

THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992

UNIT I

(Questions based on the SEBI Act, 1992)

Purpose of the Act & Establishment of SEBI

Question 1

Explain briefly the purpose of establishing SEBI. (May 2002)

The purpose of the SEBI Act is to provide for the establishment of a Board called Securities and Exchange Board of India (SEBI). The Preamble to the Act provides for the establishment of a Board to:

- (i) Protect the interests of investors in securities,
- (ii) Promote the development of the securities market,
- (iii) To regulate the securities market, and
- (iv) For matters connected therewith or incidental thereto.

The Securities and Exchange Board of India was set up to achieve the following objectives:

- (i) To promote fair dealings by the issuers of securities and ensure a market place where they can raise funds at a relatively low cost.
- (ii) To provide a degree of protection to the investors and safeguard their rights and interests so that there is a steady flow of savings into the market.
- (iii) To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers, etc., with a view to making them competitive and professional.

Board to regulate or prohibit issue of prospectus, offer document or advertisement soliciting money for issue of securities – Section 11

Question 2

State the circumstances under which Securities and Exchange Board of India may prohibit a company from issuing prospectus, any offer document or advertisement soliciting money from public for issue of securities. (November, 2006)

Point out the circumstances where under the following powers may be exercised by the Securities and Exchange Board of India:

- (a) *Prohibiting a company from issuing or publishing any document or advertisement soliciting money from public for issue of securities.*
- (b) *Pass cease and desist order in relation to any listed company.*

What remedies are available to the companies against such orders under the SEBI Act, 1992?
(June, 2009)

Answer

Without prejudice to the provisions of the Companies Act, 1956, the Board may, for the protection of investors specify, by regulations

- (a) (i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and (ii) the manner in which such matters shall be disclosed by the companies; and
- (b) by general or special orders (i) prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities; (ii) specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued. The Board may specify the requirements for listing and transfer of securities and other matters incidental thereto. without prejudice to the provisions of section 21 of the Securities Contracts (Regulation) Act, 1956.

Seizure of records of a Stock Broker by SEBI

Question 3

Explain briefly the powers of SEBI under Securities and Exchange Board of India Act, 1992 to seize the records of a Stock broker or other Intermediaries associated with Securities Market.
(May, 2004)

Answer

Section 11C was inserted by SEBI (Amendment) Act, 2002. Where SEBI has reasonable grounds to believe that (a) transactions in securities are being dealt with in a manner detrimental to the investors or securities market or (b) any intermediary or any person associated with securities has violated provisions of SEBI Act, rules, regulations or directions issued by SEBI, it can appoint an investigating Authority to investigate the affairs of such intermediary/person and report matter thereon to the Board [Section 11C (1)].

If Investigating Authority is of the opinion that the records are likely to be destroyed or mutilated or secreted or altered, he can make application to Judicial Magistrate of First Class for an order of seizure of such books, registers, other documents and record [Section 11C(8)]. The Magistrate can authorize Investigating Authority to enter premises search and seize records. But Magistrate will authorize seizure of records of a listed company or company intending to be listed only if it is indulging in insider trading or market manipulation [11C (9)]. The seized records will be kept by Investigating Authority till conclusion of investigation and then return it to person concerned after placing identification marks on them [11C(10)].

Price Manipulation by brokers – Action by SEBI

Question 4

SEBI received complaints from some investors alleging that ABC Ltd. And some brokers are indulging in price manipulation in the shares of ABC Ltd. Explain the powers that can be exercised by SEBI under the Securities and Exchange Board of India Act, 1992 in case the allegations are found to be correct.

(May, 2006)

Answer

Price manipulation in the shares of ABC Ltd. can be considered as fraudulent and unfair trade practices relating to securities market. In this case SEBI may exercise the following powers under Section 11(4) of securities and Exchange Board of India Act, 1992.

- (i) Suspend the trading of any security (in this case the securities of ABC Ltd.) in a recognized stock exchange.
- (ii) Restrain persons (in this case ABC Ltd.) from accessing the securities market. It can also prohibit any person associated with securities market (i.e. brokers who have indulged in price manipulation) to buy, sale or deal in securities market.

SEBI may issue the above orders for reasons to be recorded in writing. SEBI shall, either before or after passing such orders give an opportunity of hearing to company and brokers concerned (proviso 2 to Section 11(4)) SEBI may also appoint an adjudicating officer who may levy penalty under Section 15 HA after holding an enquiry in the prescribed manner. According to Section 15HA if any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of Rs. 25 crores or 3 times the amount of profits made out of such practices, whichever is higher.

Prohibition on manipulation and deceptive practices: Further according to Section 12A, no person shall directly or indirectly indulge in following (i.e.) (a) using in manipulative or deceptive device in connection with purchase, sale or securities listed (b) Employ any scheme or device to defraud in connection with dealing in securities which are listed (c) engage in an act which would operate as fraud or deceit upon any person in connection with dealing in

securities which are listed. SEBI may impose penalty upto Rs. 1 crore on any person who fails to comply with any provisions of SEBI Act (Section 15 HB).

Penalties

Question 5

Mr. Clever who is registered as an Intermediary fails to enter into an agreement with his client and hence penalised by SEBI under Section 15B of the SEBI Act. Advise Mr. Clever as to what remedies are available to him against the order of SEBI. (May, 2002)

Answer

Remedies against SEBI order: Section 15B of the Securities and Exchange Board of India Act, 1992 lays down that if any person, who is registered as an intermediary and is required under this Act or any rules or regulations made there under, to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less. Mr. Clever has been penalised under the above mentioned provision. Two remedies are available to Mr. Clever in this matter:-

(i) **Appeal to the Securities Appellate Tribunal :**

Section 15 T of the SEBI Act, 1992 provides that any person aggrieved by an order of the Board made, on and after the commencement of the Security Laws (Second Amendment) Act, 1999, under this Act or the rules or regulations made there under may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

Such appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the Board is received and it shall be in such form and be accompanied by such fee as may be prescribed. However, the Tribunal may entertain an appeal after satisfied that there was sufficient cause for not filing it within the said period. The Tribunal may, after giving the parties an opportunity of being heard, pass such orders as it thinks fit, confirming, modifying or setting aside the order appealed against.

(ii) **Appeal to the High Court**

Section 15 Z of the SEBI Act, 1992 provides that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the High Court within 60 days from the date of communication of the decision or order to him on any question or fact or law arising out of such order. The High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

Failure to redress investor grievances (Section 15C)

Question 6

Mr. DB is a member of RPA Ltd. He obtains an order against the company for redressal of his grievances against the company. But the company fails to redress the grievances of DB within the time fixed by the SEBI. The Board thereafter imposed penalty upon the company U/s 15C of the SEBI Act. RPL Ltd. seeks your advice whether it has any remedy against the order of SEBI. Advise. **(November 2008)**

Answer

Section 15C of Securities Exchange Board of India Act, 1992 lays down that if any listed company or any person who is registered as an intermediary, after having been called upon by the board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the board, such company or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

RPA limited was penalized under the provisions of above-mentioned section. Now two remedies are available to RPA limited in this matter:

- (i) **Appeal to the Securities Appellate Tribunal:** Section 15T of the SEBI Act, 1992 provides that any person aggrieved by an order of the Board made, on and after the commencement of the security laws (second amendment) act 1999, under this act or the rules or regulations made there under may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

Such appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the Board is received and it shall be in such form and be accompanied by such fee as may be prescribed. However the Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within the said period.

The Tribunal may, after giving the parties an opportunity of being heard, pass such orders as it thinks fit, confirming, modifying or setting aside the order appealed against.

- (ii) **Appeal to the Supreme Court:** Section 15Z of the SEBI Act, 1992 provides that any person aggrieved by any decision or an order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or an order to him on any question of law arising out of such order. The Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

Penalty for failure in case of stock brokers – (Section 15F)

Question 7

What are the default for which a stock-broker may be penalized under the provisions of Securities and Exchange Board of India Act, 1992 in respect of his dealings with the investors? State the factors that must be taken into account by the adjudicating officer while determining the quantum of penalty in such cases. (May, 2000)

SEBI received a complaint from an investor that he has not received the payment due to him from a registered stock broker. Explain the action that can be taken by SEBI against the stock broker under the provisions of Securities and Exchange Board of India Act, 1992 and the factors that will be taken into account while taking such action. (May, 2003)

Answer

Penalty for default in case of stock brokers: Section 15F of Securities and Exchange Board of India Act, 1992 provides for penalty for default in case of stock brokers. If any person who, is registered, as a stock broker under this Act:

- (a) fails to issue contract notes in the form and in the manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty not exceeding five times the amount for which the contract note was required to be issued by that broker.
- (b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner or within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.
- (c) charges an amount of brokerage which is on excess of the brokerage specified in the regulations, he shall be liable to a penalty of one lakh rupees or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Factors for taking into account while action

While adjudging quantum of penalty under section 15J, the adjudicating officer shall have due regard to the following factors:

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the defaults.
- (b) the amount of loss to an investor or group of investors as a result of the default.
- (c) the repetitive nature of the default.

Taking into consideration the above factors, the adjudicating officer may levy a maximum penalty as prescribed in Section 15F for default by the concern stock broker in making the payment to the investor.

Question 8

A group of investors are upset with the functioning of two leading stock brokers of Calcutta Stock Exchange and want to make a complaint to SEBI for intervention and redressal of their grievances. Explain briefly the purpose of establishing SEBI and what type of defaults by the stock brokers come within the purview of SEBI Act, 1992. (May, 2002)

Answer

The Securities and Exchange Board of India (SEBI) was established primarily for the purpose of

1. to protect the interests of investors in securities
2. to promote the development of securities market
3. to regulate the securities market and (iv) for matters connected therewith and incidental thereto.

The following defaults by stock brokers come within the purview of SEBI Act:

- (a) Any failure on the part of the stock broker to issue contract notes in the form and in the manner specified by the Stock Exchange.
- (b) Any failure on the part of the broker to deliver any security or to make payment of the amount due to the investor in the manner or within the period specified in the regulations.
- (c) Any collection of charges by way of brokerage in excess of the brokerage as specified in the regulations. (Section 15 F, SEBI Act, 1992)

Question 9

Mr. Raman, an investor is not satisfied with the dealings of his stock broker who is registered with Delhi Stock Exchange. Mr. Raman approaches you to guide him regarding the avenues available to him for making a complaint against the stock broker under Securities and Exchange Board of India Act, 1992 and also the grounds on which such complaint can be made. You are required to briefly explain the answer to his queries. (November, 2003)

Answer

Securities and Exchange Board of India (SEBI) was established for regulating the various aspects of stock market. One of its functions is to register and regulate the stock brokers. In the light of this, Mr. Raman is advised that the complaint against the erring stock broker may be submitted to SEBI.

The grounds on which or the defaults for which complaints may be made to SEBI are as follows:

- (a) Any failure on the part of the stock broker to issue contract notes in the form and manner specified by the stock exchange of which the stock broker is a member.
- (b) Any failure to deliver any security or any failure to make payment of the amount due to the investor in the manner within the period specified in the regulations.
- (c) Any collection of charges by way of brokerage which is in excess of the brokerage specified in the regulations.

Penalty for insider trading – Section 15G

Question 10

On the complaint of Mr. Kamlesh Gupta, after enquiry SEBI finds that Mr. P. Mehta a Chief Executive Officer of the Company, on the basis of unpublished price sensitive information, has indulged in the trading of the securities of that company. Explain, on the basis of the said finding, what action SEBI can take against Mr. P. Mehra under the Securities and Exchange Board of India Act, 1992.

(May, 2002)

Answer

Section 15G of the Securities and Exchange Board of India (SEBI) Act, 1992 deals with penalty for Insider Trading. According to this, if any insider

- (i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate on any stock exchange on the basis of any unpublished price sensitive information; or
- (ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary cause of business or under any law, or
- (iii) counsels or procures for, any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information,

shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher. As such SEBI can, after following the prescribed procedure, impose a penalty on Mr. P. Mehra. The maximum penalty that SEBI can impose is Rupees twenty-five crores or three times the amount of profits made out of insider trading, whichever is higher.

Question 11

What provision has been made under Section 15G of the SEBI Act, 1992, in connection with penalty for insider trading?

(November, 2000)

Answer

If any insider who:

- (i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate on any stock exchange on the basis of any unpublished price sensitive information; or
- (ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or
- (iii) counsels, or procures for, any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information,

shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher. [Section 15, SEBI Act, 1992].

UNIT – II

Questions based on

SECURITIES AND EXCHANGE BOARD OF INDIA

(ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009

Earlier known as SEBI (Disclosure for Investor Protection) Guidelines, 2000

Book-Building Process

Question 12

What is the specific advantage of Book-building process in connection with issue of securities by a company?
(May, 2000)

Answer

Book building is a process of price discovery. The issuer discloses a price band or floor price before opening of the issue of the securities offered. On the basis of the demands received at various price levels within the price band specified by the issuer, Book Running Lead Manager (BRLM) in close consultation with the issuer arrives at a price at which the security offered by the issuer, can be issued. When the price of an issue is discovered on the basis of demand received from the prospective investors at various price levels, it is called "Book Built Issue". According to Regulation 2(f) of SEBI (ICDR) Regulation 2009 "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 these regulations.

The specific advantage of the book-building process is:

- (a) It is a process which helps the issuer company and the lead merchant banker to discover the price through the demand received.
- (b) Cut-off option is available for the investors. i.e investors who are applying for securities worth up to Rs 1,00,000/- only. Such investors are required to tick the cut off option which indicates their willingness to subscribe to shares at any price discovered within the price band. Unlike price bids (where a specific price is indicated) which can be invalid, if price indicated by applicant is lower than the price discovered, the cut off bids always remain valid for the purpose of allotment.
- (c) Investors can change/revise/before the date of closure of the issue and also cancel the bid anytime before the finalization of the basis of allotment by approaching/ writing/ making an application to the registrar to the issue.

Common Conditions for Public Issues and Rights Issues (Regulation 4)

Question 13

What are the Common restrictions for issuers in case of public and rights issues?

Answer

No issuer shall make a public issue or rights issue of specified securities:

- (a) if the issuer, any of its promoters, promoter group or directors or persons in control of the issuer are debarred from accessing the capital market by the Board;
- (b) if any of the promoters, directors or persons in control of the issuer was or also is a promoter, director or person in control of any other company which is debarred from accessing the capital market under any order or directions made by the Board;
- (c) if the issuer of convertible debt instruments is in the list of wilful defaulters published by the Reserve Bank of India or it is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months;
- (d) unless it has made an application to one or more recognised stock exchanges for listing of specified securities on such stock exchanges and has chosen one of them as the designated stock exchange:

Provided that in case of an initial public offer, the issuer shall make an application for listing of the specified securities in at least one recognised stock exchange having nationwide trading terminals;

- (e) unless it has entered into an agreement with a depository for dematerialisation of specified securities already issued or proposed to be issued;
- (f) unless all existing partly paid-up equity shares of the issuer have either been fully paid up or forfeited;
- (g) unless firm arrangements of finance through verifiable means towards seventy five per cent. of the stated means of finance, excluding the amount to be raised through the proposed public issue or rights issue or through existing identifiable internal accruals, have been made.

Eligibility Requirements in case of Public Issues (Chapter III - Regulation 26)

Question 14

M/s Herbal Pharma Limited, a listed company, decides to make a public issue of equity shares. Explain briefly the eligibility norms prescribed by SEBI guidelines to be complied with by the company. (May, 2002) or

AVD Limited was incorporated on 1st April, 2006. The Company got its shares listed at Bombay Stock Exchange on 30th September, 2007. The Company at an Extra-Ordinary General Meeting

held on 31st October, 2009, decided to go for public issue of equity shares to an extent of Rs.300 crores. The net worth of the Company as per the audited Balance sheets in the financial years 2007-08 and 2008-09 was Rs.50 crores and 60 crores respectively. During the financial year 2008-09 the Company had already issued equity shares amounting to Rs.20 crores. There is no change in the name of the Company or its business activities during the financial year 2008-09. Referring to the guidelines issued by Securities and Exchange Board of India, advise the Company on the following:

- (i) *Whether the Company can go ahead with the public issue of equity shares as stated above.*
- (ii) *What would be your advice in case the net worth of the Company as per audited balance sheets in the financial years 2007-08 and 2008-09 was Rs.20 crores and 30 crores respectively?*
- (iii) *What would be the position in case the Company in question changed its name to AJD Limited during the year 2008-09, three months before filing the offer document and the revenue due to change of business activity suggested by the new name during the financial year 2008-09 was 40% less than the total revenue for the financial year 2007-08 reckoned from the date of filing the offer document?*

(November, 2009)

Answer

As per the SEBI (ICDR) Regulations 2009, vide Regulation 26 (d) & (e), a listed Company shall be eligible to make a public issue of equity shares or any other security which may be converted into or exchanged with equity shares at a later date provided

- (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
- (e) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

Applying the above Regulations, the questions as asked in the problem can be answered as under:

1. There are two conditions in the guidelines as stated above viz. i) that the aggregate issue i.e. proposed + all the previous issues made in the same financial year should not exceed 5 times the net worth of the Company; ii) there is no change in the name of the issuer Company within the last 1 year. In the question the proposed issue of Rs.300 crores + Previous issue in the same financial year is Rs.20 crores, making an aggregate of Rs.320. Since the aggregate of the issue is more than 5 times of Net Worth, i.e. more than Rs.300 crores, the proposed offer is not within the limit, Company cannot proceed ahead with the proposed issue of Rs.300 crores.

2. In the second case the net worth is only Rs.30 crores. 5 times of the net worth comes to Rs.150 crores only. Since the aggregate of the proposed issue and the previous issue during the same financial year is Rs.320 crores, which is exceeding the limits of Rs.150 crores, as calculated above, the Company cannot proceed with the public issue of shares as proposed in the second case.
3. In the third case the offer cannot be made since the current year revenue is less than 50% of the total revenue of the previous year.

