act, 2013 , no person, after the commencement of this Act, shall hold office as a director, including any alternate directorship, in more than -------- companies at same time provided that the maximum number of public companies in which a person can be appointed as a directors shall not exceed ----------.
    a. 15 and 10
    b. 20 and 10
    c. 20 and 10
    d. 20 and 15

14. The historical provisions of promoting 'Gender Diversity' in board for the first time in Indian corporate structure falls under the ambit of-
    a. Sec 135
    b. Sec 145 (1)
    c. Sec 149 (1)
    d. Sec 148

15. XYZ Ltd was incorporated on 1st April 2018. As per Sec 173(1) what should be the maximum time limit by which the first board meeting should be convened?
    a. 30th April, 2018
    b. 31st May, 2018
    c. 30th June, 2018
    d. 30th September, 2018

16. Which theory assumes that owner can drive the business in his best interest if he self-manages the concern? Otherwise, the manager though is supposed to maximize the shareholders' wealth, may not intend to give their maximized effort for maximizing shareholders' value. Rather they may work to attain a distinct personal goodwill and reputation in the market at the cost of the shareholders.
    a. Agency Theory
    b. Stakeholder Theory
    c. Stewardship Theory
    d. Managerial Hegemony Theory

17. Foundation of which theory of corporate governance rests on the idea that the corporate policies that generate the most wealth for shareholders may not be policies that generate greatest total social wealth?
    a. Agency Theory
    b. Stakeholder Theory
    c. Stewardship Theory
    d. Managerial Hegemony Theory

Answer:

| Question No. | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Answer | c | c | c | b | b | a | a | c | b | c | b | b | b | c | a | a | b |

## Group-B

1. **(a) Give a brief account of the evolution of Corporate Governance Reforms in India.**

   **(b) Write a short note on OECD Principles of Corporate Governance.**

**Answer:**

(a) At the time of Independence India bears the legacy of British-derived convention of corporate governance based on the Anglo- Saxon Model. However, from 1947 through 1991, the Indian government pursued mixed economic policies when the state nationalized banks primarily became the principal provider of both debt and equity capital for private firms, the Public Sector Undertakings were evaluated based on the amount of capital invested rather than on their return on investment, competition, especially the foreign competition, was suppressed. In that time period a little emphasis on corporate governance mechanisms was given in India. Public listed companies in India were only required to comply with limited governance and disclosure standards enumerated in the Companies Act of 1956, the Listing Norms, and the accounting standards set forth by the Institute of Chartered Accountants of India (ICAI). Faced with a fiscal crisis in 1991, the Indian Government responded by enacting a series of reforms aimed at general economic liberalization, privatization and globalization (LPG) movements. The Securities and Exchange Board of India (SEBI) -- India's securities market regulator – was formed in 1992 and by the mid-1990s, the Indian economy was growing steadily, and Indian firms began to seek equity capital especially from abroad to finance expansion into the market spaces created by LPG movement. Ever since its financial liberalization began in 1991, India has undergone significant Corporate Governance reforms. The need for capital especially that of coveted Foreign Institutional Investments (FIIs) amongst other things, led to Corporate Governance reform and many major Corporate Governance initiatives have been launched in India since the mid-1990s; most of these initiatives were focused on improving the governance climate in corporate India which was far from satisfactory and truly an international standards. A glimpse of such Corporate Governance initiatives taken in India is presented here-

(a) **Confederation of Indian Industry (CII)Desirable Corporate Governance: A Code, 1998**
The first major initiative was taken by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. More than a year before the onset of the East Asian crisis, CII had set up a committee under the able leadership of Sri Rahul Bajaj to examine corporate governance issues, and recommend a voluntary code of best practices. Drawing heavily from the Anglo-Saxon Model of Corporate Governance, CII drew up a voluntary Corporate Governance Code. The first draft of the code was prepared by April 1997, and the final document, Desirable Corporate Governance: A Code, was publicly released in April 1998. The code was voluntary, contained detailed provisions, and focused on listed companies. However, the CII Code's voluntary nature did not result in a broad overhaul of governance norms and practices by Indian companies. Although the CII Code was welcomed with much fanfare and even adopted by a few progressive companies, it was felt that under Indian conditions a statutory rather than a voluntary code would be far more purposive and meaningful. Consequently, the second major corporate governance initiative in the country was undertaken by SEBI.

(b) **Clause 49 of the Listing Agreement of SEBI evolved from the Recommendation of Kumar Manglam Birla Committee, 1999**

In early 1999, SEBI had set up a committee under Kumar Mangalam Birla to promote and raise the standards of good corporate governance. The Birla Committee specifically placed an emphasis on independent directors in discussing board recommendations and made specific recommendations regarding board representation and independence. The Committee also recognized the importance of audit committees and made many specific recommendations regarding the function and constitution of board audit committees. Furthermore, the Committee made several recommendations regarding disclosure and transparency issues, in particular with respect to information to be provided to shareholders. Among other recommendations, the Birla Committee stated that a company's annual report to shareholders should contain a Management Discussion and Analysis (MD&A) section, modelled after annual reports issued by companies in the United States, and that companies should transmit certain information, such as quarterly reports and analyst presentations, to shareholders. Furthermore, with respect to shareholder complaints, the Committee recommended that a board committee known as the Investors Grievance Committee, chaired by a nonexecutive director, be formed to address grievances. In early 2000, the SEBI board had accepted and ratified key recommendations of this committee, and these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges which is mandatory for almost every listed firm to comply with and report in proper way.

(c) **Committee on Corporate Audit & Governance (Naresh Chandra Committee ) ,2002**

The Naresh Chandra committee was appointed in August 2002 by the Department of Company Affairs (DCA) under the Ministry of Finance and Company Affairs to examine various corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in two key aspects of corporate governance: financial and non-financial disclosures and independent auditing and board oversight of management and made a series of recommendations regarding, among other matters, the grounds for disqualifying auditors from assignments, the type of non-audit services that auditors should be prohibited from performing, and the need for compulsory rotation of audit partners.

(d) **Narayana Murthy Committee on Corporate Governance, 2003**

The fourth initiative on corporate governance in India is in the form of the recommendations of the Narayana Murthy committee. The committee was set up by SEBI, under the chairmanship of Mr. N. R. Narayana Murthy, to review Clause 49, and suggest measures to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosures. The Murthy Committee, like the Birla Committee, described the international developments as a factor that motivated reform and stated that recent failures of corporate governance, particularly in the United States, combined with the observations of India's stock exchanges that compliance with Clause 49 up to that point had been uneven, recommended further reform. The Murthy Committee examined a range of corporate governance issues relating to corporate boards and audit committees, as well as disclosure to shareholders. The Murthy Committee focused heavily on the role and structure of corporate boards and strengthened the director independence definition in the then-existing Clause 49, particularly to address the role of insiders on Indian boards like the director cannot be related to promoters or management at the board level, or one below the board; an executive of the company in the preceding three years; be a supplier, service provider, or customer of the company; or a shareholder owning two percent or more of the company. The Murthy Committee also recommended that nominee directors (i.e., directors nominated by financial institutions particularly, with relationships with the company) be excluded from the definition of independent director, and be subject to the same responsibilities and liabilities applicable to any other director. In order to improve the function of boards, the Murthy Committee recommended that they should also receive training in the company's business model and quarterly reports on business risk and risk management strategies. The Murthy Committee also paid particular attention to the role and responsibilities of audit committees. It recommended that audit committees be composed of "financially literate" members, with at least one member having accounting or related financial management expertise. It provided a greater role for the audit committee as well. For example, the Murthy Committee recommendations promoted disclosure and approval of related party transactions by the audit committee. In addition, the committee stated that whistle-blowers must have access to the audit committee without first having to inform their supervisors, and that companies should annually affirm that they have not denied access to the audit committee or unfairly treated whistle-blowers generally. SEBI had initiated certain changes in Listing Agreement in line with the Murthy Report covering the areas of governance requirements with respect to corporate boards, audit committees, shareholder disclosure and CEO/CFO certification of internal controls which led transformation of the governance and disclosure standards of Indian public companies.

(e) **J.J. Irani Committee on Company Law, 2004**

India's corporate governance reform efforts did not cease after adoption of Clause 49. In parallel, the review and redrafting of the Companies Act, 1956 was taken up by the Ministry of Corporate Affairs (MCA) on the basis of a detailed consultative process and the Government constituted an Expert Committee on Company Law under the Chairmanship of Dr. J.J. Irani on 2nd December 2004 to advise on new Companies Bill. There were significant differences between the proposals contained in the Irani report and the requirements of Clause 49, particularly with respect to the board of directors. First, the requirements for independent directors were different in several respects. Clause 49 required that no independent director should have been an executive of the company in the preceding three financial years, while the Irani Committee's recommendations weaken that requirement so that independent directors, along with their relatives, should not have been an employee of the company in any capacity only in the past single year. Similarly, while clause 49 prohibited an independent director from having served in any executive capacity in a statutory or internal auditing firm that has a material association with the company for the past three years, the Irani report recommended the same requirement for a period of one year only for independent directors and their relatives. The Irani Committee also recommended that a third of company directors be independent.

**Corporate Governance Reform in Post Satyam Saga: Biggest Corporate Scam in India**

In the meanwhile in January 2009, the Indian corporate community was rocked by a massive accounting scandal involving Satyam Computer Services (Satyam), one of India's largest information technology companies. The Satyam scandal prompted quick action by the Indian government, including the arrest of several Satyam insiders and auditors, investigations by the MCA and SEBI, and substitution of the company's directors with government nominees.

Satyam's failures were many and systemic—from a weak auditing process to ineffective board oversight to a leader intent on committing fraud.

Similar to their role in the first phase of corporate governance reforms, in the post-Satyam period, Indian corporate groups have once again advocated for reconsideration of India's corporate governance rules and advocated for reforms. Shortly after news of the scandal broke, the CII began examining the corporate governance issues arising out of the Satyam scandal and in late 2009, the CII Task Force put out recommendations on corporate governance reform. In addition to the CII, a number of other corporate groups have joined the corporate governance dialogue. The National Association of Software and Services Companies (NASSCOM) also formed a Corporate Governance and Ethics Committee chaired by Mr. N. R. Narayana Murthy, one of the founders of Infosys and a leading figure in Indian corporate governance reforms. The Committee issued its recommendations in mid-2010, focusing on stakeholders in the company. The report emphasized recommendations relating to the audit committee and a whistleblower policy. The report also addressed improving shareholder rights. Additionally, the Institute of Company Secretaries of India (ICSI) has also put forth a series of corporate governance recommendations. In 2009, SEBI made several announcements regarding disclosure and accounting reforms that could result in changes to the Listing Agreement and in September 2009, the SEBI Committee on Disclosure and Accounting Standards published a discussion paper seeking public comment on several governance issues for reviewing Clause 49 of Listing Rules. Later the Clause 49 of Listing Agreement of SEBI was revised thoroughly in light of provisions of new Companies Act, 2013.

**The Companies Act 2013 - Key Initiatives**

The passing of the long awaited Companies Act in 2013 is probably the single most important development in India's history of corporate legislation. While significant improvements have been effected in required standards of corporate governance, there is also some concern regarding overly increasing compliance and regulatory costs and efforts for companies as well as their independent directors. Among the major provisions of the Act are those of restraining voting rights of interested shareholders on related party transactions, recognition of board accountability to stakeholders besides shareholders, and extension of several good governance requirements to relatively large unlisted corporations.

These initiatives are discussed under five thematic categories, those relating to:
(a) corporations and society.
(b) absentee shareholder primacy and protection.
(c) boards and their processes.
(d) disclosure and transparency in reporting, and
(e) unlisted company governance.

(b) **OECD Principles of Corporate Governance:-**

(a) In response to a call by its council, the OECD issued the OECD Principles of Corporate Governance in1999 after extensive consultations. These were later revised in 2004 following a comprehensive survey of corporate governance practices in and outside the OECD area. Since their launch, the principles have formed the basis for corporate governance initiatives in both OECD and non-OECD countries alike. They represent the minimum standard that countries with different traditions have agreed on, being applicable to countries with a civil and common law tradition without being unduly prescriptive.

The principles have been devised with four fundamental concepts in mind: responsibility, accountability, fairness and transparency and enabling diversity of rules and regulations. They outline the following:
(1) the basis for an effective corporate governance framework.
(2) the rights of shareholders.
(3) equitable treatment of shareholders.
(4) the role of stakeholders in corporate governance.
(5) disclosure and transparency, and
(6) the responsibilities of the board.