Question 15

Following information is available from the Records of Star Chemicals & Engineering Ltd.:

- (i) *The company is a closely held unlisted company.*
- (ii) *The paid up share capital of the company since 1st April, 1999 is Rs.3.00 crores and its net worth as at 31st March, 2008 was Rs.5.00 crores as per audited Balance Sheet.*
- (iii) *The Net Tangible Assets of the company as per last 3(three) audited Balance Sheets as at 31st March, 2005, 2006 and 2007 were Rs.4.00 crores, 4.50 crores and 5.00 crores respectively, out of which monetary assets were less than Rs. 50 lacs in each of the three years.*
- (iv) *The company was incorporated in 1996 and commenced its business on 1st April, 1996 and since then it has earned good profits and it has not incurred any loss in any year in past.*
- (v) *The company has not declared any dividend so far, but according to the profits earned so far, the management could have declared the dividend in each of the last five years.*
- (vi) *The name of the company was changed from Star Engineering Ltd. to its present name with effect from 1st January, 2007*
- (vii) *The company's turnover in the years ended 31st March, 2006, 2007 and 2008 was Rs.20 crores, 30 crores and 35 crores respectively.*

The company wants to make a public issue of shares to raise Rs. 20.00 crores by issuing equity shares at premium. For the purpose of including the information in the prospectus, the Company has prepared its accounts for 12 months ended 31st December, 2007 showing segment wise revenue which reveals that revenue from chemical segment is more than the revenue from Engineering segment.

You are required to state the relevant guidelines issued by SEBI and your conclusion whether the Company can make the desired issue of equity shares based on the facts stated above.

(November, 2005)

Question 16

M/s Earth Chemicals and Engineering Ltd. is a closely held unlisted company with a paid up share capital of Rs. 3.00 crores, since 1st April, 2001 and its net worth as on 31st March, 2007 was Rs.

5.00 crores. The net tangible assets of the company as per last three audited balance sheets as at 31st March, 2005, 2006 and 2007 were Rs. 4.00 crores, 4.50 crores and 5.00 crores respectively out of which momentary assets were less than Rs. 50 lakhs in each of the three years. The company was incorporated in 1998 and commenced its business on 1st April, 1998 and since then it has earned good profits and it has not incurred any loss in any year in the past. The company has not declared any dividend so far. But according to the profits earned so far, the management could have declared dividends in each of the last five years. The name of the company was changed from Earth Engineering Ltd. to its present name effective from 1st October, 2006. The company wants to make a public issue of shares to raise Rs. 20.00 crores by issuing equity shares at premium. For the purpose of including the information in the prospectus. The company has prepared its accounts for 12 months ended 30th September, 2007 showing segment wise revenue, which reveals that revenue from chemical segment was more than the revenue from engineering segment. Keeping the relevant guidelines issued by SEBI into account, examine whether the company can make the desired issue of equity shares based on the facts stated above.

(November 2007)

Answer

Regulation 26 of the SEBI (ICDR) Regulations, 2009 prescribes the conditions to be fulfilled for issue of shares. As per the said Regulation, an issuer may make an initial public offer, if:

- (a) it has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent. are held in monetary assets. Further that if more than fifty per cent of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project.
- (b) it has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of the immediately preceding five years. The extraordinary items shall not be considered for calculating distributable profits.
- (c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each).
- (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year.
- (e) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

In the given case,

- (a) The net tangible assets of the company as per the last three audited balance sheets as on 31st March, 2005, 2006 and 2007 were Rs. 4.00 crores, Rs. 4.50 crores, and Rs.

5.00 crores respectively. It satisfies the requirements of clause (a) as above as during each of the preceding three full years, it has net tangible assets, more than Rs.3 crores and out of which the monetary assets are not more than 50 % of the net tangible assets. (In this case it has monetary assets less than Rs 50 lacs).

- (b) The company has good track record of distributable profits in terms of section 205 of the Companies Act, 1956. In other words, it has not incurred any loss in any year in the past.
- (c) The net worth of the company during the three preceding years was at least Rs. 1 crore in the preceding three full years. (paid-up capital since 1st April, 1999 is Rs 3 crores and net worth as at 31st March, 2005 was Rs. 5.00 crores.
- (d) The aggregate of the proposed issue and all previous issues made in the same financial years does not exceed 5 times its pre-issue net worth. (Rs. 20 crores is the proposed issue and pre-issue net worth is Rs. 5 crores as on 31st March, 2007.
- (e) It is stated in the problem that the revenue earned by the company under its activity (chemical) the new name is more than from the old activity (engineering, it satisfied the condition (e) as stated above.

Hence Star Chemicals & Engineering Ltd can proceed to make a public issue of shares to raise Rs. 20.00 crores by issuing equity shares at premium.

Question 17

The Annual Accounts of CALM Ltd., a listed company from for the year ended 31st March, 2003 were finalized on 31st May, 2004. The Company had a paid up capital of Rs.50.00 Lacs and free reserves of Rs.100.00 Lacs. The Company did not have any accumulated losses. The Board of Directors of the Company wishes to make a public issue of Equity Shares amounting to Rs. 10.00 Crores comprising of offer to public through offer document, firm allotment and promoters contribution. State, how this can be done under SEBI Guidelines.

What would be your answer in the following cases?

- (a) *If CALM Ltd. was a Private Sector Bank known as CALM Bank Ltd.*
- (b) *If the issue of above mentioned Rs.10.00 Crores was a right issue* **(November, 2004)**

Answer

To determine, whether CALM Ltd can proceed with the public issue of equity shares amounting to Rs.10.00 crores, one has to find out whether the company satisfied Regulation 26 of the SEBI (ICDR) Regulations, 2009 applying clause (c) of the said Regulation, the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited

balance sheet of the preceding financial year. In this case, it exceeds 5 times the net worth as on 31st March, 2004. (Proposed issue is Rs.10 crores and net worth as at 31st March, 2003 is Rs. 1.5 crores). Since the company does not satisfy the above stated condition, it has to satisfy any of the alternate conditions specified in Clause 2(a)(b), which states that,

the issue is made through the book building process and the issuer undertakes to allot at least fifty per cent. 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 ; **or**

at least fifteen per cent. of the cost of the project is contributed by scheduled commercial banks or public financial institutions, of which not less than ten per cent. shall come from the appraisers and the issuer undertakes to allot at least ten per cent. of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make the allotment to the qualified institutional buyers;

- a. (i) the minimum post-issue face value capital of the issuer is ten crore rupees; or
- (ii) the issuer undertakes to provide market-making for at least two years from the date of listing of the specified securities, subject to the following:
 - (A) the market makers offer buy and sell quotes for a minimum depth of three hundred specified securities and ensure that the bid-ask spread for their quotes does not, at any time, exceed ten per cent.;
 - (B) the inventory of the market makers, as on the date of allotment of the specified securities, shall be at least five per cent. of the proposed issue.

Pricing in Public Issue (Regulation 28)

Question 18

State the guidelines issued by SEBI in this regard in respect of the following matters:

- (i) *Determination of issue price and that of successful bidders.*
- (ii) *Reservation for individual investors who have not participated in the bidding process and basis of allotment to such investors.* **(May, 2000)**

Answer

Determination of issue price: (Regulation 28, read with Schedule XI)

- (a) The issuer shall, in consultation with lead book runner, determine the issue price based on the bids received.
- (b) On determination of the price, the number of specified securities to be offered shall be determined (i.e. issue size divided by the price to be determined).
- (c) Once the final price (cut-off price) is determined, all those bidders whose bids have been found to be successful (i.e. at and above the final price or cut-off price) shall be entitled

for allotment of specified securities.

- (d) Retail individual investors may bid at "cut off" price instead of their writing the specific bid price in the bid forms.
- (e) The lead book runner may reject a bid placed by a qualified institutional buyer for reasons to be recorded in writing provided that such rejection shall be made at the time of acceptance of the bid and the reasons therefor shall be disclosed to the bidders. Necessary disclosures in this regard shall also be made in the red herring prospectus.

Allotment procedure and basis of allotment. (Regulation 50)

1. The allotment of specified securities to applicants other than anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer: Provided that value of specified securities allotted to any person in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 42, shall not exceed one lakh rupees.]
2. The executive director or managing director of the designated stock exchange along with the post issue lead merchant bankers and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in **Schedule XV**.

Manner of Allotment/ Allocation.

- (a) Allotment to retail individual investors, non-institutional investors and qualified institutional buyers other than anchor investors shall be made proportionately as illustrated in this Schedule.
- (b) In case of under subscription in any category, the undersubscribed portion in that category shall be allocated to the bidders as per disclosures made in the red herring prospectus; Provided that the unsubscribed portion in qualified institutional buyer category shall not be available for subscription to other categories, in case the book building process is undertaken for the purpose of compliance of eligibility conditions for public issue.
- (c) On receipt of the sum payable on application for the amount towards minimum subscription, the issuer shall allot the specified securities to the applicants as per these regulations.
- (d) Definition of CAN to be modified to state that it is for 'allocation of shares' and not 'confirmation of shares'

Question 19

M/s Ambitious Financiers Ltd., an existing unlisted Public Company, is planning to issue to the

public five lakhs fully convertible debentures of Rs. 100 each. Explain the eligibility norms to be fulfilled by the company as per SEBI guidelines before making the issue. (May, 2001)

Answer

Conditions for initial public offer (Regulation 26)

- (1) An issuer may make an initial public offer, if:
 - (a) it has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent. are held in monetary assets: **Provided** that if more than fifty per cent. of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project;
 - (b) it has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of the immediately preceding five years: **Provided** that extraordinary items shall not be considered for calculating distributable profits;
 - (c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
 - (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
 - (e) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.
- (2) An issuer not satisfying any of the conditions stipulated in sub-regulation (1) may make an initial public offer if:
 - (a) (i) the issue is made through the book building process and the issuer undertakes to allot at least fifty per cent. 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;

Or

 - (ii) at least fifteen per cent. of the cost of the project is contributed by scheduled commercial banks or public financial institutions, of which not less than ten per cent. shall come from the appraisers and the issuer undertakes to allot at least ten per cent. of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make the allotment to the qualified institutional buyers;

- (b) (i) the minimum post-issue face value capital of the issuer is ten crore rupees;

Or

- (ii) the issuer undertakes to provide market-making for at least two years from the date of listing of the specified securities, subject to the following:

- (A) the market makers offer buy and sell quotes for a minimum depth of three hundred specified securities and ensure that the bid-ask spread for their quotes does not, at any time, exceed ten per cent.;
- (B) the inventory of the market makers, as on the date of allotment of the specified securities, shall be at least five per cent. of the proposed issue.

- (3) An issuer may make an initial public offer of convertible debt instruments without making a prior public issue of its equity shares and listing thereof.
- (4) An issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.
- (5) No issuer shall 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: **Provided** that the provisions of this sub-regulation shall not apply to:
- (a) 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;
 - (b) 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.
- (6) Subject to provisions of the Companies Act, 1956 and these regulations, equity shares may be offered for sale to public if such equity shares have been held by the sellers for a period of at least one year prior to the filing of draft offer document with the Board in accordance with sub-regulation (1) of regulation 6: **Provided** that in case equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period referred in this sub-regulation: **Provided** further that the requirement of holding equity shares for a period of one year shall not apply:

- (a) in case of an offer for sale of specified securities of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector;
 - (b) if the specified securities offered for sale were acquired pursuant to any scheme approved by a High Court under sections 391-394 of the Companies Act, 1956, in lieu of business and invested capital which had been in existence for a period of more than one year prior to such approval.
- (7) No issuer shall make an initial public offer, unless as on the date of registering prospectus or red herring prospectus with the Registrar of Companies, the issuer has obtained grading for the initial public offer from at least one credit rating agency registered with the Board.

Explanation: For the purposes of this regulation:

- (I) "net tangible assets" mean the sum of all net assets of the issuer, excluding intangible assets as defined in Accounting Standard 26 (AS 26) issued by the Institute of Chartered Accountants of India;
- (II) "project" means the object for which monies are proposed to be raised to cover the objects of the issue;
- (III) In case of an issuer which had been a partnership firm, the track record of distributable profits of the partnership firm shall be considered only if the financial statements of the partnership business for the period during which the issuer was a partnership firm, conform to and are revised in the format prescribed for companies under the Companies Act, 1956 and also comply with the following:
 - (a) adequate disclosures are made in the financial statements as required to be made by the issuer as per Schedule VI of the Companies Act, 1956;
 - (b) the financial statements are duly certified by a Chartered Accountant stating that:
 - (i) the accounts and the disclosures made are in accordance with the provisions of Schedule VI of the Companies Act, 1956;
 - (ii) the accounting standards of the Institute of Chartered Accountants of India have been followed;
 - (iii) the financial statements present a true and fair view of the firm's accounts;
- (IV) In case of an issuer formed out of a division of an existing company, the track record of distributable profits of the division spun-off shall be considered only if the requirements regarding financial statements as provided for partnership firms in Explanation III are complied with;

- (V) "bid-ask spread" means the difference between quotations for sale and purchase;
- (VI) The term "infrastructure sector" includes the facilities or services as specified in **Schedule X**.

Conditions for further public offer (Regulation 27)

An issuer may make a further public offer if it satisfies the conditions specified in clauses (d) and (e) of sub-regulation (1) of regulation 26 and if it does not satisfy those conditions, it may make a further public offer if it satisfies the conditions specified in sub-regulation (2) of regulation 26.

Question 20

Super Chemicals Limited, a closely held unlisted company, is in need of about Rs. 20 crores for financing its expansion programme. The company has not declared any dividend so far though it has made good profits from the commencement of commercial operations on 1st January, 1995. The paid-up capital of the company was increased to Rs. 3.5 crores on 1st April, 1998. The net worth of the company as per latest audited Balance Sheet as at 31st March, 2002 is Rs. 5 crores. The company seeks your advice as to its eligibility to raise Rs. 20 crores through public issue of equity shares at a premium. Advise with reference to relevant guidelines issued by SEBI.

(May, 2003)

Answer

Super Chemicals Ltd, a closely held company is eligible to raise Rs.20 crores through public issue of equity shares at a premium provided it satisfies the **Conditions for initial public offer contained in Regulation 26 of the SEBI (ICDR) Regulations 2009**.

- (a) it has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent. are held in monetary assets: **Provided** that if more than fifty per cent. of the net tangible assets are held in monetary assets, the issuer has made firm commitments to utilise such excess monetary assets in its business or project;
- (b) it has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of the immediately preceding five years: **Provided** that extraordinary items shall not be considered for calculating distributable profits;
- (c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each);
- (d) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;

- (e) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

Question 21

What are the SEBI's important guidelines regarding pricing of first issue of Equity shares of new companies? (November, 2000)

A company proposes to make a public issue of equity shares for financing its project through book building process. It proposes to fix the floor price of the share at Rs.500 for a share of Rs. 10. Answer the following with reference to SEBI (Disclosure and Investor Protection) guidelines:

What is the price band that may be indicated in the red herring prospectus?

If the company wants to lower the floor price during the bidding period in order to increase the response to the issue, state the conditions subject to which such revision can be made.

(CA Final, New Course, November, 2008)

Answer

Pricing of public issue of equity shares are contained in SEBI (ICDR) Regulations, 2009 - Regulations 28 to 31, Part II of Chapter III

Pricing

- 28.** (1) An issuer may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.
- (2) An issuer may determine the coupon rate and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process.
- (3) The issuer shall undertake the book building process in a manner specified in **Schedule XI**.

Differential pricing

- 29.** An issuer may offer specified securities at different prices, subject to the following:
- (a) retail individual investors or retail individual shareholders ¹[or employees of the issuer entitled for reservation made under regulation 42 making an application for specified securities of value not more than one lakh rupees,] may be offered specified securities at a price lower than the price at which net offer is made to other categories of applicants:

¹ Inserted by SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2009, w.e.f. 11.12.09.

Provided that such difference shall not be more than ten per cent. of the price at which specified securities are offered to other categories of applicants;

- (b) in case of a book built issue, the price of the specified securities offered to an anchor investor shall not be lower than the price offered to other applicants;
- (c) in case of a composite issue, the price of the specified securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference shall be given in the offer document.
- (d) In case the issuer opts for the alternate method of book building in terms of Part D of Schedule XI, the issuer may offer specified securities to its employees at a price lower than the floor price:

Provided that the difference between the floor price and the price at which specified securities are offered to employees shall not be more than ten per cent. of the floor price.]

Price and price band

30. (1) The issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies: Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.
- (2) If the floor price or price band is not mentioned in the red herring prospectus, the issuer shall announce the floor price or price band at least two working days before the opening of the bid (in case of an initial public offer) and at least one working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre issue advertisement was released.
- (3) The announcement referred to in sub-regulation (2) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.
- (4) The cap on the price band shall be less than or equal to one hundred and twenty per cent. of the floor price.
- (5) The floor price or the final price shall not be less than the face value of the specified securities. **Explanation:** For the purposes of sub-regulation (4), the "cap on the price band" includes cap on the coupon rate in case of convertible debt instruments.

Face value of equity shares.

31. (1) Subject to the provisions of the Companies Act, 1956, the Act and these regulations, an issuer making an initial public offer may determine the face value of the equity shares in the following manner:

- (a) if the issue price per equity share is five hundred rupees or more, the issuer shall have the option to determine the face value at less than ten rupees per equity share: Provided that the face value shall not be less than one rupee per equity share;
- (b) if the issue price per equity share is less than five hundred rupees, the face value of the equity shares shall be ten rupees per equity share:

Provided that nothing contained in this sub-regulation shall apply to initial public offer made by any government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in infrastructure sector.

- (2) The disclosure about the face value of equity shares (including the statement about the issue price being "X" times of the face value) shall be made in the advertisements, offer documents and application forms in identical font size as that of issue price or price band.

Explanation: For the purposes of this regulation, the term "infrastructure sector" includes the facilities or services as specified in **Schedule X**.

Question 22

An Unlisted Public Company, having a paid-up equity share capital of Rs.5 Crores consisting of 50,00,000 equity shares of Rs.10 each fully paid-up, proposes to reduce the denomination of equity shares to less than Rs.10 Per share and make an initial public offer of equity shares at a premium. Examine whether it is possible for the company to issue shares at a denomination of less than Rs.10 and, if so, state the minimum issue price and other conditions to be fulfilled under the SEBI (Disclosure and Investor Protection) Guidelines, 2000. **(November, 2009)**

Answer

Denomination of shares for public issue

An eligible company shall be free to make a public or right issue of equity shares in any denomination determined by it by complying with section 13(4) of the Companies Act, 1956 and also SEBI Guidelines.

According to SEBI guidelines, in case of initial public offer by an unlisted company.

- (a) if the issue price is Rs.500 or more, the issuer company shall have a discretion to fix the face value below Rs.10 per share subject shall in no case be less than Re.1 per share and also it shall not be is decimal of a rupee.
- (b) If issue price is less than Rs.500 per share the face value shall be Re.10 per share.

Here the issue price has not been given in the question. It is possible for the company to issue shares having a face value of less than Rs.10 per share only if the issue price is Rs.500 or more (para 3.7.1)

However, at any one time, shares shall be only of one denomination. Hence the denomination of existing shares can be altered by changing memorandum and articles by passing special resolution disclosure and accounting norms specified by the SEBI from time to time (para 3.7.). The face value shall be disclosed in the advertisement offer documents and is application fauses, in the same font size as that of issue price or price band .

Promoters' Contribution and Lock in period (Regulations 32)

Question 23

An unlisted Company, having paid-up Share Capital of Rs.3 crores consisting of 30,00,000 Equity Shares of Rs. 10 each fully paid-up, proposes to make an initial Public offer of 90,000 Equity Shares of Rs.10 each at a premium of Rs.5 per share, in July, 2004. The promoters acquired 10,00,000 shares on 1st January, 2000 and another 10,00,000 shares on 1st January, 2004 at face value:

- (i) *What should be the minimum contribution that should be made by the promoters of the above company in order to comply with the guidelines issued by SEBI?*
 - (ii) *State also the period for which the promoters are required to hold these shares and also the shares, if any acquired by the promoters in excess of the required minimum contribution.*
- (May, 2004)**

Answer

- (i) The minimum contribution that should be made by the promoters should be in accordance with the Regulation 32 (1) of the SEBI (ICDR) Regulations, 2009. According to the said regulations the promoters of the issuer shall contribute in the public issue in case of an initial public offer, not less than twenty per cent. of the post issue capital. In the above case, pre-issued capital is Rs. 3 crores and proposed issue is Rs. 9 crores (90,000 equity shares of Rs. 10 each). Of the total post issue capital ie. Rs. 12 crores (Rs. 3 crores + Rs. 9 crores), **the promoters have to contribute minimum of Rs. 2.4 crores (20% of Rs. 12 crores). For the purpose of promoters' contribution, the following securities shall be considered as ineligible as per Regulation 33 (b) (i)**

Specified securities acquired by promoters during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer: Provided that nothing contained in this clause shall apply: if promoters pay to the issuer, the difference between the price at which specified securities are offered in the initial public offer and the price at which the specified securities had been acquired.

In the above case, shares acquired by the promoters on 1st January, 2004 shall not be taken into account for the computation of promoter's contribution, as the allotment was made in the preceding one year. However, shares acquired during the 1st January, 2000 shall be taken into account for promoter's contribution. Further, it is to be noted that there is a difference in price (shares which were earlier acquired at Rs.10 each as on 1st January, 2000 and the issue price in July, 2004 (Rs 15 per share). In view of the proviso in the said Regulation, the difference in price (Rs. 15 including premium of Rs. 5 per share for issue in July, 2004 and acquisition @ Rs.10 per share = Rs. 5 per share for 10 lakh equity shares (Rs 50 lakhs) acquired in 1st January, 2004 need to be brought in by the promoters. In view of the proviso to the said Regulation, the acquisition of shares in July, 2004 of 10 lakh shares will also be taken into consideration for calculating promoters' contribution. Of the total Rs.2.4 crores issue of shares, if Rs. 2 crores issue already acquired by the promoters are taken into account, then the promoters are eligible to subscribe only for the balance of 4 lakh shares (ie. 2.4 crores – 2 crores = 0.4 crores or 44 lakh equity shares).

(ii) **Lock-in of specified securities held by promoters: As per Regulation 36 of the SEBI (ICDR) Regulations, 2009**, In a public issue, the specified securities held by promoters shall be locked-in for the period stipulated hereunder:

- (a) minimum promoters' contribution shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the public issue, whichever is later;
- (b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year: Provided that excess promoters' contribution as provided in proviso to clause (b) of regulation 34 shall not be subject to lock-in.

Explanation: For the purposes of this clause, the expression "date of commencement of commercial production" means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document.

Accordingly, in the above case, promoters are required to hold the shares for a lock-in-period of 3 years. However, any excess of minimum promoter's contribution shall be locked in for a period of 1 year.

Green Shoe Option (Regulation 45)

Explain clearly the meaning of the term “Green shoe option” in relation to a public company going for public offer of equity shares. What disclosures is such a company required to make in the draft red herring prospectus in accordance with SEBI (Disclosure and Investor Protection) Guidelines? (November, 2008)

“Green Shoe Option” means an option of allotting equity shares in excess of the equity shares offered in the public issue as a post-listing price stabilizing mechanism; (Regulation 2(o))

Price stabilisation through green shoe option.

- (1) An issuer making a public issue of specified securities may provide green shoe option for stabilising the post listing price of its specified securities, subject to the following:
 - (a) the issuer has been authorized, by a resolution passed in the general meeting of shareholders approving the public issue, to allot specified securities to the stabilising agent, if required, on the expiry of the stabilisation period;
 - (b) the issuer has appointed a merchant banker or book runner, as the case may be, from amongst the merchant bankers appointed by the issuer as a stabilising agent, who shall be responsible for the price stabilisation process;
 - (c) prior to filing the draft offer document with the Board, the issuer and the stabilising agent have entered into an agreement, stating all the terms and conditions relating to the green shoe option including fees charged and expenses to be incurred by the stabilising agent for discharging his responsibilities;
 - (d) prior to filing the offer document with the Board, the stabilising agent has entered into an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them in accordance with clause (g) of this sub-regulation, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size (hereinafter referred to as the “over-allotment”), which shall not be in excess of fifteen per cent. of the issue size;
 - (e) subject to clause (d), the lead merchant banker or lead book runner, in consultation with the stabilising agent, shall determine the amount of specified securities to be over-allotted in the public issue;
 - (f) the draft and final offer documents shall contain all material disclosures about the green shoe option specified in this regard in **Part A of Schedule VIII**;
 - (g) in case of an initial public offer pre-issue shareholders and promoters and in case of a further public offer pre-issue shareholders holding more than five per

- cent. specified securities and promoters, may lend specified securities to the extent of the proposed over- allotment;
- (h) the specified securities borrowed shall be in dematerialised form and allocation of these securities shall be made pro-rata to all successful applicants.
- (2) For the purpose of stabilisation of post-listing price of the specified securities, the stabilising agent shall determine the relevant aspects including the timing of buying such securities, quantity to be bought and the price at which such securities are to be bought from the market.
- (3) The stabilisation process shall be available for a period not exceeding thirty days from the date on which trading permission is given by the recognised stock exchanges in respect of the specified securities allotted in the public issue.
- (4) The stabilising agent shall open a special account, distinct from the issue account, with a bank for crediting the monies received from the applicants against the over-allotment and a special account with a depository participant for crediting specified securities to be bought from the market during the stabilisation period out of the monies credited in the special bank account.
- (5) The specified securities bought from the market and credited in the special account with the depository participant shall be returned to the promoters or pre-issue shareholders immediately, in any case not later than two working days after the end of the stabilization period.
- (6) On expiry of the stabilisation period, if the stabilising agent has not been able to buy specified securities from the market to the extent of such securities over-allotted, the issuer shall allot specified securities at issue price in dematerialised form to the extent of the shortfall to the special account with the depository participant, within five days of the closure of the stabilisation period and such specified securities shall be returned to the promoters or pre-issue shareholders by the stabilising agent in lieu of the specified securities borrowed from them and the account with the depository participant shall be closed thereafter.
- (7) The issuer shall make a listing application in respect of the further specified securities allotted under sub-regulation (6), to all the recognised stock exchanges where the specified securities allotted in the public issue are listed and the provisions of Chapter VII shall not be applicable to such allotment.
- (8) The stabilising agent shall remit the monies with respect to the specified securities allotted under sub-regulation (6) to the issuer from the special bank account.
- (9) Any monies left in the special bank account after remittance of monies to the issuer under sub- regulation (8) and deduction of expenses incurred by the stabilising agent

for the stabilisation process shall be transferred to the Investor Protection and Education Fund established by the Board and the special bank account shall be closed soon thereafter.

- (10) The stabilising agent shall submit a report to the stock exchange on a daily basis during the stabilisation period and a final report to the Board in the format specified in **Schedule XII**.
- (11) The stabilising agent shall maintain a register for a period of at least three years from the date of the end of the stabilisation period and such register shall contain the following particulars:
- (a) The names of the promoters or pre-issue shareholders from whom the specified securities were borrowed and the number of specified securities borrowed from each of them;
 - (b) The price, date and time in respect of each transaction effected in the course of the stabilisation process; and
 - (c) The details of allotment made by the issuer on expiry of the stabilisation process.

Preferential Issue (Chapter VII – Regulation 76)

Question 24

MGR Ltd. wants to issue certain shares on preferential basis and has sought your advice in respect of pricing the shares for such issue. You are required to state the guidelines issued by the Securities and Exchange Board of India in respect of pricing of the issue of shares on a preferential basis.

(May, 2008)

Answer

The Regulations relating to pricing of the issue of shares on a preferential basis is contained in Regulation 76 in Chapter VII of the SEBI (ICDR) Regulations, 2009.

Pricing of equity shares.

- (1) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of six months or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:
- (a) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the six months preceding the relevant date; or
 - (b) The average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

- (2) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than six months as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:
- (a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, pursuant to which the equity shares of the issuer were listed, as the case may be;
- Or
- (b) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or
 - (c) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.
- (3) Where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of six months from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these six months and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.
- (4) Any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

Explanation: For the purpose of this regulation, 'stock exchange' means any of the recognised stock exchanges in which the equity shares are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding six months prior to the relevant date.

Question 25

Excel Ltd., a public limited company listed with The Stock Exchange, Mumbai, wants to make issue of equity shares on preferential basis pursuant to a scheme approved under Corporate Debt Restructuring framework specified by Reserve Bank of India to various persons as may be selected by the Board of Director of the Company. Following information relevant to the preferential issue is available:

- (i) *Total No. of equity shares to be issued: 50 Lac equity shares of Rs.10 each out of which 30 lac equity shares will be allotted on 30th June, 2005 as fully paid up and*

balance 20 lac equity shares shall be allotted on the same date but paid up to Rs.5 each and balance Rs.5 shall be called upon at a later date and shall be paid up on 30th November, 2005.

- (ii) Out of the proposed allottees some persons are holding their shares in Excel Ltd. in physical form and not in dematerialised form and some persons had sold their entire shareholding in Excel Ltd. in January, 2005.*
- (iii) The meeting of general body of shareholders for approving the preferential issue was held on 15th March, 2005.*

Based on the above information you are required to answer the following queries with reference to the SEBI (Disclosure and Investor Protection Guidelines, 2000:

- (i) What would be the lock-in period for the shares allotted on preferential basis?*
- (ii) Who are the persons not entitled for allotment of shares on preferential basis?*

(May, 2005, May 2008)

Answer

- (i) Lock-in period for the shares allotted on preferential basis: Regulation 76(4), SEBI, (ICDR) Regulations, 2009.**

As per the aforesaid regulation, the equity shares issued on preferential basis pursuant to a scheme of corporate debt restructuring as per the Corporate Debt Restructuring framework specified by the Reserve Bank of India shall be locked-in for a period of one year from the date of allotment: **Provided** that partly paid up equity shares, if any, shall be locked-in from the date of allotment and the lock-in shall end on the expiry of one year from the date when such equity shares become fully paid up. Accordingly, the first lot of 30 lac full paid equity shares issued on 30th June, 2005 will have a lock-in period of 1 year from the date of allotment. i.e. till 30th June, 2006. In respect of the second lot, of partly paid 20 lac equity shares, the lock in period will be till 30th November, 2006 being the date on which the calls shall be paid up on 30th November, 2005.

- (ii) Persons not entitled for allotment of shares on preferential basis (Regulation 72)**

- (1) A listed issuer may make a preferential issue of specified securities, if:
 - (a) a special resolution has been passed by its shareholders;
 - (b) all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;
 - (c) the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed;

- (d) the issuer has obtained the Permanent Account Number of the proposed allottees.
- (2) The issuer shall not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date: **Provided** that in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of regulation 29A of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 to such preferential allotment.

Accordingly, as given in the problem, persons are holding their shares in Excel Ltd. in physical form and not in dematerialised form and persons had sold their entire shareholding in Excel Ltd. in January, 2005 shall not be eligible for preferential allotment of shares.

Issue of Bonus Shares - Chapter IX – Regulations 92 - 95

Question 26

The Balance Sheet of M/s Get Rich Quick Ltd. as at 31.3.2001 disclosed the following details:

- (i) Share Capital Rs. 150 crores
- (ii) Reserves and Surplus Rs. 750 crores

The company has issued in the year 1996, fully convertible debentures of Rs.100 crores, which are due for conversion in the year 2001. The company proposes to issue bonus shares in the ratio of 1: 1. Explain briefly the SEBI guidelines to be followed by the company.

(May, 2001)

or

Following information and figures are noticed from the Annual Accounts for the year ended 31st March, 2003 of MNP Limited, a listed company:

- (i) Authorised Shares Capital Rs.10 crores comprising of one crore Equity shares of Rs.10 each.
- (ii) Paid-up Share Capital of Rs.4.5 crores comprising of 40,00,000 Equity shares of Rs.10 each fully paid-up and 10,00,000 Equity shares of Rs.10 each called and paid-up to Rs.5 each. The total paid-up capital is paid up in cash.
- (iii) Securities Premium Account Rs.10 crores.

- (iv) 2,50,000 fully convertible debentures of Rs.100 each. These debentures are due for conversion on 30th June, 2003 in full into fully paid Equity shares of Rs.10 each in the ratio of two equity shares for one debenture.
- (v) General Reserve Rs.15 crores.
- (vi) Fixed asset revaluation reserves Rs.2.5 crores.

It was further ascertained that the partly paid shares were made fully paid by 30th June, 2003.

The Directors of MNP Limited propose to issue bonus shares in the ratio of 1:1.

Advise the Directors on the matter with reference to the guidelines issued by SEBI on bonus issue. What will be your advice, if the company has defaulted in the matter of payment of interest on fixed deposits?
(November, 2003)

Answer

Chapter IX of the SEBI (ICDR) Regulations, 2009 deal with the issue of Bonus Shares. They are contained in Regulations 92 to 95 of the said Regulations. Applying the said Regulations, the above stated problem can be solved as follows:

1. Conditions for Bonus Issue

Subject to the provisions of the Companies Act, 1956 or any other applicable law for the time being in force, a listed issuer may issue bonus shares to its members if:

- (a) it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.. If there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve.
- (b) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (c) it has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
- (d) the partly paid shares, if any outstanding on the date of allotment, are made fully paid up.

In the above stated problem, MNP Ltd, authorized capital is Rs.10 crores and proposes to issue bonus shares in the ratio of 1:1, which means the authorized capital after bonus issue is to increase the company has to pass a special resolution for increase of its authorized capital because of bonus issue. In the said problem, MNP Ltd has –

Fully paid up share capital	Rs 4.0 crores	40,00,000 shares of Rs. 10 each)
Partly paid-up capital (to be made fully paid-up before bonus issue)	Rs.1 crore	10,00,000 shares of Rs. 10 each, Rs. 5 paid-up
2,50,000 convertible debentures of Rs. 100 each convertible into full paid up shares of Rs. 10 each in the ratio of 2 equity shares for every 1 debenture	Rs. 5 crores	5,00,000 shares of Rs. 10 each.
Total capital after conversion	Rs.5.5 crores	5,50,000 shares of Rs. 10 each

In all the company will be having 40,00,000 + 10,00,000 + 5,00,000 shares of Rs. 10 each amounting to Rs. 5.5 crores of paid-up capital.

If the company propose to issue bonus shares in the ratio of 1:1, then post-issue capital will be Rs.11 crores (5.5 crores + 5.5 crores), bringing the authorized capital to Rs. 11 crores (post bonus issue) and since its present authorized capital is Rs. 10crores, it has to pass a special resolution for increasing to Rs. 11 crores.

Bonus shares only against reserves, etc. if capitalised in cash. (Regulation 94)

- (1) The bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares.
- (2) Without prejudice to the provisions of sub-regulation (1), the bonus share shall not be issued in lieu of dividend.

Applying the above regulations, MNP Ltd, currently has Rs. 25 crores (general reserve of Rs 15 crores and Rs. 10 crores as securities premium amount) which can be utilised for the purpose of bonus issue amounting to Rs. 5.5 crores.

Completion of bonus issue (Regulation 95)

- (1) An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors. **Provided** that where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

- (2) Once the decision to make a bonus issue is announced, the issue can not be withdrawn.

Question 27

- (a) As on 31st December, 2004, following information and figures are noticed from the Annual Accounts for the year ended 31st March, 2004 of SKP Ltd., a Company listed with The Stock Exchange, Mumbai:
- (i) Authorised Share Capital Rs.20.00 Crores comprising of 2 Crore Equity Shares of Rs.10 each.
 - (ii) Paid up Share Capital Rs.9.00 Crores comprising of 80 lac Equity Shares of Rs.10 each fully paid up and 20 lac Equity Shares of Rs.10 each called and paid up to Rs.5 each. The total paid up capital is paid up in cash.
 - (iii) Securities Premium Account Rs.20.00 Crores.
 - (iv) 5 lac Fully Convertible Debentures of Rs.100 each. These debentures are due for conversion on 31st March, 2005 in full into fully paid Equity Shares of Rs.10 each in the ratio of one Debenture: two Equity Shares.
 - (v) General Reserve Rs.30.00 Crores.
 - (vi) Fixed Assets Revaluation Reserve Rs.10.00 Crores.
 - (vii) Outstanding Liabilities in respect of Bonus to Employees and Workers Rs.25.00 lacs.
 - (viii) Outstanding Liabilities in respect of Interest payable on Public Deposits comprising of Fixed Deposits from general public Rs.15.00 lacs.

Following other information is gathered from the books of account and other records of the said Company for the period upto 31st December, 2004:

- (a) The partly paid shares were made fully paid prior to 30th September, 2004.
- (b) Bonus to employees and workers was paid on 15th September, 2004.
- (c) Interest on Public Deposits was outstanding on 31st December, 2004.

The Directors of SKP Ltd. wants to issue Bonus Shares on or after 1st April, 2005 in the ratio of 1:1. Advise the Directors on the matter with reference to the guidelines issued by Securities and Exchange Board of India on Bonus Issue. **(May, 2005, May, 2007)**

Answer

Chapter IX of the SEBI (ICDR) Regulations, 2009 deal with the issue of Bonus Shares. They are contained in Regulations 92 to 95 of the said Regulations. Applying the said Regulations, the above stated problem can be solved as follows:

Whether there is any need for increase of authorized capital because of bonus issue?