(b) The 2004 revisions covered four main areas:
(1) a new set of principles on the development of regulatory framework to underpin corporate governance mechanisms for implementation and enforcements.
(2) additional principles to strengthen the exercise of informed ownership by shareholders that call on institutional investors to disclose their corporate governance policies and to strengthen the rights of shareholders when choosing Board members.
(3) strengthened principles to reinforce Board oversight and enhance Board members' independent judgment, and
(4) new and strengthened principles to contain conflicts of interest through enhanced disclosure and transparency (for example, on related party transactions), thus making auditors more accountable to shareholders and promoting auditors' independence.

**2. (a) Elucidate the contribution of the Companies Act 2013 towards promoting the contributions of corporations to the society.**

**(b) How the issue of independence in Board was introduced first time in Corporate legislature in India by the Companies Act, 2013?**

**Answer:**

2. (a) Corporate Social Responsibility

The positioning of the business corporation in the larger frame of society has been a subject of contentious debate for decades with views ranging from total denial of any corporate responsibility to society as long as operating under prescribed law through to overriding accountability to society on pain of losing the sanction and license to operate, with several shades of mix in between. It is fair to observe, though, that in recent decades, there have been signs of a measure of corporate recognition of some responsibility towards society, as evidenced by increasing number of corporations reporting on their sustainability Initiatives. The acceptance of social responsibility is arguably embedded in the Indian business psyche although modern day competitive commercialism may have whittled it down in numerous instances; this inherent conviction is reflected in a large number of business people voluntarily engaging in some form of social response based on their perceptions and convictions, even while aggressively pursuing profit objectives and personal gain.

In the arena of government intervention in this domain, virtually every country around the world has a record of activism in varying degrees: this manifests itself in public interest legislation, gentle prodding through guidance for voluntary adoption, or specific mandatory directions imposing an obligation to socially respond as equivalent to taxing business. India has an impressive history of measures in the first two categories and with the 2013 initiatives has also moved towards the third, perhaps the first country to legislate prescriptive social responsibility on corporations.

The Act now requires every company having at least a net worth of INR 500 Crores or sales revenue of INR 1,000 Crores, or a net profit of INR5 Crores during any year to do the following:

(1) Spend in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, on CSR activities.
(2) Give preference in spending to the local area and areas around it where it operates.
(3) In case of failure achieve the spend target, the Board shall, in its annual report to shareholders, explain the reasons why the required obligation to spend was not met.
(4) The board shall appoint a Corporate Social Responsibility Committee of three or more directors, at least one of them being independent; the Committee, its composition having to be reported in the directors' report to shareholders, is required to:
    a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company.
    b) recommend the amount of expenditure to be incurred on the activities, and
    c) monitor the Corporate Social Responsibility Policy of the company from time to time.

(b) **On Enhancing Board Independence and Objectivity**

Ideally, board independence cumulatively should be more than the sum of its constituent parts, building on the synergies of individual members' independence and objectivity. Group inter action dynamics and mutual complementarities generally help in achieving this result which defies arithmetical logic, several components in the Initiatives potentially offer help in achieving this very desirable objective. For example:

(1) The Act requires listed companies to have at least a third of their board members qualifying as independent Section 149(6) of the Companies Act, 2013. Inclusion of this requirement in the statute enables wider applicability to larger unlisted companies as well. In case of listed companies, the regulatory requirements are even more rigorous and require a minimum of one half of the board to qualify as independent:

a) where the board chair and CEO positions are combined in one individual; and,
b) even where they are separated, if the non-executive chair happens to be the promoter or his/her relative, or a person related to another person occupying management positions at the board level or one level below:

(2) The provision to have at least one woman director on board Section 149(1) of the Companies Act, 2013 is a welcome initiative in the interests of board diversity, which should have been addressed by companies even without legislation because of not only its equitable claims but more importantly since such diversity enriches board capacity and leads potentially to better decisions.

(3) The Act visualises a term-based appointment of independent directors for a period of five years, renewable (by special resolution) for a similar second term, and not subject to retirement by rotation. This certainty of a reasonably long period in office should provide a measure of stability and continuity to this component of the board which can possibly pursue its agenda more consistently and effectively. Listed companies face stricter conditions: Independent directors who have already served for five years or more (as of October 2014) may now serve for only one more term of up to five years after the expiry of the current term. Although this is a transitional measure, the regulator's urgency in getting higher governance standards in place at the earliest is clearly evident.

(4) An innovative concept has been introduced in the Act to ensure the 'independence' of persons who wish to be re-appointed as such after serving two five year terms. They can be so appointed but only after a 'cool-off' period of three years and, this is important, during the three year break, the independent director 'shall not be appointed in or be associated with the company in any other capacity, either directly or indirectly.' One can only speculate as to why the applicability of this ban was limited to only the 'company' and not to others in the cluster such as 'its holding, subsidiary or associate company, or promoters' and so on as has been specified in so many other sections. If erosion of independence is considered to be a function of proximity and familiarity, as appears to be the case in drafting other sections on independence, it would have been consistent if the same phraseology had been used here as well. Perhaps, this would be covered under the 'directly or indirectly' caveat; maybe, the person would be disqualified anyway under the independence criteria Section 149 (6) (c), (which holds only for two years and not three) of the Companies Act, 2013.

(5) The Act settles the vexed issue of the independence status of nominee directors on company boards appointed by financial institutions, government and such other bodies. They will not be deemed independent. With this "grey" element of independence now firmly out of the way, the other independent directors could enhance their effectiveness without any inhibition that may have been occasioned by the presence of their nominee colleagues and their influence onboard issues.

(6) Executive compensation is an issue that corporate boards around the world are grappling with and the Act appropriately mandates a Nomination and Remuneration Committee (NRC) in all listed companies and other prescribed companies Section 178 of the Companies Act, 2013. By requiring

at least one half of the NRC membership to be independent directors, the board is now equipped to play a more active and objective role in determination of CEO and other executive directors' pay and perquisites. Unlike before, boards and in particular their independent directors are in a position to influence these pay packages in the best interests of their companies, without being hamstrung by the debilitating realisation that the promoters will be able to get their way in any case at the members' meeting by virtue of their superior voting strength. With the promoter-CEOs and directors as interested parties restrained from voting on such proposals at shareholders' meetings, it is up to the independent directors to decide on such pay proposals as they feel appropriate and recommend to the other shareholders for their super-majority approval. If conscientiously applied in practice, boards would seem to have been unshackled from any real or imaginary inhibitions to their effectiveness in this matter and provided with an opportunity to display their objective assessment and act in the best interests of the company.

(7) Nomination and Remuneration Committees of listed and other large public companies are required to evolve and disclose their remuneration policies in respect of directors, key management personnel and other employees. Listed companies are required to disclose comprehensive details of remuneration including the break-up between fixed and variable pay, stock options, pension etc. Criteria of compensation to non-executive directors are also required to be published in the Annual Report of the companies. How such statutory and regulatory disclosures measure up to comparable requirements in developed markets like the US can be meaningfully assessed possibly after the first set of such reports by companies become available in mid-to-late 2015.

(8) The company and independent directors are required to "abide by the provisions specified in Schedule IV" of the Act, which provides a detailed Code for independent directors. This incorporates fundamental legal, ethical and procedural principles and best practices that will be of help to directors in their role as trustees and stewards for the company and its shareholders. Many companies provide their own customised Induction Kit to their newly appointed directors; it will be a good refresher to the more experienced directors as well if they are also provided updated versions, preferably with changes highlighted so that everyone on the board is up to speed on what is expected of them both by statute and regulation, and the company and its values.

(9) On the flip side of all these improvements to promote the importance and contribution of independent directors, some would argue the Act has overreached itself in making the institution of independent directors very difficult for the directors to do justice to. By definition, independent directors can only be part time contributors, counsellors and controllers. By and large, they are dependent upon executive management for most of their information inputs. While their trusteeship obligations to the company and its shareholders have long been recognised and established in terms of the broad duties of care and loyalty, their interpretation in many jurisdictions have always been principle-based and not bogged down by any set of inflexible rules. Some of the provisions of the Act tend to tilt the balance towards the latter structured format of do's and don'ts which may hinder rather than help independent directors efficient functioning.

Together with some of the provisions already in place and continued in the Act, the doors to more effective board performance appear to have been thrown open to a large extent. It is upto the boards and their directors to capitalise on this long-awaited opportunity and take their companies' governance to higher standards. And equally, it would be in the long term interest of the promoters and managements to buy into these improvements and enhance the reputational and hence the market value of their companies.

**3. Write Short Notes on the following-**

**(a) Duality in Board Chairmanship and position of CEO,**

**(b) Gender Diversity in Board,**

**(c) Stakeholder Relationship Committee,**

**(d) Remuneration & Nomination Committee,**

**(e) Independence of Auditors,**

**Answer:**

**(a) Board Chair – CEO Duality**

In the context of the different roles and requirements of the two positions of board chair (monitoring)and chief executive (execution), best practice standards stipulate their separation. Notwithstanding the strong advocacy of this separation, the US predominantly continues to combine these two roles(with an independent senior or lead director in place as a compromise), although a glacial movement towards separation is noticeable in recent years. Indian regulation has not so far mandated such a requirement for listed companies though many companies have found it attractive to separate if only to qualify for a lower proportion of independent directors on their boards.

The Initiatives, for the first time, prescribe such separation in future in case of all listed and other large public companies. There is no mention however as to whether the board chair has to qualify as an independent director as well. Rather than including this requirement as part of the sections dealing with boards, directors, committees, and meetings, this separation provision is included as part of the sections dealing with Key Managerial Personnel.

There are exceptions provided for as well: this mandate will not apply if the company's Articles provide otherwise; it will not apply if the company operates several lines of business, each with its own chief executive. This latter exemption is presumably based on the distancing theory: as the respective CEOs of the businesses will be in charge of execution, the managing director will be distanced from operational responsibilities and assume an intermediary monitoring role which may not be wholly incompatible with the oversight role of the board chair. Clearly, this view is debatable: what indeed then is the role of such a managing director if he or she is not personally accountable to the board for the company's (as opposed to each constituent business unit's) performance? If the underlying logic of role separation is accepted (as it seems to have been) the exceptions do not seem defensible.

Evolution of these exceptions from the concept to the consummation stage of the legislative process is indicative of the multiple influences that shape the final product, often resulting in dilution of the original intent.

**(b) Gender Diversity in Board**

In common parlance, gender diversity stands for the distinction between the physical characteristics that identify one either as male or female or even both and the individual sense of being either man or women or even both. But the term is generally used to identify the rise of pink collar employees in an organisational set up at various levels with different capacities. Although women are joining the labour force in increasing numbers around the world (Economist, 2006), they remain proportionately underrepresented in the top echelon of management (ILO, 2004). In particular, the lack of female representation on corporate boards of directors is a global phenomenon. Women comprise less than 15 percent. of the corporate board members in the USA, the UK, Canada, Australia and many European countries, and as low as 0.2 percent. in some Asian countries. A growing body of research on business ethics has tried to explore the relationship between gender diversity and corporate governance, focusing on the micro-level studies on the characteristics of female board members, boards and firms they are serving and the effects of gender diversity. However, gender diversity in management is said to provide a number of benefits, including new ideas and improved communication (Milliken and Martins, 1996), insights into the female market segmentation (Daily, Certo and Dalton, 1999) and transformational management style (Rosener, 1990). These competencies are particularly critical in a global world, where women also play active roles as entrepreneurs, managers and consumers (Economist, 2006). Adler (1997) has emphasized the importance of having women as well as men in the global talent pool in order to identify the next generation of leaders in the global society. Wise global leaders need the ability to work interactively and sensitively with the leaders from the other cultures and she has highlighted how some women global leaders use influence and inspiration rather than command and control to achieve their goals. Furthermore, female board members represent career opportunities for potential female employees (Bilimoria, 2006), inspire women employees to senior management roles (Bilimoria and Wheeler, 2000) and often engage in networking and mentoring of women through corporate networks. These positive spill overs may extend outside the firm. For example, law firms, whose key clients have women on their boards, are more likely to promote women (Beckman and Phillips, 2005). While the importance of women in corporate boards has long been acknowledged (Burke, 1997; Bilimoria and Wheeler, 2000), females have made only modest gains in terms of directorships on corporate boards (Daily, Certo and Dalton, 1999; Arfken, Bellar and Helms, 2004). Studies at individual-and firm-level assumed that the labour market is open and fully competitive and have focused on the efforts of individuals and their organisations to adapt to the idea of gender diversity so that more women can achieve top positions. A review of the glass ceiling literature by Powell (1999) has indicated that, at the individual level, in the past, women were said to lack the necessary qualities, such as ambition and confidence in comparison to men as well as leadership skills, such as assertiveness and influencing behaviour. Women were also said to lack the relevant experience or education for leadership (Powell, 1999), although women now have higher academic qualifications, on an average, than men (HESA, 2003). Situation-centered explanations include women's family responsibilities that hinder or are perceived to hinder their commitment to the organisation and their lack of involvement in the corporate networks that provide access to powerful people. Other barriers are based in gendered social systems, where work has been designed by men for men and where patriarchy defines work roles by gender, leading to direct discrimination and stereotyping. Structures, such as recruitment and promotion systems operate in a gender biased way, for instance, on the assumption that career paths for leaders will be unbroken, thereby, excluding women who take maternity leave or part-time work, or who relocate several times due to partners' career moves. Finally, interaction-centered explanations, for the lack of women's advancement, focus on the aggregated effect of interacting processes, such as women's reluctance to self-promote or actively manage their careers in organisations with informal promotion processes (Singh, Kumra and Vinnicombe, 2002). This can lead to managerial assumptions that women are happy to continue with their present position, whilst male peers indicate much more strongly to the promotion gatekeepers their ambition, their career successes and their readiness for the next step. In such processes, women may self-limit their advancement unless managers are aware of gender differences and take steps, such as mentoring and advocacy, to address the situation. However, it has been observed from time to time, through different researches, that higher proportion of female members in a board helps them positively contribute towards the organizational value. In 2007, both Catalyst and McKinsey have shown a correlation between gender-diverse boards and greater company performance. A recent McKinsey publication has reported measurement of organizational excellence across 231 companies worldwide, revealing that the companies with three or more women in the senior management functions have more high score for each organizational criterion than the companies with no women at the top level. The study has shown that performance increases significantly once a critical mass of 30% women at the board level is attain, noting, however, no significant difference in the performance of the companies below the threshold. Recently the Government of India has adopted an appropriate measure for inclusion of, at least, one women director in the boards of the listed companies, public sector companies and other special class of companies through in terms of Section 149 (1) of the New Companies Act, 2013.