Fully Paid up share capital	80,00,000 x Rs. 10	Rs 8 crores
Partly paid-up capital (Rs 5 each) converted into fully paid-up of Rs. 10 each	20,00,000 x Rs 10	Rs. 2 crores
Total paid up capital after conversion partly paid up are converted into fully paid-up	1,00,00,000 x Rs. 10	Rs 10 crores
<i>5 lac Fully Convertible Debentures of Rs.100 each. (These debentures are due for conversion on 31st March, 2005 in full into fully paid Equity Shares of Rs.10 each in the ratio of one Debenture: two Equity Shares)</i>	10,00,000 x Rs 10	Rs 1crore
Capital before bonus issue		Rs 11 crores
Bonus issue 1:1		Rs/ 11 crores
Capital after bonus issue		Rs. 22 crores
Current authorized capital		Rs 20 crores

In view of the increase in authorized capital because of bonus issue, the company has to pass a special resolution.

Bonus shares only against reserves, etc. if capitalised in cash

As per Regulation 94 (1), the bonus issue shall be made out of free reserves built out of the genuine profits or securities premium collected in cash only and reserves created by revaluation of fixed assets shall not be capitalised for the purpose of issuing bonus shares. In the given case, the bonus issue amounts to Rs. 11 crores which can be paid out of Securities premium account (Rs. 20 crores) and General Reserves (Rs. 30 crores).

As per the Conditions for bonus issue stated in Regulation 92, bonus issue cannot be made if the company has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it; it has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus and the partly paid shares, if any outstanding on the date of allotment, are made fully paid up. In the present case, SKP Ltd, proposed date of bonus issue is on or after 1st April, 2005 and since partly paid-up shares were made fully paid-up prior to 30th June, 2004, bonus to employees and workers were paid on 15th September, 2004 and interest on public deposits was still outstanding on 31st December, 2004, it is advised that the company shall make good the interest on public deposits before proceeding for its bonus issue.

Question 28

The Balance Sheet of Get Well soon Ltd as at 31.3.2009 disclosed the following details:

- (i) *Authorised share capital Rs.400 crores*
- (ii) *Paid up share capital Rs.150 crores*
- (iii) *Reserves and surplus Rs.750 crores*

The company has issued in the year 2004, Fully Convertible Debentures of Rs.100 crores which are due for conversion in the year 2009. The company proposes, after conversion of Debentures to issue Bonus shares in the ratio of 1:1. Explain briefly the requirements of the Companies Act, 1956 and the Securities and Exchange Board of India (SEBI) guidelines to be followed by the company in this regard. **(May 2009)**

Answer

Chapter IX of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 contains the Regulations (Regulations 92 to 95) for issue of bonus shares, following which M/s Get well soon Ltd. can make a bonus issue in the ratio of 1:1 as follows:

1. The articles of M/s Get well Soon Ltd. must authorize it to issue the bonus shares. If there is no provision in the articles authorizing the company to issue bonus shares, firstly, the articles shall be amended by passing a special resolution.
2. Steps for determining whether any increase in authorised share capital is required.
 - (a) Paid up share capital as on 31st March, 2009 Rs.150 crores.
 - (b) Paid up capital (after conversion of Rs.100 crores fully convertible debentures, assuming that these debentures shall be converted into share capital Rs.100 crores) Rs.250 crores.
 - (c) Proposed bonus issue – 1 share for every held.
 - (d) Post bonus issue capital. Rs.500 crores.

Since the authorised share capital of the company is only Rs.400 crores, it has to take steps to increase the amount to Rs.500 crores or beyond by complying with the provisions laid down in section 94 and 97 of the Companies Act,1956.

3. Sources of bonus shares.

Reserves and surplus (since free reserves built out of the genuine profits can be used for issue of bonus issue). Rs. 750 Crores

Since the source of issue of bonus shares (Rs.750 crores) is sufficient to issue bonus shares (Rs.250 crores), the proposed issue can be made.

4. Other legal requirements for issue of bonus shares are as under.
 - (a) A resolution shall be passed by the board in a duly convened board meeting.
 - (b) The bonus issue shall be made within 6 months of passing the board resolution.

5. The bonus issue can be made if there is no default in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption there of; and Payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

Pricing under Book-Building Process

Question 29

XYZ Automobiles Ltd. intends to make a public issue of 2,00,00,000 equity shares of Rs. 10 each through the 100% book building process indicating a price band. You are required to answer the following with reference to the SEBI (Disclosure and Investor Protection) Guidelines:

- (i) *What is the price band that can be indicated in the red herring prospectus, if the floor price is proposed to be fixed at Rs. 300 per equity share?*
 - (ii) *What are the restrictions, if the company wants to revise the price band during the bidding period?*
 - (iii) *How the shares are to be allocated to different categories of investors like Qualified institutional buyers, Retail individual investors, etc.?*
- (November 2006)**

Answer

Schedule XI of the SEBI (ICDR) Regulations, 2009 contains provisions relating to Book-Building process. Clause 8 (b) deals with the Floor Price and Price Band. According to the said clause where the issuer decides to opt for price band instead of floor price, the issuer shall also ensure compliance with the following conditions:

- 1. The cap of the price band should not be more than 20% of the floor of the band; i.e cap of the price band shall be less than or equal to 120% of the floor of the price band.
- 2. The price band can be revised during the bidding period in which case the maximum revision on either side shall not exceed 20% i.e floor of price band can move up or down to the extent of 20% of floor of the price band disclosed in the red herring prospectus and the cap of the revised price band will be fixed in accordance with clause (i) above.
- 3. Any revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing press release and also indicating the change on the relevant website and the terminals of the syndicate members.
- 4. In case the price band is revised, the bidding period shall be extended as per provisions of sub-regulation (2) of regulation 46.

5. The manner in which the shortfall, if any, in the project financing, arising on account of lowering of price band to the extent of 20% will be met shall be disclosed in the red herring prospectus. It shall also be disclosed that the allotment shall not be made unless the financing is tied up.

Accordingly, in the given problem

- (i) The price band that can be indicated in the red herring prospectus, if the floor price is to be fixed at Rs. 300 per share will be 20% of the floor price i.e. $\text{Rs. } 300 + 20\% = \text{Rs. } 360$ per share.
- (ii) If the company wants to revise the price band during the bidding period, the maximum revision on either side shall not exceed 20% i.e. floor of price band can move up or down to the extent of 20% of floor of the price and the cap of the revised price band shall not be more than 20% of the revised floor price band. In other words, on the lower side it can be down by Rs. 240 ($300 - 20\% = \text{Rs. } 260$) and 360 being the revised price band $- 20\% = \text{Rs. } 288$) and on the upper side, it can be Rs. 360 ($\text{Rs. } 300 + 20\%$) and Rs. 432 ($360 + 20\%$).
- (iii) Any revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing press release and also indicating the change on the relevant website and the terminals of the syndicate members. Regarding the period of subscription, Regulation 46 provides that a public issue shall be kept open for at least three working days but not more than ten working days including the days for which the issue is kept open in case of revision in price band. In case the price band in a public issue made through the book building process is revised, the bidding (issue) period disclosed in the red herring prospectus shall be extended for a minimum period of three working days, provided that the total bidding period shall not exceed ten working days.
- (iv) As per Regulation 42, if an issue is made through book building process, the allocation to different categories of investors will be as follows:
 - o Not less than 35% to retail individual investors
 - o Not less than 15% to non-institutional investors
 - o Not less than 50% to qualified institutional buyers, five per cent. of which shall be allocated to mutual funds:

Question 30

A company proposes to make a public issue of equity shares for financing its project through book building process. It proposes to fix the floor price of the share at Rs.500 for a share of Rs. 10. Answer the following with reference to SEBI (Disclosure and Investor Protection) guidelines:

What is the price band that may be indicated in the red herring prospectus?

If the company wants to lower the floor price during the bidding period in order to increase the response to the issue, state the conditions subject to which such revision can be made.

(November, 2008)

Answer

The price band is the range within which the price can move. The cap of the price band shall not be more than 20% of the floor price. If the floor price is Rs.500 the cap of the price shall be Rs.600 and the company may indicate a price band of Rs.500 to 600 in the red herring prospectus (Schedule XI, Clause 8(b) SEBI (ICDR) Regulations, 2009..

The price band can be revised during the bidding period in which case the maximum revision on either side shall not exceed 20% i.e. floor of the price band can move up or down to the extent of 20% of the floor price. Hence the revised price band may be Rs. 400 (Rs. 500 less 20%) to 480 (120% of Rs.400).

Any revision in the price band shall be widely disseminated by informing the stock exchange, by issuing press releases and also indicating the change on the relevant website and terminals of syndicate members. The bidding period shall be extended for a further period of 3 days subject to the total bidding period not exceeding 10 days. The manner in which the shortfall, if any in the project financing arising on account of lowering of price band will be met shall be disclosed in the red- herring prospectus. It shall also be disclosed that the allotment shall not be made unless the financing is tied up. These are the conditions subject to which the price the price band may be lowered

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THE SECURITIES CONTRACTS (REGULATION) ACT, 1956

Question 1

- (a) (i) *Delhi Stock Exchange wants to establish additional Trading Floor. Explain briefly the meaning of and procedure for establishing additional Trading Floor.*
- (ii) *Complaints of unethical practices have been received against members of the Governing Body of a Recognized Stock Exchange. Examine whether the Government has any power to take action against the Governing Body of the said exchange.*
- (b) *The application filed by M/s XYZ Ltd. for the listing of its securities has been rejected by the Mumbai Stock Exchange. Advise the company regarding the steps it can take against the rejection.* **(November, 2002)**

Answer

- (a) (i) According to Section 13 A of Securities Contracts (Regulation) Act 1956, a Stock Exchange may establish additional trading floor with the prior approval of the Securities Exchange Board of India in accordance with the terms and conditions stipulated by the said Board.
- For the purpose of this section 'Additional Trading Floor' means a trading ring or trading facility offered by a recognized stock exchange outside its area of operation to enable the investor to buy and sell securities through such trading floor under the regulatory frame work of that Stock Exchange.
- (ii) Section 11, of the Securities Contracts (Regulation) Act, 1956 deals with the powers of the Central Government to supersede the Governing body of a recognized Stock Exchange. The Central Government may serve on a governing body a written notice specifying the reasons and after giving an opportunity to the governing body to be heard, may, by notification in the Official Gazette, declare the governing body as superseded. The Central Government after superseding the governing body may appoint any person or persons to exercise and perform all the powers and duties of governing body. It may also appoint one of such nominees as Chairman.

- (b) Yes XYZ Ltd. can appeal against refusal of stock exchange to list the securities. Section 22 of Securities Contracts (Regulation) Act 1956 deals with this. According to section:

where a recognized stock exchange refuses listing to a company, it has to furnish reasons for refusal to the company. Section 73(1) of the Companies Act, 1956 specifies the time period within which stock exchange has to grant listing permission. If exchange fails to do so within the time limit or refuses to list, the company may within 15 days make an appeal to the Central Government. The Central Government may after hearing the Stock Exchange vary or set aside the decision of the Stock Exchange, or grant permission for listing.

However, no appeal under this section shall be allowed after the commencement of Securities Laws (Second Amendment) Act 1999 since appeal before Securities Appellate Tribunal is permitted under Section 22A.

Where a Stock Exchange refuses listing or is unable to grant listing within time frame prescribed, company is entitled to appeal to Securities Appellate Tribunal (SAT). SAT may, after hearing the exchange vary or set aside exchange's order or grant or refuse. (Section 22A).

Question 2

- (a) *M/s AB & Company, a member of a recognised stock exchange propose to buy and sell shares of a particular company on behalf of investors as well as on their own account. They seek your advice as to restrictions, if any, under Securities Contracts (Regulation) Act, 1956 for dealing in securities on their own account. Advise.*
- (b) *Rampur Stock Exchange wants to get itself recognize. Explain':*
- (i) *Who enjoys the power to recognize stock exchange?*
 - (ii) *What information will have to be provided with the application for recognition?*

(May, 2003)

Answer

- (a) **Members not to act as principals in certain circumstances:**

Members of stock exchange normally carry out transactions on behalf of investors and hence principal agent relationship exists. A Member can enter into transaction as principal with another member of the Exchange only. If he desires to enter into contract as principal with a non-member, then he has to get written consent from such person to act as principal. Contract note should indicate that he is acting as principal [Section 15, Securities Contract (Regulation) Act, 1956].

Where the member has secured the consent of such person other wise than on writing he shall secure written confirmation by such person or such consent within three days from the date of the contract [Proviso to Section 15].

Spot delivery contracts are outside the preview of section 15 (Section 18).

A & Co, stock broker must bear in mind the above restrictions while entering into any transaction as principal with a non member.

- (b) (i) Power to recognize Stock Exchange vests with Central Government. However, Central Government has delegated the powers to SEBI vide its notification No.F.No.1/57/SE/93 dated 13.9.94. (Section 3 of Securities Contracts (Regulation) Act, 1956).
- (ii) Application for recognition must be accompanied with Bye-Laws, Rules, Regulations which must contain specific details on:
 - 1. Constitution, powers of management and manner of transacting business by the Governing Body of the Stock Exchange.
 - 2. Powers and duties of the offer bearers of Stock Exchange.
 - 3. Various classes of Members, qualification of membership and the exclusion, suspension, expulsion and re-admission of members.
 - 4. The procedure for registration of Partnerships as members to stock exchange and rules of nomination of authorised representatives.

Membership provisions, composition of Board Powers of Governing Board are defined in the Articles of the Exchange. Rules governing Listing Trading and Settlement, Penalties and Prohibitions, Disciplinary Actions and Defaults are defined in Bye-Laws of the Exchange.

Question 3

- (a) *Mr. Patel has transferred his shares of a listed company registered in his name to Mr. Mehta. Mr. Mehta has failed to get the shares registered in his name before the company declared and paid the dividend on the shares. Examine with reference to the provisions of Securities Contracts (Regulation) Act, 1956 whether Mr. Patel is entitled to retain the dividend even though he has transferred the shares before declaration of dividend.*
- (b) *SEBI is of the opinion that in the interest of investors it is desirable to amend the rules of XYZ Stock Exchange prohibiting the appointment of the broker-member as President of the stock exchange. Explain with reference to the provisions of the Securities Contracts (Regulation) Act, 1956 whether it is possible for SEBI to amend the rules of the Stock Exchange, if the rules are not amended by the stock exchange.*

(November, 2003)

Answer

- (a) **Title to dividends:** Section 27(1) of Securities Contracts (Regulation) Act, 1956 provides that a holder of security can legally receive and retain any dividend declared by the company even if he has transferred the security for valuable consideration. However, he (i.e. holder of security who is a transferor) cannot receive or retain the dividend if the transfer deed with all other documents required for transfer are lodged with the company within 15 days of the date on which the dividend became due.

The period of 15 days shall be extended as follows: - (1) In case of death of the transferee by the actual period taken by his legal representative to establish his claim to the dividend. (2) In case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof and (3) In case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of delay (Explanation to Section 27(1) of SCRA).

In view of the above, Mr. Patel is entitled to retain the dividend received by him if the transferee, Mr. Mehta has not lodged the transfer deed with the company within 15 days of the date on which the dividend became due or the extended period as per explanation to Section 27(1).

However, Section 27(1) will not affect the right of the transferee to enforce his rights, if any against the transferor or any other person, if the company refuses to register the transfer of security in the name of the transferee.

- (b) **Power of Central Government/SEBI to direct rules to be made or to make rules:** Central Government is empowered under Section 8 of the Securities Contracts (Regulation) Act, 1956 to issue written order directing all or any of the recognized stock exchanges to make any rules or to amend any rules already made within 2 months from the date of the order in respect of matters specified in Section 3(2). One of the matters specified in Section 3(2) is the governing body of stock exchange, its constitution and powers of management and the manner in which its business is to be transacted. Hence, the Central Government is empowered to direct the Stock Exchange in respect of prohibition of broker-member being appointed as president of the stock exchange. According to the notification issued by the Central Government under Section 29A, this power is also exercisable by SEBI.

If any recognized stock exchange fails or neglects to comply with any order made by SEBI within 2 months, SEBI may itself make the rules made, either in the form prepared in the order or with such modifications thereof as may be agreed to between the stock exchange and SEBI. The amended rules should be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the

recognized stock exchange is situated. After such publication, the rules will be valid, as if they had been made or amended by the stock exchange itself.

Hence SEBI can issue directions to the recognized stock exchange to amend the rules and if the said stock exchange does not take steps for amending the rules, SEBI may amend the rules on its own by following the procedure laid down in Section 8.

Question 4

- (a) *Securities and Exchange Board of India received serious complaints against the Affairs of a Member of a Stock Exchange. Explain the powers of SEBI under Securities Contracts (Regulation) Act, 1956 to make enquiries and to take action, if necessary, against the member of a Stock Exchange.*
- (b) *The governing body of City Stock Exchange Association Ltd. is desirous of putting various restrictions on voting rights of its members to be exercised in a meeting and on their right to appoint a proxy. You are required to state whether the same is permissible. Also state the role of Central Government in this respect. (May, 2004)*

Answer

- (a) **Disciplinary action against members of Stock Exchange:** SEBI can exercise the following powers under Securities Contracts (Regulation) Act, 1956 on receipt of serious complaints against the affairs of a member of a stock exchange.
- (i) SEBI may, if it is satisfied that it is in the interest of the trade or in the public interest, by order in writing call upon the member of the stock exchange to furnish in writing information or explanation in respect of the matter under inquiry [Section 6(3)(a)].
- (ii) SEBI instead of calling for information, may either appoint one or more persons to make an enquiry or direct the governing body of stock exchange to make inquiry and submit its report to SEBI [Section 6(3)(b)].

In case of adverse findings, SEBI can direct stock exchange to take disciplinary action against the member such as fine, expulsion from membership, suspension from membership for a specified period and any other penalty of a like nature not involving the payment of money. Bye-laws of the stock exchange usually provide for such punishment [Section 9(3)(b)]. Stock exchange is under obligation to take the action as directed.

- (b) As per Section 7A(1) of the Securities Contracts (Regulation) Act, 1956 a recognized stock exchange may make rules or amend any rules made by it in respect of voting rights of its members and also on appointment of proxy. The restrictions can be put in respect of the following matters:

- (a) The restriction of voting rights to the members only in respect of any matter placed before the stock exchange at any meeting.
- (b) The regulation of any voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid up equity capital of the stock exchange.
- (c) The restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange.
- (d) Such incidental, consequential and supplementary matters as may be necessary to give effect to the matters as stated in (a), (b) and /or (c) above.

As per section 7(A)(2) of the said Act, the role of the Central Government in respect of the restriction placed by the stock exchange as stated above is as follows:

- (i) Approval of the proposed changes by the stock exchange.
- (ii) Publishing the same in the Official Gazette.
- (iii) To make such modification in the proposed changes as it deems fit.

Question 5

The Rural Electrification Corporation, New Delhi issued 6 years bonds to public directly and not through any Stock Exchange. Whether the Rural Electrification Corporation can do so? Is it not a violation of Securities Contracts (Regulation) Act, 1956? (November, 2004)

Answer

In order to prevent undesirable transactions in securities and to promote healthy stock market, the Securities Contract (Regulation) Act, 1956 was enacted. Stock Exchanges are recognized under the Act. Section 73 of the Companies Act, 1956 lays down that offer of shares or debentures to public for subscription shall be only after the permission of the Stock Exchange. Section 28 of the Securities Contract (Regulation) Act, 1956 says that the provisions of the Act shall not apply to the Government, the Reserve Bank of India, any local authority or any corporation set-up by a special law or any person who has effected any transaction with or through the agency of any such authority as stated above. The Rural Electrification Corporation is a corporation established under a special statute enacted by the Parliament. Therefore, the Corporation need not require permission of any Stock Exchange. It is exempted. There is no violation of the provisions of the Act of 1956 because according to section 28 provisions are not applicable to this corporation.

Question 6

Working of City Stock Exchange Association Ltd., is not being carried on by its Governing Board in public interest. On receipt of representations from various Investors and Investors'

Association, the Central Government is thinking to withdraw the recognition granted to the said Stock Exchange. You are required to state the circumstances and procedure for withdrawal of such recognition as per the provisions of Securities Contracts (Regulation) Act, 1956 in this regard. Also state the effect of such withdrawal on the contracts outstanding on the date of withdrawal.
(May 2005)

Answer

Section 5 of the Securities Contracts (Regulation) Act, 1956 empowers the Central government to withdraw the recognition granted to a Stock Exchange. The circumstances and procedure to be followed for withdrawal of such recognition is stated below:

- (i) If, considering the interest of the trade or the public interest, the Central Government is of the opinion that the recognition granted to a stock exchange should be withdrawn, the Central Government shall serve a written notice of the governing body of the stock exchange.
- (ii) The said notice shall specify the reasons for the proposed withdrawal of the recognition.
- (iii) The governing body of the stock exchange shall be afforded an opportunity of being heard by the Central Government.
- (iv) Even after hearing the governing body, the Central Government is satisfied that the recognition granted to the stock exchange should be withdrawn, the Central Government may, by way of a notification in the Official Gazette, withdraw the recognition granted to the stock exchange.

The proviso to the said section 5 states that no such withdrawal shall affect the validity of any contract entered into or made prior to the date of notification withdrawing the recognition and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification for the due performance of any contracts outstanding on that date.

Question 7

Delhi Stock Exchange has refused to grant listing of the shares of ABC Limited but the Exchange has not disclosed any reason therefore. The company wants to challenge the decision of the Stock Exchange in the Civil Court.

Advise the company pursuant to relevant provisions of the Securities Contracts (Regulation) Act, 1956.
(May 2005)

Answer

Under section 22A of the Securities Contracts (Regulation) Act, 1956 where a recognised Stock Exchange refuses to list the securities of any public company, the company shall be entitled to be furnished with reasons for such refusal. If aggrieved, the company may appeal to the Securities Appellate Tribunal:

- (i) within 15 days from the date on which the reasons for such refusal are furnished to it, or
- (ii) where the Stock Exchange has omitted or failed to dispose of within the time specified in section 73(1A) of the Companies Act, 1956 (i.e., before the expiry of ten weeks from the date of closing of the subscription list as per prospectus) within 15 days from the expiry of the specified time or within such further period not exceeding one month as Securities Appellate Tribunal may allow.

In terms of section 22E of the Act, Civil Court has no jurisdiction to entertain any suit in respect of this matter.

The company may be advised accordingly.

Question 8

Describe the provisions of the Securities Contracts (Regulation) Act, 1956 regarding the powers of the Central Government to supersede the Governing Body of a recognized Stock Exchange and the consequences of such supersession. (November 2005)

Answer

According to the provisions of section 11 of the Securities Contracts (Regulation) Act, 1956, where the Central Government is of opinion that the governing body of any recognized stock exchange should be superseded, then notwithstanding any thing contained in any other law for the time being in force, the Central Government may serve on the governing body a written notice that the Central Government is considering the supersession of the governing body for the reasons specified in the notice. After giving an opportunity to the governing body of such Stock Exchange to be heard in the matter, the Central Government may, by notification in the Official Gazette, declare the governing body of such Stock Exchange to be superseded.

The Central Government may appoint any person or persons to exercise and perform all the powers and duties of the governing body. If more than one person is so appointed, one of them may be the Chairman and another as the Vice-Chairman. Such person or persons shall hold office for such period as may be specified in the Notification and the Central Government may vary such period by way of another Notification.

On the publication of the notification in the Official Gazette, following are the consequences:

- (i) The members of the governing body of such Stock Exchange ceases to hold office as such members on and from the date of notification.
- (ii) The person or persons appointed by the Central Government may exercise and perform all the powers and duties of the governing body which has been so superseded.

- (iii) The property of the Stock Exchange as deemed necessary and so specified in writing by such person or persons to carry on the business of the Stock Exchange shall vest in such person or persons.

Question 9

- (i) *Delhi Stock Exchange wants to establish additional trading floor. Advise.*
- (ii) *Complaints of unethical practices have been received against members of a recognized Stock Exchange by the Government. Examine whether the government has any power to suspend the business of such a recognized Stock Exchange. (November 2005)*

Answer

- (i) According to Section 13A of Securities Contracts (Regulation) Act, 1956, a Stock Exchange may establish additional trading floor with the prior approval of the Securities Exchange Board of India with the terms and conditions stipulated by the said Board. 'Additional Trading Floor' means a trading facility offered by a recognized stock exchange outside its area of operation to enable the investors to buy and sell securities through such trading floor under the regulatory frame work of that Stock-Exchange.
- (ii) Section 12 of the Securities Contracts (Regulation) Act, 1956 deals with the powers of the Central Government to suspend business of recognized Stock Exchange. Central Government, if it deems fit, is vested with power to suspend business for a period not exceeding 7 days by notification in Gazette. Central Government also have power to extend this period by a like notification. However, such power can be exercised by the Central Government, if it is of opinion that an emergency has arisen and it is expedient so to do.

Question 10

On 31st March, 2006 D holds certain securities issued under 'Collective Investment Scheme.' His name appears in the books of the scheme. He has transferred these securities to another person for a consideration. The transferee lodged the instrument of transfer with the authorities one month after the date on which the income on these securities became due. Examining the provisions of the Securities Contracts (Regulation) Act, 1956 state:

- (i) *Whether D is entitled to receive and retain the income on these securities for the financial year ended 31st March, 2006 in the given case?*
- (ii) *Would your answer be still the same in case the transferee lodged the instrument of transfer with the authorities 14 days after the date on which the income on these securities became due? (May 2006)*

Answer

Transfer of securities under Collective Investment Scheme under the Securities Contracts (Regulation) Act, 1956 (Section 27A)

Problem as asked in the question is based on the provisions of Section 27A of the Securities Contracts (Regulation) Act, 1956, wherein it shall be lawful for the holder of any securities, being units or the other instruments issued by collective investment scheme, whose name appears on the books of the scheme, issuing the said security to receive and retain any income in respect of units issued by the scheme in respect thereof for any year, notwithstanding that the said security, being units issued by the scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units issued by the scheme from the transferor has lodged the security and all other documents relating to the transfer which may be required by the scheme with the scheme for being registered in his name within 15 days of the date on which the income in respect of units or other instruments issued under the scheme became due. The period of 15 days can be extended in certain contingencies as stated in Explanation to Section 27A(1).

Applying the above provisions in the given case:

- (i) the holder of securities (i.e. D, the transferor) has right to receive or retain the income on these securities for the financial year ended 31st March, 2006, since the instrument for transfer was lodged one month after the date on which the income became due.
- (ii) The answer in the second case would differ. The holder (i.e. D, the transferor) cannot receive and retain the income since the instruments for transfer was lodged with the company within the statutory period of 15 days by the transferee.

Question 11

The Executive Committee of a recognized Stock Exchange desires to transfer certain duties and functions of a clearing house to a recently set up Clearing Corporation, incorporated as a company under the Companies Act, 1956. Examining the provisions of the Securities Contracts (Regulation) Act, 1956:

- (i) *State the purpose for which such transfer of duties and functions can be made to Clearing Corporation.*
- (ii) *What is the procedure to be adopted for such transfer of duties and functions?*

(May 2006)

Answer

Transfer of certain duties and functions of a clearing house by a stock exchange to clearing corporation under the Securities Contracts (Regulation) Act, 1956 (Section 8A)

Purposes:

A recognized stock exchange may, with the prior approval of the Securities and Exchange Board of India, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956 for the purpose of:

- (i) the periodical settlement of contracts and differences thereunder,
- (ii) the delivery of, and payments for, securities;
- (iii) any other matter incidental to, or connected with, such transfer.

Procedure:

- 1. Every clearing corporation shall for the purpose of transfer of the duties and functions of a clearing house to clearing corporation make bye-laws and submit the same to the SEBI for approval.
- 2. The SEBI may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of a clearing house to a clearing corporation, grant approval to the bye-laws submitted to it under sub-section (2) and approve transfer of the duties and functions of a clearing house to a clearing corporation.
- 3. The provisions of Sections 4 to 12 shall, as far as may be, apply to a clearing corporation as they apply in relation to a recognized stock exchange.

Question 12

The shares of MLM Ltd. were listed in Cochin Stock Exchange. The stock exchange delists the shares of the company. The aggrieved company approaches you to know the remedy available to the company. Give your suggestion to the company keeping in view the provision of the Securities Contracts (Regulation) Act, 1956. (November 2006)

Answer

Section 21A of Securities Contracts (Regulation) Act, 1956 contains the provision relating to delisting of securities. As per this section

- (1) A recognized Stock Exchange may delist the securities after recording reasons therefor from any recognized stock exchange on any ground or grounds as may be prescribed under this Act.
- (2) The Securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard.
- (3) A listed company may file an appeal before the Securities Appellate Tribunal (SAT) against the decision of the recognized stock exchange delisting the securities within

fifteen days from the date of the decision of recognized stock exchange delisting the securities.

- (4) Securities Appellate Tribunal may, if it is satisfied that the company was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period of not exceeding one month.

So here, the company may make an appeal to the Securities Appellate Tribunal against the delisting within fifteen days or such extended period not exceeding one month after showing sufficient cause of not filing within fifteen days.

Question 13

Explain the powers, which can be exercised by the Securities and Exchange Board of India under the Securities Contracts (Regulation) Act, 1956, while approving the schemes for corporatisation and demutualization submitted by recognized stock exchanges, so that there is segregation of ownership and management from the trading rights of members of such stock exchanges. (November 2006)

Answer

Corporatisation and Demutualisation – Power of SEBI under SCRA, 1956

SEBI has been empowered under sub-section (2) of Section 4B of Securities Contracts (Regulation) Act, 1956 to approve the scheme of corporatisation and demutualisation with or without modification. SEBI can reject the proposed scheme if it is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme. Besides these general powers, SEBI has got certain specific powers under Section 4B(6). SEBI, while approving the scheme, may, by an order in writing restrict

- (a) the voting rights of the shareholders who are also stock-brokers of the recognized stock exchange.
- (b) the right of shareholders in a stockbroker of the recognized stock exchange to appoint the representatives on the governing board of the stock exchange.
- (c) the maximum number of representatives of the stock-broker of the recognized stock exchange to be appointed on the governing board of the stock exchange shall not exceed one-fourth of the total strength of the governing body.

On receipt of approval of scheme, stock exchange will issue shares to public within 12 months so that at least 51% equity shares are with public other than shareholders having trading rights. SEBI can extend the period upto another 12 months [Section 4B(8)].

Question 14

Describe the provisions of the Securities Contracts (Regulation) Act, 1956 regarding the powers of the Central Government to supersede the Governing Body of a recognized Stock Exchange and the consequences of such supersession. (May 2007)

Answer

In accordance with the provisions of Section 11 of the Securities Contracts (Regulation) Act, 1956, where the Central Government is of opinion that the governing body of any recognized stock exchange should be superseded, then notwithstanding anything contained in any other law for the time being in force, the Central Government may serve on the governing body a written notice that the Central Government is considering the supersession of the governing body for the reasons specified in the notice. After giving an opportunity to the governing body of such Stock Exchange to be heard in the matter, the Central Government may, by notification in the Official Gazette, declare the governing body of such Stock Exchange to be superseded.

The Central Government may appoint any person or persons to exercise and perform all the powers and duties of the governing body. If more than one person is so appointed, one of them may be the Chairman and another as the Vice-chairman. Such person shall hold office for such period as may be specified in the Notification and the Central Government may vary such period by way of another Notification.

On the publication of the notification in the Official Gazette, following are the consequences:

- (i) the members of the governing body of such Stock Exchange ceases to hold office as such members on and from the date of notification.
- (ii) The person or persons appointed by the Central Government may exercise and perform all the powers and duties of the governing body which has been so superseded.
- (iii) The property of the Stock Exchange as deemed necessary and so specified in writing by such person or persons to carry on the business of Stock Exchange shall vest in such person or persons.

Question 15

SEBI is of the opinion that in the interest of investors, it is desirable to amend the rules of RSP Stock Exchange prohibiting the appointment of the broker-member as President of the Stock Exchange. Explain briefly with reference to the provisions of Securities Contracts (Regulation) Act, 1956, whether it is possible for SEBI to amend the rules of the Stock Exchange, if the Stock Exchange does not change the rules.

(May 2007)

Answer

In accordance with the provisions of section 8 of Securities Contracts (Regulation) Act, 1956, The Central Government is empowered to issue written order directing all or any of the recognized stock exchange to make any rules or to amend any rules already made within two months from the date of the order in respect of matters specified in section 3(2) of the said Act. One of the matters specified in the said section 3(2) is the governing body of stock

exchange, its constitution and powers of management and the manner in which its business is to be transacted. Hence, the Central Government is empowered to direct the stock exchange in respect of prohibition on broker-member being appointed as President of the stock exchange. According to notification issued by Central Government under section 29A of the said Act, this power is also exercisable by SEBI.

If any recognized stock exchange fails or neglects to comply with any order made by SEBI within two months, SEBI may itself make the rules or amend the rules made by stock exchange either in the form proposed in the order or with such modification thereof as may be agreed to between SEBI and the stock exchange. The amended rules are required to be notified in the Gazette of India and in the Gazette of the State where the principal office of the stock exchange is situated. After such publication, the rules shall be valid as if the same were made or amended by the recognized stock exchange itself.

Accordingly of the above provisions of Securities Contracts (Regulation) Act, 1956, SEBI can issue directions to RSP Stock Exchange to amend the rules and if the said stock exchange does not comply with the above, SEBI can amend the rules on its own.

Question 16

PQR Ltd. is holding 33% of the paid up equity capital of Koya Stock Exchange. The company appoints MNL Ltd. as its proxy who is not a member of the Koya Stock Exchange, to attend the vote at the meeting of the stock exchange. Examine whether the Koya Stock Exchange can restrict the appointment of MNL Ltd. as proxy for PQR Ltd. and further restrict, the voting rights of PQR Ltd. in the Koya Stock Exchange.

(November 2007)

Answer

Section 7(a) of the Securities (Contracts) Regulation Act, 1956 provides that a recognised stock exchange is empowered to amend rules to provide for all or any of the following matters:

- (a) Restriction of voting right to members only.
- (b) Regulation of voting rights by specifying that each member is entitled to one vote only irrespective of number of shares held.
- (c) Restriction on right of members to appoint proxy.

As such Koya Stock Exchange can restrict the appointment of MNL Ltd., as proxy, if rules of the exchange so provide. If it is not so provided, rules may be amended and after getting approval of the Central Government regarding amendment, it can restrict appointment of proxies.

Koya Stock Exchange can also restrict the voting rights of PQR Ltd. as proxy if rules of the exchange so provide. If it is not so provided, rules maybe amended and after getting approval of Central Government regarding amendment, it can restrict appointment of proxies.

Koya Stock Exchange can also restrict the voting rights of PQR Ltd.

Question 17

Working of City Stock Exchange Association Ltd., is not being carried on by its governing Board in public interest. On receipt of representations from various investors and Investors' Association, the Central government is thinking to withdraw the recognition granted to the said Stock Exchange. You are required to state the circumstances the procedure for withdrawal of such recognition as per the provisions of Securities Contracts (Regulation) Act, 1956 in this regard. Also state the effect of such withdrawal on the contracts outstanding on the date of withdrawal. **(May 2008)**

Answer

Section 5 of the Securities Contracts (Regulation) Act, 1956 empowers the Central Government to withdraw the recognition granted to a stock exchange. The circumstances and procedure to be followed for withdrawal of such recognition is stated below

- (i) if considering the interest of the trade or the public interest, the Central government is of the opinion that the recognition granted to a stock exchange should be withdrawn, the Central Government shall serve a written notice on the governing body of the stock exchange.
- (ii) The said notice shall specify the reasons for the proposed withdrawal of the recognition.
- (iii) The governing body of the stock exchange shall be afforded an opportunity of being heard by the Central Government.
- (iv) Even after hearing the governing body, the Central Government is satisfied that the recognition granted to the stock exchange should be withdrawn; the Central Government may, by way of a notification in the Official Gazette, withdraw the recognition granted to the stock exchange.

The proviso to the said section 5 states that no such withdrawal shall affect the validity of any contract entered into or made prior to the date of notification withdrawing the recognition and the Central Government may, after consultation with the stock exchange, make such provision as it deems fit in the notification of withdrawal or in any subsequent notification for the due performance of any contracts outstanding on that date.

Question 18

The Executive Committee of a recognized stock exchange desires to transfer certain duties and functions of a clearing house to a recently set up clearing corporation, incorporated as a company under the companies Act, 1956, examining the provisions of The Securities Contract (Regulation) Act, 1956. State the purposes for which such transfer of duties and functions can be made to clearing corporation.