**(c) Stakeholders Relationship Committee**:

This Board Committee is the new inception of the Companies Act, 2013. The Companies Act 2013 requires every company having more than 1000 (one thousand) shareholders, debenture holders, deposit holders and any other security holders at any time during a financial year to constitute a stakeholders relationship committee to resolve the grievances of security holders of the company. The main responsibility of this board committee is to look after the grievances of the stakeholders of the company in general and shareholders in particular. However, Clause 49 of the Listing Agreement in line with the recommendation of K.M. Birla Committee required listed companies to set up a shareholders / investors grievance committee to examine complaints and issues of shareholders. As per Sec 178(6) of Companies Act, 2013, the Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the board to consider and resolve the grievances of security holders of the company.

**(d) Remuneration and Nominations Committee:-**

Executive compensation is an issue that corporate boards around the world are grappling with and the Act appropriately mandates a Nomination and Remuneration Committee (NRC) in all listed companies and other prescribed companies Section 178 of the Companies Act, 2013. By requiring at least one half of the NRC membership to be independent directors, the board is now equipped to play a more active and objective role in determination of CEO and other executive directors' pay and perquisites. Unlike before, boards and in particular their independent directors are in a position to influence these pay packages in the best interests of their companies, without being hamstrung by the debilitating realisation that the promoters will be able to get their way in any case at the members' meeting by virtue of their superior voting strength. With the promoter- CEOs and directors as interested parties restrained from voting on such proposals at shareholders' meetings, it is up to the independent directors to decide on such pay proposals as they feel appropriate and recommend to the other shareholders for their super-majority approval. If conscientiously applied in practice, boards would seem to have been unshackled from any real or imaginary inhibitions to their effectiveness in this matter and provided with an opportunity to display their objective assessment and act in the best interests of the company. Nomination and Remuneration Committees of listed and other large public companies are required to evolve and disclose their remuneration policies in respect of directors, key management personnel and other employees. Listed companies are required to disclose comprehensive details of remuneration including the break-up between fixed and variable pay, stock options, pension etc. Criteria of compensation to non-executive directors are also required to be published in the Annual Report of the companies. How such statutory and regulatory disclosures measure up to comparable requirements in developed markets like the US can be meaningfully assessed possibly after the first set of such reports by companies become available in mid-to-late 2015.

(e) **Independence of Auditors**

Audit independence is an important pillar of good governance. Uninterrupted tenures tend to beget a measure of familiarity and complacency that may be injurious to the required levels of independence and objectivity (not unlike in the case of independent directors). Individuals and firms can now be appointed by shareholders of listed companies (on the recommendation of the audit committee and the board) for a fixed term of five years and two such terms of ten years in all respectively.

After the expiry of their maximum terms, individual and firms will have to observe a five-year cool off period before they can be considered for appointment again. There are certain pre-emptive measures to eliminate circumvention of these tenure prescriptions. For example, no firm will be eligible for appointment if they have one or more common partners in the exiting firm.

(1) Audit independence is sought to be further strengthened by requiring a super-majority special resolution to remove an auditor before expiry of the term. The Auditor will have an opportunity to be heard before he can be removed. An auditor resigning before his term is required to file with the Registrar a statement explaining the reasons for his resignation. If a retiring audit firm at the end of its first term is not to be reappointed for a second term, the retiring auditor has the right to make a representation that must be circulated to members, or filed with the Registrar.

(2) As well as protecting the auditor from any victimisation for doing his job, there are also some serious disincentives to pre-empt auditors failing to act professionally and independently as expected. For

example, the Company law Tribunal, on its own or on the representation of any concerned person inquire in to and direct the company to change the auditor if it is satisfied that the auditor had acted in a fraudulent manner or abetted and colluded with the directors or the management of the company; in that case, the auditor will be banned from acting as an auditor of any company for a period of five years. The liability for such misdemeanours will impact both the partner concerned and his firm.

(3) Audit independence criteria, disqualifying a person, have also been tightened. For example:

a) A business relationship with the company, or its subsidiary, or its holding or associate company, or subsidiary of the holding company, or an associate company.
b) A relative is a director or employed as key management personnel.
c) A conviction for an offence within the ten years preceding.
d) A subsidiary or associate company or any other form of entity is engaged in prohibited consultancy or specialised services specified in Section 144 of the Act.

(4) The prohibited services set out to include services such as accounting and book keeping, internal audit, investment banking, internal audit, actuarial, investment advisory, management and outsourced financial services. The important point to note is that provision of such prohibited services even by specified associates of the auditor or audit firm will disqualify them for appointment as auditor of a company. Theses associates are:

a) In case of an individual auditor, his relatives or other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by the individual.

b) In case of a firm, the same connections as above, of the firm or any of its partners or through its parent, subsidiary or associate entity, or through any other entity, whatsoever, in which the firm or any partner has significant influence or control, or whose name or trade mark is used by the firm or any of its partners The underlying objective behind all these complex provisions is simply that the "independent auditor" should not only be actually free from any economic or other influence that may militate against his ability to truly and fairly discharge his reputational obligations to the shareholders who appoint him but also be seen to be so.

As in the case of independent directors, economic dependence on the audited company or group is presumed to be a potential factor eroding independence, whether or not such will be the result in every case. Since audit by itself is the least glamorous and remunerative part of an accountant's practice, over time it has been used more as an entry point to more lucrative services such accountants have the competencies to offer; often, audit revenue is reportedly a minor proportion of the revenues generated by other services. Any impairment of such revenues from a company or a group is thus, in theory, vulnerable to independence erosion, which the Act provisions seek to prevent.

c) On auditing practices and competencies, the profession has so far been guided by auditing\standards issued by the Institute of Chartered Accountants of India and other international standard setting agencies. The Act now has assumed the authority to set these standards (generated by the professional body and reviewed and recommended by the NFRA) so that they are clothed with legislative sanctity to enable the auditor to meaningfully exercise his right of access to documents and information from the company.

d) NFRA has been vested with the authority to inquire into, and punish if proven, any alleged professional or other misconduct of a chartered accountant or a firm of such chartered accountants. This is a salutary and welcome provision since the extant system of disciplinary jurisdiction over its members being vested in the CA Institute is inherently vulnerable to conflicts of interest, as the Institute was (and is) the authority to conduct qualifying examinations, provide coaching and tuitions to the prospective candidates, certify them as chartered accountants, and also exercise disciplinary jurisdiction over them in case of misconduct.

NFRA and its operating bodies by their constitution ought to be independent and broad based (and not limited only to fellow accountants) and hopefully should be able to take unbiased decisions on matters of professional discipline and conduct. In some respects, the concept follows the Public Company Accounting Oversight Board (PCAOB) established in the US as a private not-for-profit corporation under the Sarbanes-Oxley Act of 2002 and the Professional Oversight Board (POB) in the UK created by the Financial Reporting Council in 2006. There are of course significant differences between NFRA (jurisdiction not limited to listed companies) and PCAOB (jurisdiction only over publicly traded company accounts and auditors) or POB (with disciplinary action remaining with professional institutes exclusively).

It is noteworthy that in the PCAOB, the five-member board is mandated not to have more than two certified public accountants (with no affiliations or practice for at least two years) and if the board chair is a CPA, he should have been away from active practice for at least five years. A clearer picture of NFRA's operating functions and procedural regimes will emerge once related rules and regulations are formulated, but this initiative is certainly to be commended as a step in the right direction.

**4. (a) For checking the governance practices of listed companies in India we have Clause 49 of Listing Agreements. But for unlisted companies how do we ensure that good governance do prevail in these organizations?**

**(b) What are the challenges lie in front of the corporate India for ensuring holistic governance practices?**

**Answer:**

(a) There is generally an incorrect perception that 'unlisted' or 'closely held' companies are small, mostly family run and relatively insignificant part of the corporate sector when it comes to policymaking and regulation relating to their governance. Undoubtedly, this group includes a vast proportion of such small and medium size entities but it is also home to several very substantial corporations which qualify as unlisted only by virtue of their ownership structures notwithstanding their revenues, profits, employee population, customer and vendor base, and sourcing of funds from banks and financial institutions. Illustratively, a Reserve Bank of India study of finances of select private limited companies (covering 6.8% of the paid up capital of all private limited companies at work) as of March 2012 indicated that the ratio of total borrowings (including both long and short term funds) to equity was 74.1 to 25.9; in other words, three fourths of the finances of these companies were borrowed from banks and financial institutions, and as such there was nothing strictly private about these companies except their ownership that was closely held. Many of these private limited companies would be joint ventures, wholly owned subsidiaries, venture-capital or other investor assisted units, and so on. Several companies in these groups may well be aspiring for listed status in the near future; ironically, the group would also include companies that preferred to delist from stock exchanges for whatever reason. A major thrust of the Act has been to extend several good governance practices to the unlisted segment of corporate business. As of December 2012, there were 852,957 companies at work comprising 806,666 private limited companies and 66,291 public limited companies; of these, about 6500 (10%) public companies were listed on the two major Indian stock exchanges. Given their predominant contribution to a nation's economy and employment potential, not to mention their extensive use of borrowed funds to sustain their operation, adoption of good corporate governance practices voluntarily or by legislation will likely help to improve their performance and reputational perceptions. Recognising these imperatives, guidelines have already been issued for such companies in Europe and the UK. Due allowance has also been made to minimise the costs of governance by segregating smaller from the relatively larger unlisted companies in these guidelines. In India, while SEBI over the last decade and more has gradually strengthened regulatory requirements in respect of listed companies, the vast unlisted segment has received virtually no major policy interventions in this regard. The 2013 Act has taken the first steps to bridge this enormous vacuum by extending several good governance practices to the unlisted companies segment. The Act and the rules framed there under reckon several criteria thresholds for extending application of such governance practices to unlisted companies. Primarily, these are based on paid-up capital and net worth, sales revenue, profits after tax, number of shareholders, deposit holders and debt security holders, and the extent of bank and other borrowings. Threshold levels of course will have to be such that they ensure additional costs of governance are commensurate with desired levels of benefits to the companies themselves and their stakeholders.

There are daunting problems ahead: appropriate capacity building exercises have to be undertaken, both in getting these companies' buy-in to the new measures (based on their value-add to them rather than on threat of punishment for non-compliance) and in enlarging the pool of independent directors, and other key management personnel to take up the relevant responsibilities.

How this interesting experiment works out in practice and to what extent it helps in upgrading the overall standards of corporate governance in the country will be keenly watched by investors, regulators, and company managements not only in India but elsewhere in the developing world as well.

(b) Important and pioneering as many of these Initiatives are, there are still miles to go before one can claim, if ever at all, to have scaled commanding heights in governance. Mary Schapiro, the former SEC Chair, very aptly portrayed the scene: 'when you've struggled up the side of an impressive ridge and paused to enjoy your achievement, only to look around and discover another hill ahead, another ascent to undertake'.

Without detracting from the considerable merits of the Initiatives already launched, the following further thoughts seem worthy of pursuit if Indian corporate governance standards are to move up the scale to the next level of excellence.