What is the procedure to be adopted for such transfer of duties and functions?

(November 2008)

Answer

A recognized stock exchange may, with the prior approval of the Securities Exchange Board of India, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956 for the purpose of:

- (a) The periodical settlement of contracts and differences there under
- (b) The delivery of, and payment for, securities;
- (c) Any other matter incidental to, or connected with, such transfer

PROCEDURE

Every clearing corporation shall for the purpose of transfer of the duties and functions of a clearing house to clearing corporation, make byelaws and submit the same to the SEBI for approval.

The SEBI may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of the clearing house to a clearing corporation, grant approval to the byelaws submitted to it under sub-section (2) of Section 8A of the Securities Contracts (Regulation) Act, 1956 and approve transfer of the duties and function of a clearing house to a clearing corporation.

The provision of Sections 4 to 12 of the said act shall as far as may be apply to a clearing corporation as they apply in relation to a recognized stock exchange.

Question 19

Mr. Bansal holds certain securities on 31st March, 2008, issued in his favour under the "Collective Investment Scheme." For a consideration, Mr. Bansal transferred the said securities in favour of another person. One month after the date on which the income on these securities became due, the transferee lodged the instrument of transfer. Decide in the light of the provisions of the Securities Contracts (Regulation) Act, 1956.

- (i) *Whether in the given case Mr. Bansal is entitled to receive and retain the income on these securities for the financial year ended 31st March, 2008?*
- (ii) *What would be your answer in case the transferee lodged the instrument of transfer 10 days after the date on which the income on these securities became due?*

(November 2008)

Answer

TRANSFER OF SECURITIES:

The problem as asked in the question is based on the provisions of Section 27A of the Securities contracts (Regulation) Act, 1956, wherein it shall be lawful for the holder of any securities, being units or the other instruments issued by collective investment scheme, whose

name appears on the books of the scheme, issuing the said security to receive and retain any income in respect of units issued by the scheme in respect thereof for any year, notwithstanding that the said security, being units issued by the scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units issued by the scheme from the transferor has lodged the security and all other documents relating to the transfer which may be required by the scheme with the scheme for being registered in his name within 15 days of the date on which the income in respect of units or other instruments issued under the scheme become due. The period of 15 day can be extended in certain contingencies as stated in explanation to Section 27A (1) of the said Act.

Thus,

- (i) the holder of the securities i.e Mr. Bansal, the transferor has right to receive or retain the income of the said securities for the financial year ended 31st March 2008, since the instrument for transfer was lodged one month after the date on which the income became due.
- (ii) the answer in the second case would differ. The holder i.e. Mr. Bansal, the transferor can not receive and retain the income since the instrument for transfer was lodged with the company within the statutory period of 15 days by the transferee. Accordingly the transferee would be entitled to receive the income on these securities.

Question 20

M/s Goyanka & Company, which is a member of a recognised stock exchange desire to buy and sell shares of Crossroads Company Limited on their own count as well as on behalf of investors. Advise M/s Goyanka & Company whether there are any restrictions for dealing in securities on their own count under the provisions of the Securities Contracts (Regulation) Act, 1956.

(May 2009)

Answer

SHARE TRANSACTIONS BY MEMBERS OF STOCK EXCHANGE AS PRINCIPALS:

Members of stock exchange normally carry out transactions on behalf of investors and hence principal and agent relationship exists between them. A member can enter into transaction as principal with another member of the exchange only. If a member of stock exchange desires to enter into contract as principal with a non member then he has to get written consent from such person to act as principal. The contract note should indicate that he is acting as principal. (Section 15 of the Securities Contracts (Regulation) Act, 1956).

Where the member has obtained the consent of such person otherwise than in writing he shall secure written confirmation by such person or such consent within three days from the date of such contract.

However, such written consent of such person is not necessary for closing outstanding contract entered into by such person in accordance with the bye-laws, if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as principal.

Spot delivery contracts are not within the purview of section 15 of the said Act. (Section 18).

Thus M/s Goyanka & Company working as stock broker must bear in mind the above restrictions while entering into any transaction as principal with a non – member

Question 21

The Mewar Rural Financial Corporation, Udaipur, established under a special statute issued 5 years bonds to public directly and not through any Stock Exchange. Decide whether the said act of the Mewar Rural Financial Corporation is in violation of the provisions of the Securities Contracts (Regulation) Act, 1956.
(May 2009)

Answer

DIRECT ISSUE OF BONDS BY CORPORATION:

In order to prevent undesirable transactions in securities and to promote healthy stock market, the Securities Contracts (Regulation) Act, 1956 was enacted. Stock Exchanges are recognised under the Act. Section 73 of the Companies Act, 1956 lays down that offer of shares and debentures to public for subscription shall only be made after obtaining the permission of the stock exchange.

Section 28 of the Securities Contracts (Regulation) Act, 1956 lays down that the provisions of the Act shall not apply to the Government, Reserve Bank of India, any local authority or any corporation set up by a special law or any person who has effected any transaction with or through the agency of any such authority as stated above.

As given in the question, the Mewar Rural Financial Corporation is a corporation established under a special statute enacted by competent legislature. Therefore, the said corporation need not require to seek permission of any stock Exchange for the said purpose because it is exempted from the requirement given in the legislation.

There is no violation of the provisions of the Securities Contracts (Regulation) Act, 1956 because the provisions of Section 28 of the said act are not applicable to the said corporation.

Question 22

Industrial Finance Corporation of India, established under the Industrial Finance Corporation Act, 1948 having its registered office at Mumbai issued 8% Redeemable Bonds redeemable after 7 years. These bonds were issued directly to the members of the public and not through mechanism of Stock exchanges.

You are required to state with reference to the provisions of Securities Contracts (Regulation) Act, 1956, whether such direct issue of bonds by the Industrial Finance Corporation of India is not violating the provisions of the said Act. (CA Final, New Course, (May 2009)

Answer

In order to prevent undesirable transactions in securities and to promote healthy stock market, the Securities Contracts (Regulation) Act, 1956 was enacted and all the Stock Exchanges in the country are registered under this Act. Section 73 of the Companies Act, 1956 states that offer of shares or debentures to public for subscription shall be made only after the permission of a Stock exchange.

Section 28(1) of the Securities Contracts (Regulation) Act, 1956 states that the provisions of this Act shall not apply to the Government, the Reserve Bank of India, any local authority, or corporation set up by a special law or any person who has effected any transaction with or through the agency of any such authority as stated earlier.

As stated in the question Industrial Finance Corporation of India is a corporation set up under the Industrial Finance Corporation Act, 1948. i.e. under a special statute enacted by the Parliament. Therefore, this Corporation does not need any permission from a Stock Exchange to issue any Bond or other securities. Accordingly, it has not violated the provisions of the Securities Contracts (Regulation) Act, 1956. The nature and tenure of the Bonds are immaterial.

Question 23

- (a) *A stock exchange desirous of taking over another stock exchange, seeks your advice on corporatisation. Examining the provisions of the Securities Contracts (Regulation) Act, 1956 and the meaning of the terms 'corporatisation' and 'demutualisation', advise the stock exchange about the steps to be taken to give effect to the scheme of corporatisation.*
- (b) *Mr. Veer a newly entered investor in the field of securities business seeks your advice on the investments to be made in securities of large Companies for long term purposes. With this object in view, he wants to know the meaning of the following terms commonly used in any stock exchange.*
- (i) *Derivative*
 - (ii) *Option in securities*
 - (iii) *Spot delivery contract.*

Advise suitably.

(November, 2009)

Answer

(a) CORPORATISATION & DEMUTUALISATION OF STOCK EXCHANGES

'Corporatisation' means the succession of a recognized stock exchange, being a body of individuals or a society registered under the Societies Registration Act, 1860, by another stock exchange,

being a Company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society 'Demutualisation' means the segregation of ownership and management from the trading rights of the members of a recognized stock exchange in accordance with a scheme approved by the SEBI.

Steps for Corporatisation and Demutualization [Section 4B - Securities Contracts (Regulations) Act, 1956]

In accordance with the provisions of the Securities Contracts (Regulation) Act, 1956, as contained in Section 4B:

1. All recognized stock exchanges referred to in Section .4A shall, within such time as may be specified by the SEBI submit a scheme for corporatisation and demutualization for its approval.
2. On receipt of the scheme, the SEBI may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest, approve the scheme with or without modification.
3. No scheme shall be approved by the SEBI if the issue of shares for a lawful consideration or provision of trading rights in lieu of membership card of the members of a recognized stock exchange or payment of dividends to members have been proposed out of any reserves or assets of that stock exchange.
4. Where the scheme is approved, the scheme so approved shall be published immediately by-
 - (a) The SEBI in the Official Gazette
 - (b) The recognised Stock Exchange in such two daily newspapers circulating in India, as may be specified by the SEBI, and upon such publication, notwithstanding anything to the contrary contained in this Act or any other law for the time being in force or any agreement, award, judgment, decree or other instrument for the time being in force, the scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognized stock exchange and on all persons having any contract, right, power, obligation or liability with, against, over, to, or in connection with, the recognized stock exchange or its members.
5. Where the SEBI is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme, it may, by an order, reject the scheme and such order of rejection shall be published by it in the Official Gazette. SEBI shall give a reasonable opportunity of being heard to all the persons concerned and the recognized stock exchange concerned before passing an order rejecting the scheme.

6. SEBI may, while approving the scheme by an order in writing, restrict -
 - (a) the voting rights of the shareholders who are stock brokers of the recognized stock exchange.
 - (b) the right of shareholders or a stock broker of the recognized stock exchange to appoint the representatives on the governing board or the stock exchange.
7. The order made by SEBI shall be published in the Official Gazette and on the publication thereof, the order, notwithstanding anything to the contrary contained in the Companies Act, 1956, or any other law for the time being in force, have full effect.
8. Every recognized stock exchange, in respect of which the scheme for corporatisation or demutualization has been approved shall either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by SEBI, ensure that at least 51% of its equity share capital is held, within 12 months from the date of publication of the order by the public other than shareholders having trading rights. The SEBI may, on sufficient cause being shown to it and in the public interest, extend the said period by another 12 months.
 - (a) Mr. Veer, a new investor, desirous of entering investments business in any Stock Exchange, can be advised on different terms commonly used in any Stock Exchange.

(i) DERIVATIVE:

Derivative includes –

- (a) a security derived from a debt instrument, share, loan whether secured or unsecured risk instrument or contract for differences or any other form of security.
- (b) a contract, which derives its value from the prices or index of prices, of underlying securities.

(ii) OPTION IN SECURITIES:

Option in Securities means a contract for the purchase or sale of a right to buy or sell or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and call securities.

(iii) SPOT DELIVERY CONTRACT

Spot delivery contract means a contract which provides for:

- (i) actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the dispatch of the securities or the remittance of money therefore through the post

being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality.

- (ii) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository.

Question 24

- (a) *MNC Limited whose shares are listed on a recognized Stock Exchange, are delisted by the Stock Exchange. The company seeks your advise on the remedies available to the company against the order of the Stock Exchange. Referring to the provisions of the Securities Contracts (Regulation) Act, 1956, advise the company.*
- (b) *Referring to the provisions of the Securities Contracts (Regulation) Act, 1956:*
 - (i) *Examine the extent to which the Central Government is empowered to suspend business of a recognized Stock Exchange.*
 - (ii) *The Central Government has granted recognition to a Stock Exchange. To what conditions may such a recognition be subject to?* **(May, 2010)**

Answer

- (a) Section 21A of the Securities Contracts (Regulation) Act, 1956 describes the provisions regarding delisting of securities by a recognised stock exchange.
 - (1) A recognized stock exchange may delist the securities, after recording the reasons therefore, from any recognized stock exchange on any of the ground or grounds as may be prescribed under this Act: Provided that the securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard.
 - (2) A listed company or an aggrieved investor may file an appeal before the Securities Appellate Tribunal against the decision of the recognized stock exchange delisting the securities within fifteen days from the date of the decision of the recognized stock exchange delisting the securities and the provisions of sections 22B to 22E of this Act shall apply, as far as may be, to such appeals; Provided that the Securities Appellate Tribunal may, if it is satisfied that the company was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding one month. MNC Ltd. may be advised accordingly.
- (b) (i) **Power of the Central Government to suspend business at a Stock Exchange: Section 12, Securities Contracts (Regulations) Act, 1956.**

If in the opinion of the Central Government an emergency has arisen and for the

purpose of meeting of the emergency the Central Government considers it expedient so to do, it may, by Notification in the Official Gazette, for reasons to be set out therein, direct a recognized stock exchange to suspend such of its business for such period not exceeding 7 days and subject to such conditions as may be specified in the notification, and if in the opinion of the Central Government the interest of the trade or the public interest requires that the period should be extended, may, by like notification extend the said period from time to time. Provided that where the period of suspension is to be extended beyond the first period, no notification extending the period of suspension shall be issued unless the Governing Body of the recognized Stock Exchange has been given an opportunity of being heard in the matter.

(ii) **Grant of recognition to stock exchanges - Conditions: Section 4(2), SCR, Act, 1956**

The conditions may include, condition relating to:

- (1) qualification for Membership of the Stock Exchange.
- (2) manner in which contracts shall be entered into and enforced as between members.
- (3) representation of the Central Government. on the Stock Exchange (not exceeding 3 nominated by the Central Government.)
- (4) maintenance of Accounts of members and their audit by Chartered Accountants wherever audit is required by the Central Government.

THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999

Question 1

Explain the meaning of the term “Current Account Transaction” and the right of a citizen to obtain Foreign Exchange under the Foreign Exchange Management Act, 1999. (May, 2001)

Answer

The term “current account transaction” is defined in Section 2(j) of Foreign Exchange Management Act, 1999. It means a transaction other than a capital account transaction and includes:

- (i) payments due in connection with foreign trade in the ordinary course of business.
- (ii) payments due as interest on loans and as net income from investments.
- (iii) remittances for living expenses of parents, spouse and children residing abroad and
- (iv) expenses in connection with foreign travel education and medical care of parents, spouse and children.

According to Section 5 of FEMA, 1999 any citizen may sell or draw foreign exchange to or from an authorised person if such sale or drawl is a current account transaction. Provided that the Central Government may in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed.

Further, any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction subject to the provisions of section 6(2).

Question 2

Mr. X, an Indian national has failed to realise and repatriate foreign exchange worth more than Rs.2 crores. Mr. X having realised that he had committed a contravention of the provisions of the Foreign Exchange Management Act, 1999, desires to compound the said offence. Advise Mr. X. (November, 2001)

Answer

Because of his failure to realise and repatriate foreign exchange, Mr. X has contravened the provisions of section 8 of FEMA and he is liable to the penalties leviable under Section 13,

followed by adjudication proceedings. Section 15 of FEMA permits the offending party to compound the contravention within 180 days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank of India as may be authorised in this behalf by the Central Government in such manner as may be prescribed. No contravention shall be compounded unless the amount involved in such contravention is quantifiable. Where a contravention has been compounded, no proceeding can continue or be initiated against the person in respect of the contravention so compounded.

Question 3

Mr. G., an Indian national desires to obtain Foreign Exchange on current account transactions for the following purposes:

- (i) *Payment of commission on exports made towards equity investment in wholly owned subsidiary abroad of an Indian Company.*
- (ii) *Remittance of hiring charges of transponder.*
- (iii) *Remittance for use of trade mark in India.*

Advise G whether he can obtain Foreign Exchange and, if so, under what conditions?

(November, 2001)

Answer

Under Section 5 of Foreign Exchange Management Act, 1999, certain rules have been framed for drawal of foreign exchange on current account. According to the said rules, drawal of foreign exchange for certain transactions are prohibited. In respect of certain transactions drawal of foreign exchange is permissible with the prior approval of Central Government. In respect of some of the transaction, prior permission of RBI is sufficient for drawal of foreign exchange.

- (i) In respect of item No.1 i.e. Payment of Commission on exports made towards equity investment in wholly owned subsidiary abroad of an Indian company is prohibited.
- (ii) Drawal of foreign exchange for remittance of hiring charges of transponder, can be made with the prior approval of the Central Government.
- (iii) So far as remittance for use of Trade Mark in India is concerned, the necessary foreign exchange can be obtained with the prior permission of the Reserve Bank of India.

In the case of (ii) & (iii) above, approval of concerned authority is not required if the payment is made out of funds held in Resident Foreign Currency (RFC) Account or Exchange Earner's Foreign Currency (EEFC) Account of the remitter. Further foreign Exchange can be drawn only from an authorised person.

Question 4

- (a) According to Foreign Exchange Management Act, 1999, a person resident in India shall take all reasonable steps to repatriate to India any amount of foreign exchange earned and accrued to him. What is meant by the expression 'Repatriate to India'? State the cases where foreign exchange can be held or need not be repatriated to India by a resident in India.
- (b) Explain the meaning of the term "Adjudicating Authority" under the Foreign Exchange Management Act, 1999, the powers available with the said authority to pass orders imposing penalty and enforce the same in relation to violation of any provision of FEMA by Mr. Dubious, a resident in India.
- (c) (i) How will you determine whether a particular business unit like a factory or office is a 'person resident in India' under Foreign Exchange Management Act, 1999?
- (ii) 'Printex Computer' is a Singapore based company having several business units all over the world. It has a unit for manufacturing computer printers with its Headquarters in Pune. It has a Branch in Dubai which is controlled by the Headquarters in Pune. What would be the residential status under FEMA, 1999 of printer units in Pune and that of Dubai branch? **(May, 2002)**

Answer

- (a) The word "repatriate to India" is defined in section 2(y) of the FEMA, Act 1999. 'Repatriate to India' means the realised foreign exchange should be sold to an authorised person in India in exchange for rupees. It also includes the holding of realised amount in an account with an authorised person in India to the extent notified by the Reserve Bank and includes use of the realised amount for discharge of a debts or liability denominated in foreign exchange.

Exemption from holding/repatriation.

Section 4 of the FEMA, 1999 prohibits holding of foreign exchange by a resident in India. Section 8 requires that foreign exchange earned by a resident in India is realised and repatriated to India.