(b) On Empowering Board Independence

From an Agency theory perspective, an independent, objective, non-aligned and trustworthy board of directors is an essential building block for the protection of shareholders' interests. Over the last decade and more, regulatory measures have been gradually strengthened to bring about a measure of board independence in case of listed corporations. The Act has also for the first time in Indian corporate legislative history provided a definition of independence and mandated the minimum proportion of directors on company boards who should qualify as independent. But as the Right Honourable Lord Justice Stephen Sedley pointed out a decade and a half ago in a different context, that the rule of law is a "necessary but not a sufficient" condition for a decent society, populating boards with adequate number of independent directors may be necessary but not sufficient to achieve the objective of board independence. One could ask what else needs to be done: clearly, having inducted independent directors on to the board, they should be enabled to act and their voice should count. Two measures might be helpful in this regard:

The quorum requirements for duly constituting a board or committee meeting should be modified to require that at least a minimum number of independent directors should be present bearing the same proportion of independent directors to the total number of board members. Thus if independent directors constitute one half of the board, then one half of the quorum requirement should comprise of such independent directors (rounded up to the next higher integer) or one independent director, whichever is higher, to form a due quorum. This principle of has already been recognised in the Act which lays down at least one independent director must be present at meetings summoned at short notice; what is being suggested is that it should be extended to all meetings and in due proportion.

In terms of approvals at board and committee meetings, the law should be modified to require affirmative votes in favour by at least a majority of independent directors present or participating through video-conferencing before a resolution can be deemed duly approved.

Measures such as these would enable the institution of independent directors to perform its assigned duties and meet expectations. If even after such enabling environment some independent directors do not wish to, or are unable to discharge their duties, they will have only themselves to blame for such failures.

(c) On Strengthening Audit Independence

The Act provisions are a significant improvement over extant requirements with regard to ensuring perceived objectivity and independence of audit and the auditors of listed companies. And yet, in search of further excellence in this field, three themes that look promising are explored here.

Auditor independence, to the extent one grants that as an achievable possibility, is vulnerable to erosion for a number of reasons, among them economic dependence, familiarity, complacency and gratitude. The Act sets out and prohibits many relevant situations that may lead to such erosion of auditor independence. But all these are company-centric disqualifications. They would work well in case of stand-alone companies. But as is well known, dominant ownership by groups (of domestic, multinational or government parentage) is a prominent feature of the Indian corporate sector. It is not unusual for audit firms to be engaged for several companies in the group. While independence eroding engagements in case of individual and group companies are largely addressed by the Act, appointments as statutory auditors of group companies and their fall-out on audit independence are yet to be fully addressed. If a ten-year ceiling is considered optimal for tenure as auditors without impairing their independence, would it not be a logical extension to compute the ten-year tenureot just for a company but for a group as a whole? In other words, the tenure clock would run from the year where the firm is appointed as statutory auditors for any company in the group; during that period, the same firm can be appointed as auditors for any other company in the group but the end-year will coincide with the tenth year of the first appointment for a group company. After this, a five-year cool off period will be observed before they can return as statutory auditors for companies in the group.

The second relates to any relationships between the auditors and the company or group during the cool-off period of five years before their return as statutory auditors for any company or group company. If the intention of the cool-off period is to achieve a measure of distancing between the parties so that independence levels are restored, it should follow that during that interregnum, the auditor should have no engagements for any kind of professional services with the company or the group. Failing this, the cool-off period has no real significance and may as well be written off as an in fructuous cosmetic measure.

The third relates to the process of appointment of independent auditors. The board (through its audit committee) chooses the auditors and recommends their appointment for shareholders approval.

The question that needs addressing is which directors at board and committee meetings, and which shareholders at members' meetings should have the right to participate and vote on the appointment proposal. It would be prudent to remember that the accounts and reports are prepared by the executive and are based on their operations and activities during the period under reporting. Does it stand to reason that the very persons, whose work and financials are to be audited for reporting to the shareholders, should have a say in the appointment of the auditors who would be judging their financials? To stretch the point, would it be a tenable proposition for a defendant or accused in a trial to be given the authority to name a judge of his choice to hear the case? Pursuing this conceptual line of thinking, one could argue that only the independent directors should participate and vote on auditor choice at the audit committee and board meetings and any shareholders in operational control or acting in concert with them need to be barred from participating or voting on resolutions relating to appointment and remuneration of auditors at the general meeting of shareholders. There would of course be strong opposition to these proposals from both the controlling groups and the auditors themselves. The latter's resistance would largely be due to the dislocation and possible diminution in their professional practice but these fears can easily be allayed. All that would happen if these proposals were to go through would be a rejig of companies in the portfolio of the top ten to fifteen audit firms: instead of several group companies in their fold, each of these firms would find themselves having wider dispersal of companies from different groups, which is probably a more independence-promoting solution since their dependence on fewer groups would be diluted.

Controlling shareholders (promoters) would of course be unhappy that their rights as shareholders were being denied if they were not permitted to vote on audit appointments at members' meetings. This argument is not dissimilar to that advanced against the proposal to debar their voting on resolutions where they were interested or related parties; similar reasoning in case of related party transactions that eventually saw their voting rights curtailed by the Act would justify the present proposal as well: their rights as shareholders will not be denied if they were also not in executive management of the company; if they were in such executive management, then they should be open to be audited by a firm not necessarily of their choice. Even now, statutory auditors of public sector enterprises are appointed by the Comptroller and Auditor General of India, a constitutional authority independent of the Executive, and not by the boards or the government exercising their ownership rights as shareholders of those enterprises.

In practice, company managements with good governance will likely have no problem with these proposals. Also, this measure would further help auditors to feel more independent of the executive which can only be a good thing as far as absentee shareholders are concerned.

d) On Disclosure and Reporting

A great deal of work has already been done for improving transparent reporting and disclosure by companies. There is perhaps one area that could do with some further regulatory intervention. This is to do with continuing disclosure of material related party arrangements and shareholder agreements. Current laws require disclosure of such material contracts and so on in the year they take place, or when the company goes for a public issue of its securities. The intention of such disclosure is to reduce asymmetry of information between and among shareholders inter se. If contracts have (as many of them do) continuing relevance to shareholders (including those who became shareholders subsequently), it would seem reasonable to ensure continuing disclosure of such arrangements in the annual reports of the companies. Illustratively, shareholder agreement provisions between joint venture partners or the promoting entrepreneurs may have a continuing relevance to the company's shareholders long after the contracts were entered into.

**5. (a) What is meant by family-owned businesses? Under which grounds the family owned businesses are having advantages over as well as limitations compared to traditional non-family owned businesses?**

**(b) Against this backdrop elucidate prevalent issues of corporate governance of family run businesses.**

**Answer:**

(a) a family business is one in which the majority of the stake is held by the person who has established or acquired the company (or by his or her parents, spouse, child or child's direct heir) and at least one representative of the family is involved in the management or administration of the business. In many instances, the family owned business takes the form of a small family business whilst in other cases, it is a large business interest employing hundreds, or even thousands, of staff.

Family Controlled Businesses included all enterprises that are owned, controlled or drastically influenced by a specific family or families and having a significant dominant position in firms' equity. In fact, family ownership is prevalent not only amongst privately held firms but also in publicly traded firms in many countries across the globe. However, whatever the size of the business, it can benefit from having a good governance structure. Firms with effective governance structures will tend to have a more focused view of the business, be willing to take into account, and benefit from, the views of `outsiders' (that is, nonfamily members), and be in a better position to evolve and grow into the future.

Individual and family owned businesses are a vital part of our economy. Many of India's largest and most celebrated companies were nurtured by a small group of promoters and family members. In India, family businesses range from the small mom-and-pop store (or kirana) to large conglomerates with equally varied business interests. As their growth has skyrocketed, many have stepped outside their zones to acquire companies in new industries and geographies. Their contribution to India's growth is also being increasingly recognised.

**Advantages of the Family Businesses over Non-Family Businesses**

Family businesses identify a number of positive differences over non-family businesses. These include commitment and passion towards the success of the business, being able to make quick market focused decisions, having a deep industry knowledge, etc. Some of the advantages that family businesses share over non-family enterprises include the following:

(a) Commitment, Passion and Dedication: It is believed that owners tend to take better care of their businesses as they have greater personal stakes involved. Family businesses are more appreciative of their talent.
(b) Agile decision-making abilities: Not having responsibilities towards any shareholders gives the Indian family businesses greater flexibility in terms of making decisions faster, improving the speed with which they launch new initiatives, change operations, evaluate new business opportunities, etc.
(c) Deep industry insight: Family businesses gain significant experience and expertise as they typically work in one industry for longer durations. This gives them the added advantage of understanding and appreciating the challenges faced in that industry much better than any non-family businesses.
(d) Mutual trust: Family businesses thrive on mutual trust and believe in maintaining long-term relationships by providing a conducive, supportive and trusting work environment.

Disadvantages of the Family Businesses over Non-Family Businesses

(a) Staff recruitment: External talent can be reluctant to join the family businesses as they would not enjoy the same freedom that the other businesses offer.
(b) Raising funds for growth: Access to capital is required to grow and evolve. However, it is difficult to raise the required funds for the family businesses than non-family businesses.
(c) Family conflicts: Conflict among the family members is the major setback for the family businesses.
(d) Ownership vs. Management: Separating the ownership from the management and reaching a consensus on the roles of family members in the business are two important issues for the family businesses to address.

(b) Governance issues of Family owned firms-

The governance of a family firm is in many ways more harsh and complex than the governance of a firm with no family involvement. Family relationships have to be managed in addition to business relationship usually. The investors in companies with controlling family ownership are at risk of unreliable degrees of expropriation, mainly through the family procuring confidential benefits at the price of the other shareholders, including related-party transactions on non-commercial terms and the transfer of the company's assets to other companies owned by the family. Research study of the Italian stock market reveals that the high risk of expropriation connected with concentrated ownership can negatively affect a company's value when the ultimate owner is either the state or a family. Good corporate governance strengthens and elucidates the activities of the family Controlled firm while improving its competitiveness. Proper functioning and transparency of the roles and responsibilities of all organs in the firm are defiantly in the interest of the owners, other stakeholders and the whole company. But apart from the lengthy systems and processes that one puts in place, it is really the spirit of practice that defines the essence of the concept.

Some of the Governance Issues that crop up in Family Owned Business are discussed below:

(i) Role of the Board of Directors-

Constitution of the Board plays an important role in managing the Family Owned Businesses. The Board is expected to takes independent/unbiased decisions and the board members are the 'trustees' of the shareholders, especially the minority group. They should be in a position to provide transparent data and take decisions in the best interest of the shareholders. When it comes to board membership, most family Controlled businesses reserve this right to members of the family and in a few cases to some well trusted non-family managers. This practice is generally used to keep family control over the direction of its business. Indeed, most decisions are usually taken by the family member directors. Family directors who are also managers in the business would naturally encourage reinvesting profits in the company so as to increase its growth potential. On the contrary, family directors who do not work in the business would rather make the decision of distributing the profits as dividends to family shareholders. These gainsay views can lead to major conflicts in the board and negatively impact its way of functioning.

(ii) Role of the CEO:-

In selecting the CEO of a company, one should want the organization to be run by the 'most competent' person with professional knowledge and experience. Being employee of firm the CEO has accountability and responsibility to the organization and its shareholders. He or she should be able to be questioned by an 'independent' authority called the Board or Chairperson of the company. In a worst case situation he/she is asked to relinquish the position. Practically, it is when the CEO is a family member; this becomes quite difficult and awkward which can create further unsuitable problems for management and as a whole business. This family CEO believes that being owner of majority share owner he has full right for different experiments as well to do according to their force.

(iii) Succession Plan:-

A change of guard or succession is a complex and stressful event for any business and in the case of family businesses it gets extra complicated. On family business, there is a saying, "the first generation creates, the second inherits and the third destroys". Two words 'succession planning' seem so simple and easy to follow and yet it is so difficult because it means coming to terms with the fact that you are not indispensable.

(iv) Internal Control Formation:-

Weaknesses in Corporate governance structures of family businesses are most evident in internal controls, implementation of effective internal audit and realization of risk management. Since many families Controlled businesses are managed by the founders or their children, with their close supervisor the control environment is largely customized to their needs and according to their indulgent. The problem come when controls do not grow along with the company, as the businesses grow with the passage of time and situation becomes more complex. This space is a crucial spot of concern for external investors for their decision making and long term survival.