However, in the following cases, the foreign exchange can be held or need not be repatriated to India:-

1. Possession of foreign currency – possession of foreign currency or foreign coins upto limit prescribed by RBI is permitted (section 9(a))
2. Foreign currency account – Foreign currency account can be held and operated by such persons and within such limits as specified by RBI (Section 9(b))

- 3 Foreign currency acquired before July 1947 – Foreign exchange acquired or received before 8th July 1947 or income arising or accruing thereon can be held outside India (section 9(c))
4. Gift or inheritance – If such foreign exchange is acquired as a gift or inheritance, that exchange and income arising therefrom can be held as foreign exchange in India or held abroad and need not be repatriated (Section 9(d)).
5. Foreign exchange acquired abroad – Foreign exchange acquired from employment, business, trade, vocation, services honorarium, gifts, inheritance, or any other legitimate means can be held as foreign exchange in India or it need not be repatriated to India subject to limits specified by RBI (Section 9(e))
6. Any other receipts specified by RBI (Section 9(f))

(b) Adjudicating authority

According to Section 2(a) of FEMA, 1999, 'Adjudicating Authority' means an officer authorised under section 16(i)

Power of adjudicating authority: Persons committing an offence under FEMA are liable to penalty. An adjudicating authority appointed by the Central Government under FEMA can impose any penalty for violation of any provision of FEMA or contravention of any rule, regulation, directions or orders issued under the powers conferred by the Act. Their jurisdiction will be prescribed by the Central Government (section 16(1) & (2)). The Adjudicating Authority can hold inquiry only on receiving a complaint from an authorised officer (Section 16(3)).

They have to follow principles of natural justice by giving opportunity to Mr. Dubious of making representation. The adjudicating authority should endeavor to dispose off the complaint within one year (Section 16(6))

The adjudicating authority can impose penalty upto thrice the sum involved in such contravention where the amount is quantifiable. If the amount is not quantifiable, penalty upto Rs. 2 lakhs can be imposed. If contravention is of continuing nature, further penalty upto Rs 5,000 per day during which the default continues can be imposed [Section 13(i)].

The Adjudicating Authority adjudicating the contravention can also order confiscation of any currency, security or any other money or property in respect of which the contravention has taken place. He can also direct that foreign exchange holdings of any person committing the contravention shall be brought back to India or retained outside as per directions (Section 13(2)).

Enforcement of orders of adjudicating authority.

Person on whom penalty is imposed is required to make payment within 90 days of receipt of notice. If such payment is not made, he is liable to civil imprisonment (Section 14(ii)). Such civil imprisonment can be upto 6 months, if demand is for less than Rs. 1 crore. If demand exceeds Rs. 1 crore, civil imprisonment can be upto 3 years. If he pays the amount, he shall be released. Order for arrest and detention cannot be made unless a show cause notice is issued to the defaulter. However, arrest can be made without show cause notice, if adjudicating authority is satisfied (a) that the defaulter has dishonestly transferred, concealed or removed his property or he is refusing or neglecting to pay even if he has means to pay [Section 14(2) (b)] and (b) he is likely to abscond the local limits [Section 14(3)].

If a person to whom show cause notice is issued does not appear before Adjudicating authority, warrant of arrest can be issued [Section 14 (4)].

(c) (i) Person resident in India

Section 2 of FEMA, 1999 defines the term “person resident in India”. According to Section 2 (iii), all business units in India will be “resident in India” even though these units are owned or controlled by a person resident outside India.

Similarly all business units outside India will be ‘resident in India’ provided the business units are either owned or controlled by a person resident in India [Section 2(v) (iv)]. It is necessary to determine the residential status of the person who owns or controls the business unit.

- (ii) Printex Computer being a Singapore based company would be person resident outside India [(Section 2(w))]. Section 2 (u) defines ‘person’ under clause (viii) thereof, as person would include any agency, office or branch owned or controlled by such person. The term such person appears to refer to a person who is included in clause (i) to (vi). Accordingly printex unit in Pune, being a branch of a company would be a ‘person’.

Section 2(v) defines a person resident in India. Under clause (iii) thereof person resident in India would include an office, branch or agency in India owned or controlled by a person resident outside India. Printex unit in Pune is owned or controlled by a person resident outside India, and hence it, would be a ‘person resident in India.’

However, Dubai Branch though not owned is controlled by Print unit in Pune which is a person resident in India. Hence prima facie, it may be possible to hold a view that the Dubai Branch is a person resident in India.

Question 5

- (a) *Mr. Ram had resided in India during the Financial Year 1999-2000 for less than 183 days. He again came to India on 1st May, 2000 for Higher studies and business and stayed upto 15th July, 2001. State under the Foreign Exchange Management Act, 1999.*
- (i) *If Mr. Ram can be considered 'person Resident in India' during the Financial year 2000-2001 and*
- (ii) *Is citizenship relevant for determining such a status?*
- (b) *Mr. Ramesh of Nagpur wants to travel to Nepal and for this purpose proposes to draw Foreign Exchange. Specify.*
- (i) *Can Mr. Ramesh draw any Foreign Exchange for his journey?*
- (ii) *What are the purposes for which Foreign Exchange drawal is not allowed for Current Account Transaction?* **(November, 2002)**

Answer

- (a) (i) No. Mr. Ram cannot be considered 'Person resident in India' during the financial year 2000-2001 notwithstanding the purpose or duration of his stay in India during 2000-2001. An individual has to be present in India for more than 182 days in the preceding financial year. Mr. Ram does not satisfy this condition for the financial year 2000-2001.
- (ii) No. Citizenship is no more relevant for determining the status.
- (b) (i) No. According to the rules, drawl of foreign exchange is not allowed for travel to Nepal or Bhutan.
- (ii) Following are the transactions (current account) for which drawl of foreign exchange is prohibited.
1. Remittance of interest income on funds held in Nonresident Special Rupee (NRSR) Account Scheme.
 2. Transactions with a person resident in Nepal or Bhutan (unless specifically exempted by RBI by general/special order).
 3. Remittance out of lottery winnings.
 4. Remittance of income from racing/ riding etc. or any other hobby.
 5. Remittance for purchase of lottery tickets, banned/ prescribed magazines, football, pools etc.
 6. Payment of commission on exports made towards equity investment in joint ventures/wholly owned subsidiaries abroad of Indian Companies.

7. Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
8. Payment of commission on export under Rupee State Credit Route.
9. Payment related to 'Call Back Services' of telephones.

Question 6

- (a) *Examine whether the following branches can be considered as a 'Person resident in India' under Foreign Exchange Management Act, 1999:*
- (i) *ABC Limited, a company incorporated in India established a branch at London on 1st January, 2003.*
 - (ii) *M/s XYZ, a foreign company, established a branch at New Delhi on 1st January, 2003. The branch at New Delhi controls a branch at Colombo.*
- (b) *Mr. Ramesh is an exporter of goods and services. Explain briefly his duties under Foreign Exchange Management Act, 1999 with regard to the following:*
- (i) *Furnishing of information relating to such exports.*
 - (ii) *Realisation and repatriation of foreign exchange on such exports. (May, 2003)*

Answer

- (a) **Person resident in India (Foreign Exchange Management Act, 1999):**
- (i) Any person or body corporate registered or incorporated body in India is a resident in India [section 2(v)(ii)]. 'Person' includes a company [section 2(u)]. An office, branches or agency outside India owned or controlled by a person resident in India is a person resident in India. [Section 2(v)(iv)].

In view of the above provisions in FEMA, 1999 London branch established by ABC Ltd, a company incorporated in India, is a 'person resident in India' under the Act from the date of establishment i.e. 1st January, 2003.
 - (ii) According to Section 2(v)(iii) of FEMA, 1999 an office, branch or agency in India owned or controlled by a person resident outside India is a person resident in India'. Only a body corporate registered or incorporated in India is a 'person resident in India'. According to section 2(w), 'person resident outside India' means a person who is not resident in India. Hence M/s XYZ, foreign company is a 'resident outside India. But the branch at New Delhi owned by M/s XYZ is a 'resident in India' within the meaning of section 2(v) (iii) from the date of establishment i.e. 1st January, 2003. The branch at Colombo controlled by the branch at New Delhi referred to in the question is a person 'resident in India' within the meaning of section 2(v)(iii) read with section 2(v)(iv).

(b) Duty of every exporter of goods and services under FEMA, 1999:

- (i) *Furnishing of Information:-* Every exporter of goods is required to furnish to RBI or other prescribed authority a declaration containing true and correct material particulars, including the amount representing full export value. If full exportable value is not ascertainable at the time of export due to prevailing market conditions, the exporter shall indicate the amount he expects to share and indicate the amount he expects to receive on sale of goods in a market outside India. The exporter of goods shall also furnish to RBI such other information as may be required by RBI for the purpose of ensuring realization of export proceeds by such exporter [section 7(i)].

RBI can direct any exporter to comply with prescribed requirements to ensure that full export value of the goods or such reduced value of the goods as RBI determines, is received without delay [section 7(2)]. Every exporter of services shall furnish to RBI or other prescribed authority a declaration containing true and correct material particulars in relation to payment of such services [section 7(3)].

- (ii) *Realisation and repatriation of foreign exchange:* Where any amount of foreign exchange is due or has accrued to any resident in India, such person shall take all reasonable steps to realize and repatriate to India the foreign exchange within such period and in such manner as may be specified by RBI (section 8). Mr. Ramesh as an exporter of goods and services must comply with the requirements of section 7 and 8 of FEMA, 1999 and also with the requirements under Foreign Exchange Management (Export of Goods and Services) Regulations, 2000.

Question 7

Mr. Ram, citizen of India, left India for employment in U.S.A. on 1st June, 2002. Mr. Ram purchased a flat at New Delhi for Rs.15 lakhs in September, 2003. His brother, Mr. Gopal employed in New Delhi, also purchased a flat in the same building in September, 2003 for Rs.15 lakhs. Mr. Gopal's flat was financed by a loan from a Housing Finance Company and the loan was guaranteed by Mr. Ram.

Examine with reference to the provisions of Foreign Exchange Management Act, 1999 whether purchase of flat and guarantee by Mr. Ram are Capital Account transactions and whether these transactions are permissible.

(November, 2003)

Answer

Section 2(e) of Foreign Exchange Management Act, 1999 states that 'capital account transactions' means (a) a transaction which alters the assets or liabilities, including contingent liabilities, outside India of person's resident in India (b) a transaction which alters assets or liabilities in India of persons resident outside India and includes transactions referred to in Section 6(3). According to the said definition, a transaction which alters the contingent liability will be considered as capital account transaction in the case of person resident in India, but it is not so in the case of person resident outside India.

Purchase of immovable property by Mr. Ram in India is a capital account transaction. It has also been specifically provided in Section 6(3)(i) as a capital account transaction.

Guarantee will be considered as a capital account transaction in the following cases:

- (1) Guarantee in respect of any debt, obligation or other liability incurred by a person resident in India and owed to a person resident outside India.
- (2) Guarantee in respect of any liability, debt or other obligation incurred by a person resident outside India.

In this case, Mr. Ram, a resident outside India gives a guarantee in respect of a debt incurred by a person resident in India and owed to a person resident in India. Hence, it would appear that guarantee by Mr. Ram cannot be considered as a capital account transaction within the meaning of Section 2(e), particularly because it is a contingent liability.

All capital account transactions are prohibited unless specifically permitted. RBI is empowered to issue regulations in this regard [Section 6(3)]. Permissible capital account transactions by persons resident outside India are given in Schedule II to Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000. According to the said regulations both the purchase of immovable property by Mr. Ram and guarantee by Mr. Ram are permissible.

Question 8

- (a) *Mr. Sane, an Indian National desires to obtain Foreign Exchange for the following purposes:*
- (i) *Remittance of US Dollar 50,000 out of winnings on a lottery ticket.*
 - (ii) *US Dollar 1,00,000 for sending a cultural troupe on a tour of U.S.A.*
 - (iii) *US Dollar 50,000 for meeting the expenses of his business tour to Europe.*

Advise him whether he can get Foreign Exchange and if so, under what conditions?

- (b) *Explain the restrictions, if any, under Foreign Exchange Management Act, 1999 in respect of the following issue and transfer of shares:*
- (i) *Issue of Equity Shares of Rs.1 crore at face value accounting for 45 percent of post-issue capital to non-resident Indians in U.S.A. on non-repatriation basis. The shares are issued by M/s ABC Knitwear Limited to finance the modernization of its plant.*
 - (ii) *A Non-resident Indian, who is holding Equity shares in M/s DEF Textiles Limited, proposes to sell some shares to another Non-resident Indian for a consideration of Rs.50 lakhs and also transfer shares of face value of Rs.25 lakhs to a person resident in India by way of Gift.* **(May, 2004)**

Answer

- (a) Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions, prior permission of Reserve Bank of India is required.
- (i) In respect of item No.(i), i.e., remittance out of lottery winnings, such remittance is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence Mr. Sane can not withdraw Foreign Exchange for this purpose.
 - (ii) Foreign Exchange for meeting expenses of cultural tour can be withdrawn by any person after obtaining permission from Government of India, Ministry of Human Resources Development, (Department of Education and Culture) as prescribed in Second Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, in respect of item (ii), Mr. Sane can withdraw the Foreign Exchange after obtaining such permission.
 - (iii) The type of payment as envisaged in Item No.(iii) is covered under third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. In all the cases, where remittance of Foreign Exchange is allowed, either by general or specific permission, the remitter has to obtain the Foreign Exchange from an Authorised Person as defined in Section 2(c) read with section 10 of the Foreign Exchange Management Act, 1999.
- (b) Issue of equity shares to NRI's and transfer of shares by NRIs are capital account transactions.

RBI may in consultation with the Central Government specify any class or classes of transactions which are permissible (Section 6(2)(a)).

According to Regulation 3(1) of the Foreign Exchange Management (Permissible capital Account Transactions) Regulations, 2000 issued by RBI Investment in India by a person resident outside India is a permissible capital account transactions (Schedule II).

Further RBI is empowered under Section 6(3)(b) to prohibit, restrict or regulate, by regulations, transfer or issue of any security by a person resident outside India. In exercise of these powers RBI issued Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations 2000.

According to Regulation 5(3)(ii) of the said regulations a NRI may purchase shares of an Indian Company which is not engaged in Print Media Sector on non-repatriation basis without any limit (para 2 of Schedule 4). The shares may be issued by the company either by public issue or private placement. The only condition is that the amount of consideration for purchase of shares shall be paid by way of inward remittance through normal banking channels from abroad or out of funds held in NRE/FCNR/NRO/NRSR/N&NR account maintained with an authorized dealer or as the case may be with an authorised bank in India (Para 3 of Schedule 4).

Transfer of shares of an Indian Company by a person resident outside India.

Regulation 9(2)(ii) of Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000 permits NRI to transfer by way of sale the shares held by him to another NRI. Further according to Regulation 9(2)(iii) a person resident outside India may transfer any security held by him, to a person resident in India by way of gift. There are no restrictions in this regard.

Hence the proposed sale of shares to NRI and transfer to a persons resident in India by way of gift are permissible under FEMA.

Indian company can issue the above shares and record in its books the above transfer (Regulation 4).

Question 9

- (a) (i) Tomco Ltd., a vehicles manufacturing company in India has received an order from a transport company in Italy for supply of 100 Trucks on lease. You are required to state, how the said Tomco Ltd. can accept such an order.
- (ii) Forex Dealers Ltd. is an Authorised Person within the meaning of Foreign Exchange Management Act, 1999. Reserve Bank of India issued certain directions to the said Authorised Person to file certain returns, which it failed to

file. You are required to state the penal provisions to which the said Authorised Person has exposed itself.

- (b) (i) *Mr. Sekhar resided for a period of 150 days in India during the Financial year 2003-2004 and thereafter went abroad. He came back to India on 1st April, 2004 as an employee of a business organization. What would be his residential status during the financial year 2004-2005?*
- (ii) *Mr. Atul, an Indian National desires to obtain Foreign Exchange for the following purposes:*
- (a) *Remittance of US Dollar 10,000 for payment for goods purchased from a party situated in Nepal.*
- (b) *US Dollar 10,000 for remitting as commission to his agent in U.S.A. for sale of commercial plot situated near Bangalore, consideration in respect of which was received by Mr. Atul by way of foreign currency inward remittance amounting to US Dollar 1,00,000.*

Advise him, if he can get the Foreign Exchange and under what conditions.

(November, 2004)

Answer

- (a) (i) "Export," means the taking out of India to a place outside India any goods (Section 2(1) of Foreign Exchange Management Act, 1999). Hence sending 100 trucks on lease to Italy is an 'export' within the meaning of Section 2(1).

Under provisions of section 7 of the Foreign Exchange Management Act, 1999 rules have been made governing export of goods and services. Regulation 14-A of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 prescribes that no person shall, except with prior permission of the Reserve Bank of India, take or send out by land, sea or air any goods from India to any place outside India on lease or hire or under any arrangement or in any other manner other than sale or disposal of such goods.

Based on the above provisions, it can be concluded that if the company, namely, Tomco Ltd. wants to accept the order for despatching 100 trucks to Italy on lease, it has to take prior permission of the Reserve Bank of India.

- (ii) Section 11(3) of the Foreign Exchange Management Act, 1999 stated that where any Authorised person contravenes any direction given by the Reserve Bank of India under the said Act or fails to file any return as directed by the Reserve Bank of India, the Reserve Bank of India may, after giving reasonable opportunity of being heard, impose on Authorised Person a penalty which may

extend to ten thousand rupees and in the case of continuing contraventions with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

Since as per the facts given in the question, the Authorised person, namely, Forex Dealers Ltd., has failed to file the returns as directed by the Reserve Bank of India. According to the above provisions, it has exposed itself to a penalty which may extend to ten thousand rupees and in the case of continuing contraventions in the nature of failure to file the returns, with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

- (b) (i) According to the provisions of section 2(v) of the Foreign Exchange Management Act, 1999, a person in order to qualify for the purpose of being treated as a "Person Resident in India" in any financial year, must reside in India for a period of more than 182 days during the preceding financial year. In the given case, Mr. Sekhar has resided in India for a period of only 150 days, i.e., less than 182 days, during the financial year 2003-2004. Hence he cannot be considered as a "Person Resident in India" during the financial year 2004-2005 irrespective of the purpose or duration of his stay.
- (ii) Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, drawal of Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions prior permission of Reserve Bank of India is required.

In respect of item (a), i.e. remittance to Nepal, such remittance is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence Mr. Atul cannot withdraw Foreign Exchange for this purpose.

The type of payment as envisaged in item (b) is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and for withdrawing foreign Exchange exceeding 5% (five percent) of the inward remittance as commission to agent abroad for sale of commercial plot in India Mr. Atul will require the prior permission of the Reserve Bank of India.