(v) Family Constitution:-

Family constitution is a living document that evolves as the family and its business continue to grow. As a consequence, it is necessary to regularly update the constitution in order to reflect any changes in the family and/or the business. In fact most family businesses don't have an appropriate constitution, they usually have an informal set of rules and customs that determine the rights, obligations, and expectations of family members and other governance bodies of the business. With the growth of family business, it becomes crucial to develop a written and formal constitution that is shared among all family members to shun the conflict among family members.

Family governance structures and institutions require a certain degree of formalization if they are to function well. As families adopt policies on the family's approach to the business and on governing the business, they will formalize these efforts with documents that will differ depending on their ownership stage.

(vi) Certain Challenges Remain:-

In today's competitive environment, innovation is an essential requirement to survive and thrive. Family businesses in India view continuous innovation as the most challenging aspect over the next five years. Talent issues, technology needs and complying with the regulations are additional challenges that family businesses will have to face over the next five years.

(vii) Innovation for a Competitive Advantage:-

According to the surveys conducted recently reveals that the family businesses in India view the need to continually innovate as a key challenge over the next five years. Innovation is critical maintain their relevance in the changing business environments. In order to innovate successfully, they need to combine their new strategies to broader business goals. In addition to this, these companies need to invest in innovation, promote a culture where mistakes are permitted and also instilled in the ranks that innovation is crucial to survival.

(viii) Retaining Talent:-

This is important for any organisation. Family businesses believe that attracting the right talent and then retaining it is a challenge that will have to be faced in the medium term.

(ix) Efficient Succession Planning:-

Mentoring and developing the next generation of successors and leaders is crucial to the success of family businesses. Training and preparing the high-potential members of the staff to take up high-level decision making positions and the ability to survive succession is one of the major challenges awaiting them in the near future.

(x) Need for New Technology:-

Technological advancements are redefining business models, strategies and the changing industry dynamics. Family businesses are acutely aware of the risks their businesses face if they are unable to either adapt to the new technological advancements or bring in new technologies to enhance the quality of products and services. Therefore, they believe that the need to constantly keep up with the fast-paced technology is taking in turning the older business models obsolete and the need to invest time and resources in research and development (R&D).

(xi) Challenges with Internationalisation:--

While international markets are exciting and laden with opportunities, there are some issues that the family businesses need to address while increasing their global presence. Indian businesses are aware of these challenges and are treading with caution and measured action. Family businesses consider the following four as their major challenges while conducting international operations:

(a) Exchange rate fluctuations.
(b) Understanding or complying with local regulations.
(c) Competition.
(d) Economic situations in other markets.

**6. (a) State the provisions of corporate governance applicable for State-Owned Enterprises (SOEs) as proposed by Organisation for Economic Co-operation and Development (OECD).**

**(b) In the context of corporate governance of SOEs in India discuss the role of Memorandum of Understandings (MOUs).**

**Answer:**

**(a) OECD Guidelines**

(a) The OECD Guidelines on Corporate Governance of State-Owned Enterprises (the Guidelines) are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention. The Guidelines were first developed in 2005 as a complement to the OECD Principles of Corporate Governance. They have been updated in 2015 to reflect a decade of experience with their implementation and address new issues concerning SOEs in the domestic and international context.

The Guidelines aim to:

(1) professionalise the state as an owner.
(2) make SOEs operate with similar efficiency, transparency and accountability as good practice private enterprises, and
(3) ensure that competition between SOEs and private enterprises, where such occurs, is conducted on a level playing field.

(b) The Guidelines do not address whether certain activities are best placed in public or in private ownership. However, if a government decides to divest SOEs then good corporate governance is an important prerequisite for economically effective privatisation, enhancing SOE valuation and hence bolstering the fiscal proceeds from the privatisation process.

The OECD guidelines focused on the following areas:

(1) Rationales for State Ownership
The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.

(2) The State's Role as an Owner
The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

(3) State-Owned Enterprises in the Marketplace
Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

(4) Equitable Treatment of Shareholders and other Investors
Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

(5) Stakeholder Relations and Responsible Business
The state ownership policy should fully recognise SOEs' responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

(6) Disclosure and Transparency
State-owned enterprises should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

(7) The Responsibilities of the Boards of State-Owned Enterprises
The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions

(b) In India the Memorandum of Understanding is a negotiated document between the Government, acting as the owner of Public Sector Enterprise (PSE) and a specific PSE. It should contain the intentions, obligations and mutual responsibilities of the Government and the PSE. Further, MOU makes an attempt to move the management of PSEs from management by controls and procedures to management by results and objectives. The present institutional arrangement envisages to put in place an objective and transparent mechanism to evaluate the performance of the managements of the PSEs. It provides a system through which the commitments of both the parties to the MOU can be evaluated at the end of the year besides improving the technical inputs required to finalize the MOUs. The details of this institutional arrangement and their inter-linkages are as follows.

**Objectives of MoU System**

The specific objectives of the MoU system are to:

(a) Improve the performance of CPSEs though increased management autonomy.

(b) Remove the haziness in goals and objectives.

(c) Evaluate management performance through objective criteria; and

(d) Provide incentives for better future performance.

**(i) High Power Committee**

At the apex of this institutional arrangement is the High Power Committee (HPC) consisting of following members:

(a) Cabinet Secretary, Chairman

(b) Finance Secretary, Member

(c) Secretary (Expenditure), Member

(d) Secretary (Planning Commission), Member

(e) Secretary (Programme Implementation), Member

(f) Chairman (Public Enterprises Selection Board), Member

(g) Chief Economic Adviser, Member

(h) Secretary (Public Enterprises), Member-Secretary

The functions of this committee are to review the draft MOUs before the final draft is signed and to make an end-of-the-year evaluation to judge how far the commitments made by both parties of the MOU have been met. Now, the power to approve the final MOUs has been delegated to TF/DPE and only in those cases where TF is not able to take a decision is referred to HPC.

**(ii) Task Force**

The main objective behind the creation of a Task Force was to provide technical expertise for MOU negotiations and evaluation. The main functions of the Task Force are to:

(a) examine the design of MOU at the beginning of the year. For this purpose the draft MOU agreed upon by the PSE and the relevant Administrative Ministry is examined by the Task Force. If Task Force has any comments or questions regarding the draft MOUs, they seek clarifications via MOU Division. Once the signatories to MOUs have responded to the concerns expressed by the Task Force on their draft MOUs, the MOU negotiation meetings are organized. These meetings are attended by the executives of PSEs, senior officials of the concerned Administrative Ministry and the representatives from the nodal agencies such as

Planning Commission, Ministry of Statistics & Programme Implementation, Ministry of Finance, OCC, etc. The draft MOUs are discussed and finalized during these meetings.

(b) evaluate the determine the composite score for each enterprise at the end of the year.

The Task Force consists of retired civil servants, executives of public sector, management professionals and independent members with considerable experience. It was decided by the High Power Committee that no one belonging to the Government should be a member of this Task Force. This was considered essential to maintain objectivity and credibility of the Task Force.

**(iii) MOU Division**

The HPC and Task Force are assisted by the MOU Division in the Department of Public Enterprises. It also acts as the permanent secretariat to this HPC and Task Force. The main functions of this Division are to:

(a) provide logistical, technical and administrative support to the Task Force.
(b) act as buffer between the Task Force members and the two signatories to the MOUs - PSEs and Administrative Ministries.
(c) develop information and data base on MOU signing PSEs.
(d) assist the High Power Committee.
(e) monitor the progress of MOUs.
(f) advise and counsel to the MOU signatories on methodological and conceptual aspects of the MOU policy.
(g) coordinate research and training on various aspects of MOU policy.

**(iv) Working of MOU System**

The process of signing of MOU is initiated with the issue of guidelines by the MOU Division for drafting of MOUs. These guidelines indicate the broad structure and the aspects to be covered in the draft MOU including the weights to be assigned to the financial parameters. These guidelines reflect the main concerns of the Government and contain the general direction to the PSEs.

On the basis of these Guidelines, the draft MOUs are prepared by PSEs and submitted to DPE after due discussions in Board and with the concerned Administrative Ministry/Department in the month of December. The draft MOUs received in DPE are examined in detail in consultation with Task Force. During the process of examination of these draft MOUs all possible relevant information/sources of information are utilized to ensure that the targets proposed in the draft documents are realistic. Wherever possible inter-firm comparison is carried out and the proposed targets are viewed in the context of the past performance of the PSE.

**MOU Negotiation Meetings**

Under the present system efforts are made to ensure that all the MOUs are signed well before the beginning of the financial year. In view of this, the draft MOUs submitted by the PSEs are discussed in the MOU negotiation meetings. Besides Task Force members, these meetings are attended by senior officials of the Administrative Ministries, top executives of PSEs and the representatives from the nodal agencies of the Government of India such as Planning Commission, Ministry of Finance & Dept. of Programme Implementation. As mentioned earlier, all possible inputs provided by the professionals, Ministries and the DPE are utilized to finalise the targets. In addition to this the general aspects of existing economic situation relating to the performance of the PSE are also discussed in detail before finalizing the targets.

The parameters to measure the performance of the managements of the PSEs are selected after a great deal of thought and the weights are assigned to these performance parameters keeping in view their importance and the nature of operation of the PSE. The targets proposed by the PSEs are discussed freely and are finalized broadly on consensus basis. In fact, the MOU negotiation meeting also provide a forum to discuss certain good practices adopted in other PSEs and in a way these innovative ideas are disseminated through this process. The MOUs finalised during these meetings are signed by the Chief Executive of the PSE and the Secretary of the concerned Ministry before 31st of March.

**Evaluation of MOU**

Performance of MOU signing PSEs is evaluated with reference to their MOU targets twice in a year. First the performance is evaluated on the basis of provisional results and secondly on the basis of audited data. The performance evaluation exercise is also carried out in an extensive manner. As mentioned earlier this performance evaluation exercise is not carried out purely through a mechanical procedure. In fact, at the end of the year the review meetings are held which provides an opportunity to consider the proposals to adjust the criteria values for factors which were not predicted and could not have been predicted by either party. Thus, the MOU evaluation is finalised on the basis of the actual performance and the PSEs are graded as "EXCELLENT", "VERY GOOD", "GOOD", "FAIR" & "POOR".

**Achievements of the MOU System**

Viewed in the light of the objectives the effectiveness of the MOU system can be summarised as follows:

(a) The focus, under the MOU system, has shifted to achievements of results.

(b) Operational autonomy has also been encouraged and increased by delegation of more financial and administrative powers to the MOU signing PSEs.

(c) By laying stress on marketing effort and comparing with private sector enterprises MOU are helping PSEs to face competition.

(d) The quarterly performance review (QPR) meetings have become more focused since the introduction of MOUs. Discussion is confined to overall achievement as outlined in the MOUs.

# Study Note – 8

# Social, Environmental and Economic Responsibilities of Business

## Group-A

1. **National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business was proposed by-**
   A. Securities and Exchange Board of India,
   B. Ministry of Finance,
   C. Ministry of Corporate Affairs,
   D. International Standards Organizations

2. **How many Principles have been mentioned in the National Voluntary Guidelines, 2011?**
   A. 5
   B. 6
   C. 8
   D. 9

3. **Which of the following are not the principles of National Voluntary Guidelines, 2011?**
   A. Business should conduct and govern themselves with ethics, transparency and accountability,
   B. Business should promote the well being of all shareholders and capital providers,
   C. Business should respect, protect and make efforts to restore the environment,
   D. Business should support inclusive growth and equitable development.

4. **Under which part of the suggested framework of Business Responsibility Report the disclosure of negative consequences of the business operations on the social, environmental and Economic fronts are mentioned?**
   A. Part A,
   B. Part B,
   C. Part C-1,
   D. Part C-2.

4. **Guidance on Social Responsibility, 2011 was proposed by**
   A. Securities and Exchange Board of India,
   B. Ministry of Finance,
   C. Ministry of Corporate Affairs,
   D. International Standards Organizations

5. **Which of the following statements is true for Corporate Social Responsibility?**
   A. CSR is only a philanthropic activities of the business,

B. CSR is a standalone concept primarily addressed towards the well being of all the stakeholders connected with the organization,
C. CSR is a holistic concept which is integrated with core business strategy for addressing social and environmental impacts of business,
D. CSR is about promoting the well being of the employees

6. The allowable activities for CSR is mentioned in-
   A. Schedule VI to the Companies Act and Sec 135,
   B. Schedule VII to the Companies Act and Sec 135
   C. Schedule VIII to the Companies Act and Sec 135
   D. Schedule VII to the Companies Act and Sec 137

7. e-Seva is an initiative of Government to Citizen services of-
   A. Bihar,
   B. Assam,
   C. Andhra Pradesh
   D. Tamilnad

8. Khajane is an initiative of Government to Citizen services of-
   A. Odisa
   B. Kerala
   C. Karnataka
   D. West Bengal

9. Which of the following is not true for XBRL?
   A. XBRL is based on eXtensible Markup language,
   B. XBRL is a combination of XML and Online Analytical Processing System,
   C. XBRL is based on a static platform,
   D. XBRL is a flexible reporting system.

10. Which is not a part of activities of XBRL India?
   A. To create awareness on XBRL in India
   B. To promote XBRL as a standard reporting practices across India
   C. To develop and maintain Indian Taxonomies,
   D. To help companies adopt and implement XBRL

Answer:

| Question No. | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| Answer | C | D | B | C | C | B | C | C | C | B |

## Group-B

**1. Elucidate the issues of Corporate Citizenship as discussed in National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, 2011 by clearly mentioning the relevant principles of good governance.**

**Answer:**

Business involvement in social welfare and development has been a tradition in India and its evolution from individuals' charity or philanthropy to Corporate Social Responsibility, Corporate Citizenship and Responsible Business can be seen in the business sector over the years. The concept of parting with a portion of one's surplus wealth for the good of society is neither modern nor a Western import into India. Corporate governance in India gained prominence in the wake of liberalization during the 1990s and was introduced, as a voluntary measure to be adopted by Indian companies. It soon acquired a mandatory status in early 2000s through the introduction of Clause 49 of the Listing Agreement, as all companies (of a certain size) listed on stock exchanges were required to comply with these norms. In late 2009, the Ministry of Corporate Affairs has released a set of voluntary guidelines for corporate governance, which address a myriad corporate governance issues. Thereafter, these guidelines have been refined by the MCA during 2011.

**National Voluntary Guidelines 2011**

The Guidelines emphasize that businesses have to endeavour to become responsible actors in society, so that their every action leads to sustainable growth and economic development. These Guidelines have been developed through an extensive consultative process by a Guidelines Drafting Committee (GDC) comprising competent and experienced professionals representing different stakeholder groups. The Guidelines are designed to be used by all businesses irrespective of size, sector or location and therefore touch on the fundamental aspects the 'spirit' of an enterprise. The Guidelines have been articulated in the form of nine (9) Principles with the Core Elements to actualize each of the principles. A reading of each Principle, with its attendant Core Elements, should provide a very clear basis for putting that Principle into practice.

**Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability**

The principle recognizes that ethical conduct in all its functions and processes is the cornerstone of responsible business. The principle acknowledges that business decisions and actions, including those required to operationalize the principles in these Guidelines should be amenable to disclosure and be visible to relevant stakeholders. The principle emphasizes that businesses should inform all relevant stakeholders of the operating risks and address and redress the issues raised. The principle recognizes that the behavior, decision making styles and actions of the leadership of the business establishes a culture of integrity and ethics throughout the enterprise.

**Core Elements**

(a) Businesses should develop governance structures, procedures and practices that ensure ethical conduct at all levels and promote the adoption of this principle across its value chain.

(b) Businesses should communicate transparently and assure access to information about their decisions that impact relevant stakeholders.
(c) Businesses should not engage in practices that are abusive, corrupt or anti competition.
(d) Businesses should truthfully discharge their responsibility on financial and other mandatory disclosures.
(e) Businesses should report on the status of their adoption of these Guidelines as suggested in the reporting framework in this document.
(f) Businesses should avoid complicity with the actions of any third party that violates any of the principles contained in these Guidelines.

**Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle**

The principle emphasizes that in order to function effectively and profitably, businesses should work to improve the quality of life of people. The principle recognizes that all stages of the product life cycle, right from design to final disposal of the goods and services after use, have an impact on society and the environment. Responsible businesses, therefore, should engineer value in their goods and services by keeping in mind these impacts.

**Core Elements**

(a) Businesses should assure safety and optimal resource use over the life cycle of the product from design to disposal and ensure that everyone connected with it viz., designers, producers, value chain members, customers and recyclers are aware of their responsibilities.
(b) Businesses should raise the consumers' awareness of their rights through education, product labelling, appropriate and helpful marketing communication, full details of contents and composition and promotion of safe usage and disposal of their products and services.
(c) In designing the product, businesses should ensure that the manufacturing processes and technologies required to produce it are resource efficient and sustainable.
(d) Businesses should regularly review and improve upon the process of new technology development, deployment and commercialization, incorporating social, ethical and environmental considerations.
(e) Businesses should recognize and respect the rights of people who may be owners of traditional knowledge and other forms of intellectual property.
(f) Businesses should recognize that over consumption results in unsustainable exploitation of our planet's resources and should therefore promote sustainable consumption, including recycling of resources.

**Principle 3: Businesses should promote the well being of all employees**

The principle encompasses all policies and practices relating to the dignity and wellbeing of employees engaged within a business or in its value chain. The principle extends to all categories of employees engaged in activities contributing to the business, within or outside of its boundaries and covers work performed by individuals, including sub-contracted and home based work.

**Core Elements**

a. Businesses should respect the right to freedom of association, participation, and collective bargaining and provide access to appropriate grievance redressal mechanisms.

b. Businesses should provide and maintain equal opportunities at the time of recruitment as well as during the course of employment irrespective of caste, creed, gender, race, religion, disability or sexual orientation.
c. Businesses should not use child labour, forced labour or any form of involuntary labour, paid or unpaid.
d. Businesses should take cognizance of the work life balance of its employees, especially that of women.
e. Businesses should provide facilities for the wellbeing of its employees including those with special needs. They should ensure timely payment of fair living wages to meet basic needs and economic security of the employees.
f. Businesses should provide a workplace environment that is safe, hygienic humane and which upholds the dignity of the employees. Business should communicate this provision to their employees and train them on a regular basis.
g. Businesses should ensure continuous skill and competence upgrading of all employees by providing access to necessary learning opportunities, on an equal and non-discriminatory basis. They should promote employee morale and career development through enlightened human resource interventions.
h. Businesses should create systems and practices to ensure a harassment free workplace where employees feel safe and secure in discharging their responsibilities.

**Principle 4: Businesses should respect the interests of and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized**

The principle recognizes that businesses have a responsibility to think and act beyond the interests of its shareholders to include all their stakeholders.

The Principle, while appreciating that all stakeholders are not equally influential or aware, encourages businesses to proactively engage with and respond to those that are disadvantaged, vulnerable and marginalized.

**Core Elements**

(a) Businesses should systematically identify their stakeholders, understand their concerns, define purpose and scope of engagement, and commit to engaging with them.
(b) Businesses should acknowledge, assume responsibility and be transparent about the impact of their policies, decisions, product & services and associated operations on the stakeholders.
(c) Businesses should give special attention to stakeholders in areas that are underdeveloped.
(d) Businesses should resolve differences with stakeholders in a just, fair and equitable manner.

**Principle 5: Businesses should respect and promote human rights**

The principle recognizes that human rights are the codification and agreement of what it means to treat others with dignity and respect. Over the decades, these have evolved under the headings of civil, political, economic, cultural and social rights. This holistic and widely agreed nature of human rights offers a practical and legitimate framework for business leaders seeking to manage risks, seize business opportunities and compete in a responsible fashion. The principle imbibes its spirit from the Constitution of India, which through its provisions of Fundamental Rights and Directive Principles of State Policy, enshrines the achievement of human rights for all its citizens.

In addition, the principle is in consonance with the Universal Declaration of Human Rights, in the formation of which, India played an active role.

**Core Elements**

(a) Businesses should understand the human rights content of the Constitution of India, national laws and policies and the content of International Bill of Human Rights. Businesses should appreciate that human rights are inherent, universal, indivisible and interdependent in nature.
(b) Businesses should integrate respect for human rights in management systems, in particular through assessing and managing human rights impacts of operations, and ensuring all individuals impacted by the business have access to grievance mechanisms.
(c) Businesses should recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace, including that of communities, consumers and vulnerable and marginalized groups.
(d) Businesses should, within their sphere of influence, promote the awareness and realization of human rights across their value chain.
(e) Businesses should not be complicit with human rights abuses by a third party.

**Principle 6: Business should respect, protect and make efforts to restore the environment**

The principle recognizes that environmental responsibility is a prerequisite for sustainable economic growth and for the well being of society. The principle emphasizes that environmental issues are interconnected at the local, regional and global levels which makes it imperative for businesses to address issues such as global warming, biodiversity conservation and climate change in a comprehensive and systematic manner.

**Core Elements**

(a) Businesses should understand the human rights content of the Constitution of India, national laws and policies and the content of International Bill of Human Rights. Businesses should appreciate that human rights are inherent, universal, indivisible and interdependent in nature.
(b) Businesses should integrate respect for human rights in management systems, in particular through assessing and managing human rights impacts of operations and ensuring all individuals impacted by the business have access to grievance mechanisms.
(c) Businesses should recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace, including that of communities, consumers and vulnerable and marginalized groups.
(d) Businesses should, within their sphere of influence, promote the awareness and realization of humanrights across their value chain.
(e) Businesses should not be complicit with human rights abuses by a third party.

**Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner**

The principle recognizes that businesses operate within the specified legislative and policy frameworks prescribed by the Government, which guide their growth and also provide for certain desirable restrictions and boundaries. The principle acknowledges that in a democratic set-up, such legal frameworks are developed in a collaborative manner with participation of all the stakeholders, including businesses. The principle, in that

context, recognizes the right of businesses to engage with the Government for redressal of a grievance or for influencing public policy and public opinion.
The principle emphasizes that policy advocacy must expand public good rather than diminish it or make it available to a select few.

**Core Elements**

(a) Businesses, while pursuing policy advocacy, must ensure that their advocacy positions are consistent with the Principles and Core Elements contained in these Guidelines.
(b) To the extent possible, businesses should utilize the trade and industry chambers and associations and other such collective platforms to undertake such policy advocacy.

**Principle 8: Businesses should support inclusive growth and equitable development**

The principle recognizes the challenges of social and economic development faced by India and builds upon the development agenda that has been articulated in the government policies and priorities. The principle recognizes the value of the energy and enterprise of businesses and encourages them to innovate and contribute to the overall development of the country, especially to that of the disadvantaged, vulnerable and marginalised sections of society.

The principle also emphasizes the need for collaboration amongst businesses, government agencies and civil society in furthering this development agenda. The principle reiterates that business prosperity and inclusive growth and equitable development are interdependent.

**Core Elements**

(a) Businesses should understand their impact on social and economic development, and respond through appropriate action to minimise the negative impacts.
(b) Businesses should innovate and invest in products, technologies and processes that promote the well being of society.
(c) Businesses should make efforts to complement and support the development priorities at local and national levels, and assure appropriate resettlement and rehabilitation of communities who have been displaced owing to their business operations.
(d) Businesses operating in regions that are underdeveloped should be especially sensitive to local concerns.

**Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner**

This principle is based on the fact that the basic aim of a business entity is to provide goods and services to its customers in a manner that creates value for both. The principle acknowledges that no business entity can exist or survive in the absence of its customers. The principle recognizes that customers have the freedom of choice in the selection and usage of goods and services and that the enterprises will strive to make available goods that are safe, competitively priced, easy to use and safe to dispose off, for the benefit of their customers. The principle also recognizes that businesses have an obligation to mitigating the long term adverse impacts that excessive consumption may have on the overall wellbeing of individuals, society and our planet.

**Core Elements**

(a) Businesses, while serving the needs of their customers, should take into account the overall well being of the customers and that of society.
(b) Businesses should ensure that they do not restrict the freedom of choice and free competition in any manner while designing, promoting and selling their products.
(c) Businesses should disclose all information truthfully and factually, through labelling and other means, including the risks to the individual, to society and to the planet from the use of the products, so that the customers can exercise their freedom to consume in a responsible manner. Where required, businesses should also educate their customers on the safe and responsible usage of their products and services.
(d) Businesses should promote and advertise their products in ways that do not mislead or confuse the consumers or violate any of the principles in these Guidelines.
(e) Businesses should exercise due care and caution while providing goods and services that result in over exploitation of natural resources or lead to excessive conspicuous consumption.
(f) Businesses should provide adequate grievance handling mechanisms to address customer concerns and feedback.

Successful implementation of the Principles and Core elements require that all of them need to be integrated and embedded in the core business processes of an enterprise. This requires, specifically that the following actions are taken:

(a) Leadership: The Chairman/CEO/Owner/Manager should play a proactive role in convincing the board/Top Management and staff within the business that adopting these principles is crucial for success. The board and senior management need to ensure that the principles are fully understood across the organization and comprehensively executed.
(b) Integration: These principles and core elements must be embedded in the Business policies and strategies emanating from the core business purpose of the organization. For this to happen, these must align with each business's internal values and/or must provide clear business benefits.
(c) Engagement: Building strong relationships and engaging with stakeholders on a consistent, continuous basis is crucial.
(d) Reporting: Implementation process includes disclosure by companies of their impact on society an environment to their stakeholders.

**2. Why Corporate Social Responsibility is important for firms in today's world for achieving sustainability? State the benefits of Corporate Social Responsibility. In this context discuss the implication of the provisions of Companies Act, 2013.**

**Answer:**

The idea of CSR first came up in 1953 when it became an academic topic in HR Bowen's "Social Responsibilities of the Business". Since then, there has been continuous debate on the concept and its implementation. Although the idea has been around for more than half a century, there is still no clear consensus over its definition. One of the most contemporary definitions is from the World Bank Group, stating, "Corporate social responsibility" is the commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large, to improve their lives in ways that are good for business and for development.

Sustainability (Corporate Sustainability) is derived from the concept of sustainable development which is defined by the Brundtland Commission as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”. Corporate sustainability essentially refers to the role that companies can play in meeting the agenda of sustainable development and entails a balanced approach to economic progress, social progress and environmental stewardship. CSR in India tends to focus on what is done with profits after they are made. On the other hand, sustainability is about factoring the social and environmental impacts of conducting business, that is, how profits are made. Hence, much of the Indian practice of CSR is an important component of sustainability or responsible business, which is a larger idea, a fact that is evident from various sustainability frameworks. An interesting case in point is the National Voluntary Guidelines (NVGs) for social, environmental and economic responsibilities of business issued by the Ministry of Corporate Affairs in June 2011. Principle eight relating to inclusive development encompasses most of the aspects covered by the CSR clause of the Companies Act, 2013. However, the remaining eight principles relate to other aspects of the business. The United Nations (UN) Global Compact, a widely used sustainability framework has 10 principles covering social, environmental, human rights and governance issues, and what is described as CSR is implicit rather than explicit in these principles. Globally, the notion of CSR and sustainability seems to be converging, as is evident from the various definitions of CSR put forth by global organisations. The genesis of this convergence can be observed from the preamble to the recently released rules relating to the CSR clause within the Companies Act, 2013 which talks about stakeholders and integrating it with the social, environmental and economic objectives, all of which constitute the idea of a triple bottom line approach. It is also acknowledged in the Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises issued by the Department of Public Enterprises (DPE) in April 2013. The new guidelines, which have replaced two existing separate guidelines on CSR and sustainable development, issued in 2010 and 2011 respectively, mentions the following:

“Since CSR and sustainability are so closely entwined, it can be said that CSR and sustainability is a company’s commitment to its stakeholders to conduct business in an economically, socially and environmentally sustainable manner that is transparent and ethical.”

**Benefits of CSR programme**

As the business environment gets increasingly complex and stakeholders become vocal about their expectations, good CSR practices can only bring in greater benefits, some of which are as follows:

(a) Communities provide the licence to operate: Apart from internal drivers such as values and ethos, some of the key stakeholders that influence corporate behaviour include governments (through laws and regulations), investors and customers. In India, a fourth and increasingly important stakeholder is the community and many companies have started realising that the ‘licence to operate’ is no longer given by governments alone, but communities that are impacted by a company’s business operations. Thus, a robust CSR programme that meets the aspirations of these communities not only provides them with the licence to operate, but also to maintain the licence, thereby precluding the ‘trust deficit’.

(b) Attracting and retaining employees: Several human resource studies have linked a company's ability to attract, retain and motivate employees with their CSR commitments. Interventions that encourage and enable employees to participate are shown to increase employee morale and a sense of belonging to the company.
(c) Communities as suppliers: There are certain innovative CSR initiatives emerging, wherein companies have invested in enhancing community livelihood by incorporating them into their supply chain. This has benefitted communities and increased their income levels, while providing these companies with an additional and secure supply chain.
(d) Enhancing corporate reputation: The traditional benefit of generating goodwill, creating a positive image and branding benefits continue to exist for companies that operate effective CSR programmes. This allows companies to position themselves as responsible corporate citizens.

**The Companies Act, 2013**

The concept of CSR is governed by clause 135 of the Companies Act, 2013. The CSR provisions within the Act is applicable to companies with an annual turnover of INR 1,000 crore and more, or a net worth of INR 500 crore and more, or a net profit of five crore and more. The new rules, which are applicable from the fiscal year 2014-15 onwards, also require companies to set up a CSR committee consisting of their board members, including at least one independent director.

The Act encourages companies to spend at least 2% of their average net profit in the previous three years on CSR activities. In the rules with respect to CSR net profit is defined as the profit before tax as per the books of accounts, excluding profits arising from branches outside India.

As per Schedule VII of the Companies Act, 2013 activities which may be included by companies in their Corporate Social Responsibility Policies are as follows-

Activities relating to:
(i) eradicating extreme hunger and poverty;
(ii) promotion of education;
(iii) promoting gender equality and empowering women;
iv) reducing child mortality and improving maternal health;
(v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
(vi) ensuring environmental sustainability;
(vii) employment enhancing vocational skills;
(viii) social business projects;
(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
(x) such other matters as may be prescribed.

The main provisions contained in the rules framed under the Companies Act, 2013 stipulated the following:

(a) Surplus arising out of the CSR projects or progammes or activities shall not form part of the business profit of a company.

(b) The company can implement its CSR activities through the following methods:

(1) Directly on its own.

(2) Through its own non-profit foundation set-up so as to facilitate this initiative.

(3) Through independently registered non-profit organisations that have a record of at least three years in similar such related activities.

(4) Collaborating or pooling their resources with other companies.

(c) Only CSR activities undertaken in India will be taken into consideration.

(d) Activities meant exclusively for employees and their families will not qualify.

(e) A format for the board report on CSR has been provided which includes amongst others, activity-wise, reasons for spends under 2% of the average net profits of the previous three years and a responsibility statement that the CSR policy, implementation and monitoring process is in compliance with the CSR objectives, in letter and in spirit. This has to be signed by either the CEO, or the MD or a Director of the company and Chairman of the CSR Committee. The report is required to be published in the Annual Report.

**3. Write short notes on the following:**

**(a) Business Responsibility Report,**

**(b) e-Governance**

**(c) XBRL**

**Answer:**

**(a) Business Responsibility Report**

This report may be presented in three parts as detailed below:

Part-A of the report includes basic information and data about the operations of the business entity so that the reading of the report becomes more contextual and comparable with other similarly placed businesses.

Part-B of the report incorporates the basic parameters on which the business may report their performance. Efforts have been made to keep the reporting simple keeping in view the fact that this framework is equally applicable to the small businesses as well. The report may be prepared in a free format with the basic performance indicators being included in the same. In case the business entity has chosen not to adopt or report on any of the Principles, the same may be stated along with, if possible, the reasons for not doing so.

Part-C of the report incorporates two important aspects on Business Responsibility reporting. Part C-1 is a disclosure on by the business entity on any negative consequences of its operations on the social, environmental and economic fronts. The objective is to encourage the business to report on this aspect in a transparent manner so that it can channelize its efforts to mitigate the same. Part C-2 is aimed at encouraging the business to continuously improve its performance in the area of Business Responsibility.

**(b) e-Governance**

e-Governance may be defined as providing the citizen's benefits by the Government authorities through electronic ways. It may be of two types-

(i) Government to Business (G2B) initiatives,

(ii) Government to Citizen (G2C) initiatives

**(i) Government to Business (G2B) initiatives**

G2B initiatives encompass all activities of government which impinge upon business organizations. These include registrations under different statutes, licenses under different laws and exchange of information between government and business. The objective of bringing these activities under e-Governance is to provide a congenial legal environment to business, expedite various processes and provide relevant information to business. Some of the important initiatives are furnished below:

(a) e-Procurement Project in Andhra Pradesh - It is an initiative for procurement of material through e-tender process by avoiding human interface i.e., supplier and buyer interaction during the pre-bidding and post-bidding stages.

(b) e-Procurement in Gujarat - It is an initiative to establish transparency in procurement process, shortening of procurement cycle, availing of competitive price, enhancing confidence of suppliers and establishing flexible and economical bidding process for suppliers.

(c) MCA 21 - This project aims at providing easy and secure online access to all registry related services provided by the Union Ministry of Corporate Affairs (MCA) to corporates and other stakeholders at any time and in a manner that best suits them.

MCA made it mandatory for some companies having fulfilled the stipulated criteria to file their Balance Sheet and Profit and Loss account statements in XBRL (Extensible Business Reporting Language). With the development of taxonomies for Banks, Insurance, Non-Banking Finance Companies and Power sector, the companies operating in these sectors would also be filing their financial reports in XBRL.

**(ii) Government to Government (G2G) initiatives**

Within the government system there is large scale processing of information and decision making. G2G initiatives help in making the internal government processes more efficient. Many a time G2C and G2B processes necessitate the improvements in G2G processes. Some of the important initiatives are furnished below:

(a) Khajane Project in Karnataka - This project aims at the computerization of the entire treasury related activities of the State Government and the system has the ability to track every activity right from the approval of the State Budget to the point of rendering accounts to the government.

(b) Smart Gov in Andhra Pradesh - This project has been developed to streamline operations, enhance efficiency through workflow automation and knowledge management for implementation in the Andhra Pradesh Secretariat.

**(c) XBRL (Extensible Business Reporting Language)**

XBRL is a language for the electronic communication of business and financial data which is revolutionizing business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using financial data. XBRL stands for extensible Business Reporting Language. It is already being put to practical use in a number of countries and implementations of XBRL are growing rapidly around the world.

XBRL is an open, royalty-free software specification developed through a process of collaboration between accountants and technologists from all over the world. Together, they formed XBRL International which is now made up of over 650 members, which includes global companies, accounting, technology, government and financial services bodies. XBRL is and will remain an open specification based on XML that is being incorporated into many accounting and analytical software tools and applications.

**Advantages of XBRL**

XBRL offers major benefits at all stages of business reporting and analysis. The benefits are seen in automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and in better quality of information and decision making. XBRL enables producers and consumers of financial data to switch resources away from costly manual processes, typically involving time consuming comparison, assembly and re-entry of data. They are able to concentrate effort on analysis, aided by software which can validate and process XBRL information. XBRL is a flexible language, which is intended to support all current aspects of reporting in different countries and industries. Its extensible nature means that it can be adjusted to meet particular business requirements, even at the individual organization level.

All types of organizations can use XBRL to save costs and improve efficiency in handling business and financial information. Because XBRL is extensible and flexible, it can be adapted to a wide variety of different requirements. All participants in the financial information supply chain can benefit, whether they are preparers, transmitters or users of business data.

XBRL is set to become the standard way of recording, storing and transmitting business financial information. It is capable of use throughout the world, whatever the language of the country concerned, for a wide variety of business purposes. It will deliver major cost savings and gains in efficiency, improving processes in companies, governments and other organisations.

**Status of implementation of XBRL in India**

(a) India is now an established jurisdiction of XBRL International. A separate company, under Section 25 has been created, to manage the operations of XBRL India. The main objectives of XBRL in India are:
   (1) To create awareness about XBRL in India.
   (2) To develop and maintain Indian Taxonomies.
   (3) To help companies, adopt and implement XBRL.

   XBRL in India has come a long way since it initiated. Stock Exchanges and the Reserve Bank of India (RBI) have been using XBRL since 2009. Both BSE and NSE use an XBRL enabled integrated filing platform for corporate disclosures. RBI makes use of XBRL for internal reporting i.e. for collecting the capital adequacy related data from all banks so as to check their compliance of Basel – II requirements. More recently, Ministry of Corporate Affairs has mandated XBRL in India in a phased manner for all companies.

(b) The mandate applies to the following companies:

(1) All public listed companies in India and their Indian Subsidiaries.
(2) All companies having a paid up capital of INR 5 crores and above.
(3) All companies having a turnover of INR 100 crores and above.

(c) All the companies that fall under the mandate are required to file with MCA following information in XBRL:

(1) Balance Sheet.
(2) Profit and Loss Account.
(3) Cash Flow Statement.
(4) Schedules related to Balance Sheet and Profit and Loss Statement.
(5) Notes to Accounts.
(6) Statement relating to subsidiary companies.
(7) Auditors Report.
(8) Directors Report.
(9) Cost Audit Report.

(d) In view of the advantages of XBRL reporting, now the Companies need to quickly gear-up to this new reporting challenge and also to gain benefits from the broader business uses of XBRL. Some of the key challenges that companies might encounter as they adopt XBRL reporting are:

(1) Requirement of training staff to understand XBRL and how it needs to be implemented including matters like timely tagging and validation processes.
(2) The software tool to be used for the purpose of tagging.
(3) The first-time efforts involved in tagging and resolving errors identified by validation checks.
(4) Smooth and timely closure of reporting within the prescribed timelines.

## Insolvency and Bankruptcy Code

### Section – A

1. **Mark the correct answer and state with justification:**

**(A) Insolvency and Bankruptcy code 2016 is not applicable on:**
- (i) Financial Service Providers
- (ii) Partnership Firms and Individuals
- (iii) Limited Liability Partnership (LLP)
- (iv) Companies Incorporated under Companies Act.

**(B) Constitution of Insolvency and Bankruptcy Board of India has been specified under section:**
- (i) Section 185 of IBC
- (ii) Section 182 of IBC
- (iii) Section 189 of IBC
- (iv) Section 178 of IBC

**(C) The Insolvency and Bankruptcy Board has power of __________ Court in respect of issue of summons, discovery and production of books, inspection of books/registers and issue of commissions for examination of witnesses:**
- (i) Session Court
- (ii) High Court
- (iii) Supreme Court
- (iv) Civil Court

**(D) Insolvency and Bankruptcy Board consists of _______ members.**
- (i) 10 members
- (ii) 12 members
- (iii) 11 members
- (iv) 14 members

**(E) _________________ shall be the adjudicating authority for Individuals and firms u/s 179(1) of Insolvency and Bankruptcy Code 2016.**
- (i) Debt Recovery Tribunal (DRT)
- (ii) NCLT
- (iii) Regional Director
- (iv) Civil Court

**(F) The Adjudicating Authority shall appoint an Interim Resolution Professional within ......... days of the insolvency commencement date.**

**(i) 07**

**(ii) 14**

**(iii) 21**

**(iv) 28**

**Answers:**

| | | |
|---|---|---|
| (A) | (i) | Financial Service Providers |
| (B) | (iii) | Section 189 of IBC |
| (C) | (iv) | Civil Court |
| (D) | (i) | 10 members |
| (E) | (i) | Debt Recovery Tribunal (DRT) |
| (F) | (ii) | 14 |

## Section – B

**Answer the following questions:**

**2. (a) Explain the applicability of Insolvency and Bankruptcy Code, 2016. Also mention the sectors where the insolvency and bankruptcy code is not applicable?**

**(b) What are the composition of Insolvency and Bankruptcy Board of India? Explain the functions of Insolvency and Bankruptcy Board of India?**

**Answer:**

a. The provisions of Insolvency and Bankruptcy Code, 2016 applies to the following, in relation to their insolvency, liquidation, voluntary liquidation or bankruptcy, as the case may be (Section 2 of Insolvency and Bankruptcy Code, 2016).

- Companies incorporated under Companies Act
- Companies governed under special Act (so far as of Insolvency and Bankruptcy Code, 2016 is
- consistent with those special Acts i.e. provisions of Special Act will prevail over of Insolvency and
- Bankruptcy Code, 2016)
- Limited Liability Partnership (LLP)
- Other body corporates as may be notified by Central Government
- Partnership firms and individuals.

The Insolvency and Bankruptcy Code is not applicable to corporates in finance sector. Section 3(7) of Insolvency and Bankruptcy Code, 2016states that "Corporate person" shall not include any financial service provider. Thus, the Code does not cover Bank, Financial Institutions, Insurance Company, Asset Reconstruction Company, Mutual Funds, Collective Investment Schemes or Pension Funds.

**(b)** The Composition of Board of Insolvency and Bankruptcy Board of India are that the Board will be headed by Chairperson. It will consist of ten members out of which at least three will be whole-time members.

Function of the Board is to exercise regulatory oversight over insolvency professionals, insolvency professional agencies and information utilities. Some of the main functions of the Board are enumerated as follows:

(a) Register insolvency professional agencies, insolvency professionals and information utilities and renew, withdraw, suspend or cancel such registrations;
(b) Specify the minimum eligibility requirements for registration of insolvency professional agencies, insolvency professionals and information utilities;
(c) Levy fee or other charges for the registration of insolvency professional agencies, insolvency professionals and information utilities;
(d) Specify by regulations standards for the functioning of insolvency professional agencies, insolvency professionals and information utilities;
(e) Lay down by regulations the minimum curriculum for the examination of the insolvency professionals for their enrolment as members of the insolvency professional agencies;
(f) Carry out inspections and investigations on insolvency professional agencies, insolvency professionals and information utilities and pass such orders as may be required for compliance of the provisions of this Code and the regulations issued hereunder;
(g) Monitor the performance of insolvency professional agencies, insolvency professionals and information utilities and pass any directions as may be required for compliance of the provisions of this Code and the regulations issued hereunder;
(h) Call for any information and records from the insolvency professional agencies, insolvency professionals and information utilities;
(i) Publish such information, data, research studies and other information as may be specified by regulations;
(j) Specify by regulations the manner of collecting and storing data by the information utilities and for providing access to such data;
(k) Collect and maintain records relating to insolvency and bankruptcy cases and disseminate information relating to such cases;
(l) Constitute such committees as may be required including in particular the committees laid down in Section 197;
(m) Promote transparency and best practices in its governance;
(n) Maintain websites and such other universally accessible repositories of electronic information as may be necessary;

3. **(a) Corporate insolvency resolution process can be commenced when a corporate debtor commits a default - Section 4(1) of Insolvency and Bankruptcy Code, 2016.**

**The default should be minimum Rupees one lakh. The amount can be increased by Central Government but shall not exceed Rupees one Crore - proviso to Section 4(1) of Insolvency and Bankruptcy Code, 2016.**

**Nature India Limited filed a petition under the Insolvency and Bankruptcy Code, 2016 with NCLT against Tulip Limited and the petition was admitted. After that, Nature Indian Limited wanted to withdraw the petition based on a settlement arrived between the parties. Whether it is permissible to withdraw the petition after it has been submitted? Decide.**

**Also explain the rules relating to the admission and rejection of application by an adjudicating authority under the insolvency and Bankruptcy Code, 2016.**

**(b) Lenux International Ltd. who is a foreign trade creditor having its office in China wanted to file a petition under the Insolvency and Bankruptcy Code, 2016 on default of the debtor in India. It moved a petition u/s 9 of the Code seeking commencement of insolvency process. The foreign company was not having any office or bank account in India. Because of this, it could not submit a "Certificate from a financial institution" as required under the Code. Whether the petition is permissible under the Insolvency and Bankruptcy Code, 2016? Decide.**

**Answer:**

**(a)** As per the fact given in the question, Nature India Limited filed a petition under the Insolvency and Bankruptcy Code 2016 with NCLT against Tulip Limited and the petition was admitted. After that Nature India Limited wanted to withdraw the same due to settlement between the parties.

As per Rule 8 of the Insolvency and Bankruptcy Code 2016 (Application to Adjudicating Authority) Rule 2016, the Adjudicating Authority may permit withdrawal of the application made under rules 4 (Application by financial creditor), 6 (Application by operational creditor) or 7 (Application by corporate applicant), as the case may be, on a request made by the applicant before its admission.

Since in the given instance, Nature India Limited wanted to withdraw the petition after it was admitted by the adjudication authority. So it was not permissible to withdraw the petition after been admitted.

Provisions related to admission or rejection of application by an adjudicating authority in the Insolvency and Bankruptcy Code, 2016 are as follows:

The Adjudicating Authority shall, on the receipt of the application within the given time period under the relevant provisions, ascertain the existence of a default and pass the order [under Section 9(5) of the IBC, 2016].

Where the Adjudicating Authority is satisfied, either—

| Admit application when- | Reject application when |
|---|---|
| ➢ A default has occurred and,<br>➢ and the application is complete<br>➢ no disciplinary proceeding spending<br>➢ against the proposed resolution professional | ➢ Default has not occurred or<br>➢ The application is incomplete any disciplinary proceeding is pending against the proposed resolution professional<br>➢ Adjudicating Authority shall, before rejecting the |

| | |
|---|---|
| | application, give a notice to the applicant to rectify the defect. |

Further, the Adjudicating Authority shall communicate order of admission or rejection of such application within given time, as the case may be.

**(b)** As per the definition of the Creditor given in Section 3(10) of the Insolvency and Bankruptcy Code, 2016, it means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor, and a decree holder. So, Lenux International Ltd. is a creditor under the purview of the Code.

As per the facts given in question, Lenux International Ltd., is a foreign trade creditor.

He wanted to file a petition under the under Section 9 of the Insolvency and Bankruptcy

Code, 2016 for commencement of Insolvency process against the defaulter in India. Lenux International Ltd. was not having any office or bank account in India.

As per the requirement of section 9 of the Code, along with application certain documents were needed to be furnished by the creditor to the Adjudicating authority. Being a foreign trade creditor, Lenux International Ltd was also required to provide a copy of certificate from the financial institutions maintaining accounts of the creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor. Since, Standard International Ltd. was not having any office or bank account in India, it cannot furnish certificate from financial institution. So, Petition under Section 9 of the Code is not permissible.

**4. What are the cases when prior approval of committee of creditors for certain actions by resolution professional under Insolvency and bankruptcy code 2016?**

**Answer:**

In following cases, resolution professional can take action only with prior approval of committee of creditors, with 75% voting in favour [Section 28(1) of Insolvency and Bankruptcy Code, 2016].

(a) Raise any interim finance in excess of the amount as may be decided by the committee of creditors in their meeting.

(b) Create any security interest over the assets of the corporate debtor.

(c) Change the capital structure of the corporate debtor, including by way of issuance of additional securities, creating a new class of securities or buying back or redemption of issued securities in case the corporate debtor is a company.

(d) Record any change in the ownership interest of the corporate debtor.

(e) Give instructions to financial institutions maintaining accounts of the corporate debtor for a debit transaction from any such accounts in excess of the amount as may be decided by the committee of creditors in their meeting.
(f) Undertake any related party transaction
(g) Amend any constitutional documents of the corporate debtor.
(h) Delegate its authority to any other person.
(i) Dispose of or permit the disposal of shares of any shareholder of the corporate debtor or their nominees to third parties.
(j) Make any change in the management of the corporate debtor or its subsidiary.
(k) Transfer rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business.
(l) Make changes in the appointment or terms of contract of such personnel as specified by the committee of creditors; or
(m) Make changes in the appointment or terms of contract of statutory auditors or internal auditors of the corporate debtor.

**5. Write short notes on: (3 Questions are to be answered)**

**(i) Financial Debts as per Insolvency and Bankruptcy code, 2016.**

**(ii) Requirements of resolution plan under Insolvency and Bankruptcy code, 2016.**

**(iii) Power and duties of Liquidator under Insolvency and Bankruptcy code, 2016.**

**Answer:**

(i) Financial debt [Section 5(8)] means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes—
   (a) Money borrowed against the payment of interest;
   (b) Any amount raised by acceptance under any acceptance credit facility or its De-Materialised equivalent;
   (c) Any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;
   (d) The amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;
   (e) Receivables sold or discounted other than any receivables sold on non-recourse basis;
   (f) Any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing; any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;
   (h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;
   (i) The amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;

(ii) The resolution plan shall contain following [Section 30(2) of Insolvency and Bankruptcy Code, 2016] —

(a) provision for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the repayment of other debts of the corporate debtor.

(b) provision for the repayment of the debts of operational creditors in such manner as may be specified by the Board which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor under Section 53 of Insolvency and Bankruptcy Code, 2016.

(c) provision for the management of the affairs of the Corporate debtor after approval of the resolution plan.

(d) the implementation and supervision of the resolution plan

(e) the plan should not contravene any of the provisions of the law for the time being in force.

(f) plan should conform to such other requirements as may be specified by the Board of Insolvency and Bankruptcy of India.

(iii) The liquidator will work under overall directions of the Adjudicating Authority. He will have the following powers and duties [Section 35(1) of Insolvency and Bankruptcy Code, 2016].

(a) to verify claims of all the creditors.

(b) to take into his custody or control all the assets, property, effects and actionable claims of the corporate debtor.

(c) to evaluate the assets and property of the corporate debtor in the manner as may be specified by the Board and prepare a report.

(d) to take such measures to protect and preserve the assets and properties of the corporate debtor as he considers necessary.

(e) to carry on the business of the corporate debtor for its beneficial liquidation as he considers necessary.

(f) subject to Section 52, to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels in such manner as maybe specified.

(g) to draw, accept, make and endorse any negotiable instruments including bill of exchange, hundi or promissory note in the name and on behalf of the corporate debtor, with the same effect with respect to the liability as if such instruments were drawn, accepted, made or endorsed by or on behalf of the corporate debtor in the ordinary course of its business.

(h) to take out, in his official name, letter of administration to any deceased contributory and to do in his official name any other act necessary for obtaining payment of any money due and payable from a contributory or his estate which cannot be ordinarily done in the name of the corporate debtor, and in all such cases, the money due and payable shall, for the purpose of enabling the liquidator to take out the letter of administration or recover the money, be deemed to be due to the liquidator himself.

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