Current Account Transactions have been liberalized by RBI, Foreign Exchange Department with effect from 24.02.2004 vide A.P. (DIR Series) Circular No.76 dated 24.02.2004. Now authorized persons (authorized dealers) are authorized

to allow freely such remittances ((i.e.) commission to agents abroad for sale of commercial plots) up to USD 25000 or 5 per cent of inward remittance per transaction, whichever is higher. As the amount to be remitted is only USD 10,000, authorized person (authorized dealer) may be approached for permission.

Question 10

- (i) *MKP Limited, an Indian company having its Registered Office at Mumbai, India established a branch at New York U.S.A. on 1st April, 2004.*
- (ii) *WIP Ltd., a company incorporated and registered in London established a branch at Chandigarh in India on 1st April, 2004.*
- (iii) *WIP Ltd.'s Singapore branch which is controlled by its Chandigarh branch. (May 2005)*

Answer

- (i) As per provisions of section 2(v)(ii) of the Foreign Exchange Management Act, 1999 (FEMA) any person or body corporate registered or incorporated in India is a "Person resident in India". As per section 2(v) of the said Act the term "person" includes a company. Section 2(v)(iv) of the said Act states that an office, branch or agency outside India owned or controlled by a person resident in India is a "Person resident in India".

In the light of the above provisions of FEMA, the residential status of the New York branch of MKP Ltd is that of a "Person resident in India" from the date of its establishment since it is owned by a person, i.e., a company, resident in India.

- (ii) As per provisions of section 2(v)(iii) of the Foreign Exchange Management Act, 1999 (FEMA) an office, branch or agency in India owned or controlled by a person resident outside India is a "Person resident in India". Section 2(w) of the said Act states that a person who is not resident in India is a "Person resident outside India".

On application of the above provisions of FEMA, it can be concluded that WIP Ltd. is a "Person resident outside India" and since it owns a branch in Chandigarh, India, the residential status of the said Chandigarh branch is that of a "Person resident in India" from the date of its establishment.

- (iii) As per provisions of section 2(v)(iv) of the Foreign Exchange Management Act, 1999 (FEMA) an office, branch or agency outside India owned or controlled by a person resident in India is a "Person resident in India". Here, the Singapore branch of WIP Ltd. is controlled by its Chandigarh branch which is a "Person resident in India". Therefore, the residential status of the Singapore branch of WIP Ltd. shall be that of a "Person resident in India".

Question 11

Mr. F, an Indian National desires to obtain foreign exchange for the following purposes:

- (i) Payment of US \$10,000 as commission on exports under Rupee State Credit Route.*
- (ii) US \$ 30,000 for a business trip to U.K.*
- (iii) Remittance of US \$ 2,00,000 for payment as prize money to the winning team in a Hockey Tournament to be held in Australia.*

Advise him, if he can get the Foreign Exchange and under what condition **(May 2005)**

Answer

Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions, prior permission of Reserve Bank of India is required:

- (i) In respect of item No. (i), i.e., payment of commission on exports under Rupee State Credit Route, such payment is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000.
- (ii) Foreign Exchange for business trip upto US\$ 25,000 can be obtained by any person. If a person wants to exceed this limit, then prior permission of Reserve Bank of India is required as per Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. In respect of item (ii), since the amount involved is more than US \$ 25,000, Mr. F can obtain the foreign exchange after getting the permission of Reserve Bank of India.
- (iii) The type of payment as envisaged in item No.(iii) is covered under Second Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and for remitting of prize money exceeding US\$ 1,00,000 for sports activity abroad other than International, National or State level body will require the prior permission of the Central Government. (Ministry of Human Resource Development – Department of Youth Affairs and Sports). Since the amount involved in item No. (iii) of the question is more than US\$ 1,00,000 and Mr. F is not an International, National or State level body, he has to obtain the permission of the Central Government before remitting the prize money of US\$ 2,00,000.

In all the cases, where remittance of Foreign Exchange is allowed, either by general or specific permission, the remitter has to obtain the Foreign Exchange from an Authorised Person as defined in Section 2(c) read with section 10 of the Foreign Exchange Management Act, 1999.

Question 12

- (a) Explain the meaning of "Capital Account Transaction" under the Foreign Exchange Management Act, 1999. State whether there are any restrictions in respect of the following transactions:
- (i) Drawal of Foreign Exchange for payments due on account of amortisation of loans in ordinary course of business.
 - (ii) Purchase by a person resident outside India of shares of a company in India engaged in plantation activities.
- (b) TKM Exporters of New Delhi are engaged in Export Business. It made certain exports, but failed to realize and repatriate to India the foreign exchange due on its exports. The Adjudicating Authority imposed a penalty under the provisions of Foreign Exchange Management Act, 1999 (FEMA). Being aggrieved by this penalty, the said exporter seeks your advice as to the authority to which appeal can be made and the time limit for making such appeals. You are required to advise on the matter. **(November 2005)**

Answer

- (a) As per provisions of section 2(e) of the Foreign Exchange Management Act, 1999 (FEMA) "Capital Account Transaction" means a transaction which alters (a) the assets and liabilities, including the contingent liabilities, outside India of persons resident in India or (b) the assets and liabilities in India of persons resident outside India.

It also includes the following as stated in section 6(3) of FEMA:

- (i) Transfer or issue of any foreign security by a person resident in India.
- (ii) Transfer or issue of any security by a person resident outside India.
- (iii) Transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India.
- (iv) Any borrowing or lending in foreign exchange in whatever form or by whatever name called.
- (v) Any borrowing or lending in India rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India.
- (vi) Deposits between persons resident in India and persons resident outside India.
- (vii) Export, import or holding of currency or currency notes.
- (viii) Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India.
- (ix) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India.

- (x) Giving a guarantee or surety in respect of any debt, obligation or other liability incurred (a) by a person resident in India and owed to a person resident outside India or (b) by a person resident outside India.

(i) Amortisation of Loans:

Under provisions of FEMA, 1999 subject to Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 as amended by Foreign Exchange Management (Permissible Capital Account Transactions) (Amendment) Regulations, 2004 all capital account transactions are prohibited unless permitted by proviso to section 6(2) of FEMA. The proviso specifically permits drawal of foreign exchange for payments due on account of amortisation of loans in ordinary course of business. Hence, there is no restriction in FEMA in this regard.

(ii) Purchase of Shares of Company engaged in Plantation activities:

According to Section 6(2) of FEMA, 1999 the Reserve Bank of India is empowered to specify in consultation with the Central Government, the classes of capital account transactions which are permissible and the limits upto which the foreign exchange shall be admissible for such transactions. Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 completely prohibits certain capital account transactions. One such transaction is foreign investment in India in any company, firm or proprietary concern engaged in or proposed to be engaged in agriculture or plantation activities. Hence, purchase by a person resident outside India of shares of a company in India engaged in plantation activities is not permissible.

- (b) Sections 17 and 19 of FEMA, 1999 provide for appeals against orders of Adjudicating Authority. If Adjudicating Authority is Assistant Director of the Enforcement or Deputy Director of Enforcement, appeal will lie to Special Director (Appeals). Further appeal shall lie with Appellate Tribunal for Foreign Exchange. However, if the Adjudicating Authority is senior to the Assistant Director of Enforcement or Deputy Director of Enforcement, then the appeal shall lie directly to the Appellate Tribunal.

Appeal to Special Director (Appeals)

Appeal against order of Assistant Director of Enforcement or Deputy Director of Enforcement can be filed with Special Director (Appeals) under Section 17 within 45 days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person. The Special Director (Appeals) can condone the delay in filing the appeal if he is satisfied that there was sufficient cause for not filing the appeal within the stipulated time.

Special Director (Appeals) will hear the parties and then pass his order. Copy of the order shall be sent to the concerned parties and the Adjudicating Authority.

Appeal to Appellate Tribunal

Appeal against the order of Adjudicating Authority being senior to Assistant Director of Enforcement or Deputy Director of Enforcement or against the order of Special Director (Appeals) can be made to the Appellate Tribunal for Foreign Exchange under section 19 of FEMA within 45 days from the date on which the copy of the order made by such Adjudicating Authority or Special Director (Appeals) is received by the aggrieved person. In this case also, the delay can be condoned by the Appellate Tribunal. In case of an appeal against the order imposing penalty, the appellant has to deposit the amount of such penalty with the authority prescribed by the Central Government. However, the Appellate Tribunal may waive such deposit to mitigate the likely hardship that may be caused to the appellant. After hearing of the appeal, the Appellate Tribunal shall pass a reasoned order.

It may be noted that the Tribunal is the final fact finding authority and no appeal lies against the facts determined by the Tribunal.

Question 13

- (a) *State which kind of approval is required for the following transactions under the Foreign Exchange Management Act, 1999:*
- (i) *X, a Film Star, wants to perform alongwith associates in New York on the occasion of Diwali for Indians residing at New York. Foreign Exchange drawal to the extent of US dollars 20,000 is required for this purpose.*
 - (ii) *F International Ltd. has purchased the trade mark from a Foreign Company to establish retail business chain in India as a joint venture at a consolidated price of US dollars 500,000 which is to be paid in Foreign currency of that country.*
 - (iii) *R wants to get his heart surgery done at UK. Up to what limit Foreign Exchange can be drawn by him and what are the approvals required?*
 - (iv) *L wants to pursue a course in Fashion design in Paris. The Foreign Exchange drawal is US dollars 20,000 towards tuition fees and US dollars 30,000 for incidental and stay expenses for studying abroad.*
- (b) *A French Manufacturing Company desirous of setting up its branch office at Pune seeks your advice on the objects for which the company may be allowed to set up the desired branch office. Advise the company about the procedure as required under the Foreign Exchange Management Act, 1999 to be followed in this regards* **(May 2006)**

Answer

(a) Approval to the following transactions under FEMA, 1999:

- (i) Foreign Exchange drawals for cultural tours require prior permission/approval of the Government of India irrespective of the amount of foreign exchange required. Therefore, in the given case X, the Film Star is required to seek permission of the Government of India.
- (ii) In this case prior permission/approval of RBI is required for purchasing trade mark from a foreign company where purchase consideration is to be paid in foreign currency. Therefore, F International Ltd. needs prior permission of RBI.
- (iii) Remittance in foreign exchange for medical treatment abroad requires prior permission/approval of RBI when the expenditure in foreign currency exceeds the estimate of hospital/doctor abroad or estimate from doctor in India in that field of treatment. Therefore, R can draw foreign exchange up to the estimate of hospital/doctor abroad or estimate from doctor in India in that field of treatment and prior permission/approval of RBI is required.
- (iv) Release of foreign exchange for education abroad is permitted up to US\$ 1,00,000 on self declaration basis. Therefore, L can draw foreign exchange on self declaration basis for pursuing a course in fashion design in Paris.

(b) Setting up a branch office at Pune by a French company – Objects and the procedure under the FEMA, 1999:

Since setting up a branch office by a foreign company in India involves foreign exchange, permission of RBI is required. Following are the objects for which RBI permits companies engaged in manufacturing and trading activities abroad to set up Branch Office in India:

- 1. To represent the parent company/other foreign companies in various matters in India e.g. acting as buying/selling agents in India.
- 2. To conduct research work in the area in which the parent company is engaged.
- 3. To undertake export and import trading activities.
- 4. To promote possible technical and financial collaborations between the Indian companies and overseas companies.
- 5. Rendering professional or consultancy services.
- 6. Rendering services in information technology and development of software in India.
- 7. Rendering technical support to the products supplied by the partner/group companies.

Steps / procedure:

1. Foreign company can set up Branch Offices in India after obtaining approval from RBI.
2. The office can act as a channel of communication between Head Office abroad and parties in India. It is not allowed to undertake any business activity in India and cannot earn any income in India. Expenses of such offices are to be met entirely through inward remittances of foreign exchange from the Head Office abroad.
3. Permission to set up such office is initially granted for a period of 3 years and this may be extended from time to time by the Regional Office in whose jurisdiction the office is set up.
4. The representative office will have to file an annual activity certificate etc. from a Chartered Accountant to the concerned Regional Office of the RBI.
5. Application is required to be made in Form FNC-1.

Question 14

Mr. Loma, an Indian National desires to obtain foreign exchange for the following purposes:

- (a) *Payment to be made for securing insurance for health from a company abroad.*
- (b) *Payment of commission on exports under Rupee State Credit Route.*
- (c) *Gift remittance exceeding US Dollars 10,000.*

Advise him whether he can get foreign exchange and if so, under what condition?

(November 2006)

Answer

Under provision of Section 5 of FEMA 1999, certain Rules have been made for drawal of foreign exchange for current account transactions. As per these rules, foreign exchange for some of the current account transaction is prohibited. As regards some other current account transaction foreign exchange can be drawn with prior permission of the Central Government while in case of some other current account transaction, the prior permission of Reserve Bank of India is required.

1. The payment required to be made for securing insurance for health from a company abroad as referred in item 1 can be made after obtaining permission from Central Government of India, as prescribed in Second Schedule to Foreign Exchange Management (Current Account Transaction) Rules 2000. Hence Mr. LOMA can draw foreign exchange after obtaining such permission.
2. As regards item no. 2 i.e., the payment of commission on export under Rupee State Credit Route, such payment is prohibited as referred in First Schedule to Foreign

Exchange Management (Current Account Transaction) Rules 2000. Hence Mr. LOMA cannot withdraw for the said purpose.

3. The item referred here is covered by Third Schedule to Foreign Exchange Management (Current Account Transaction) Rules 2000. As per this schedule, gift remittance exceeding USD 5,000 per beneficiary per annum requires permission of RBI. Since the amount involved here is more than USD 5000, Mr. LOMA can draw foreign exchange after permission from RBI.

In all the cases, where remittance of foreign exchange is allowed either by general or specific permission, the remitter has to obtain the foreign exchange from an authorized person as defined in Section 2(c) read with section 10 of FEMA, 1999.

Question 15

Mrs. Kamala, a resident in India is likely to inherit an immovable property in U.S.A. from her father, who is a resident outside India. Advise Mrs. Kamla about the restrictions, if any, in this regard under the Foreign Exchange Management Act, 1999 explaining the relevant provisions of the Act. Will your answer be different, if she is likely to inherit foreign securities?

(November 2006)

Answer

- (i) As per section 15 of Competition Act 2002 any act or proceeding of the Commission shall not be invalidated merely on the ground of:
- (a) any vacancy in, or any defect in the constitution of the Commission; or
 - (b) any defect in the appointment of a person acting as a Chairperson or as a member; or
 - (c) any irregularity in the procedure of the Commission not affecting the merits of the case.
- Here in this case Mr. ZPM should have professional qualification of not less than 15 years as per section 8 of the Act but this disqualification will not invalidate the proceeding of the Commission.
- (ii) Section 2(i) of Competition Act, 2002 defines 'goods' as follows:
- 'Goods' means goods as defined the Sale of Goods Act, 1930 and includes –
- (a) products manufactured, processed or mined;
 - (b) debentures, stock and shares after allotment
 - (c) in relation to goods supplied, distributed or controlled in India, goods imported into India.

Hence, debentures and shares can be considered as 'goods' within the meaning of section 2(i) of Competition Act, 2002 only after allotment and not before allotment.

Question 16

- (i) *Tomco Ltd. a vehicles manufacturing company situate at Pune, Maharastra has received an order from a transport company in Italy for supply of 100 Trucks on lease. You are required to state, how the said Tomco Ltd. can accept such an order.*
- (ii) *Forex Dealers Ltd. Is an Authorised Person within the meaning of Foreign Exchange Management Act, 1999. Reserve Bank of India issued certain directions to the said Authorised person to file certain returns which it failed to file. You are required to state the penal provisions to which the said Authorised Person has exposed itself.*

(May 2007)

Answer

- (i) Under provisions of section 7 of the Foreign Exchange Management Act, 1999 certain rules have been made governing export of goods and services. Regulation 14-A of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 prescribes that no person shall, except with prior permission of the Reserve Bank of India, take or send out by land, sea or air any goods from India to any place outside India on lease or hire or under any arrangement or in any other manner other than sale or disposal of such goods.

Accordingly if Tomco Ltd. wants to accept the order for dispatching 100 trucks to Italy on lease, it has to take prior permission of the Reserve Bank of India.

- (ii) In accordance with the provisions of the Foreign Exchange Management Act, 1999 as contained in section 11(3), stated that where any authorized person contravenes any direction given by the Reserve Bank of India under the said Act or fails to file any return as directed by the Reserve Bank of India, the Reserve Bank of India may, after giving reasonable opportunity of being heard, impose on Authorised Person a penalty which may extend to ten thousand rupees and in the case of continuing contraventions with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

Since as per the facts given in the question, the Authorized person, namely, Forex Dealers Ltd., has failed to file the return as directed by the Reserve Bank of India, according to the above provisions if has exposed itself to a penalty which may extend to Rs. 10,000 and in the case of continuing contraventions in the nature of failure to file the return, with an additional penalty which may extend to Rs. 2,000 for every day during which such contravention continues.

Question 17

- (i) *Mr. Sekhar resided in India for a period of 150 days in India during the financial year 2006-07 and thereafter went abroad. He came back to India on 1st April, 2007 as an employee of a business organization. What would be his residential status during the financial year 2007-2008?*
- (ii) *Mr. Atul, an Indian National desires to obtain foreign exchange for the following purposes:*
- (a) *Remittance of US Dollar 10,000 for payment for goods purchased from a party situated in Nepal.*
- (b) *US Dollar 10,000 for remitting as commission to his agent in USA for sale of commercial plot situated near Bangalore, consideration in respect of which was received by Mr. Atul by way of foreign currency inward remittance amounting to US Dollar 1,00,000.*

Advise him, if he can get the Foreign Exchange and under what conditions.

(May 2007)

Answer

- (i) In accordance with the provisions of Section 2(v) of the Foreign Exchange Management Act, 1999, as contained in section 2(v) a person in order to qualify for the purpose of being treated as a "Person Resident in India" in any financial year, must reside in India for a period of more than 182 days during the preceding financial year. In the given case, Mr. Sekhar has resided in India for a period of only 150 days, i.e., less than 182 days, during the financial year 2006-2007. Hence he cannot be considered as a "Person Resident in India" during the financial year 2007-2008 irrespective of the purpose or duration of his stay.
- (ii) In accordance with the provisions the Foreign Exchange Management Act, 1999 as contained in Section 5, certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, drawal Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current account transactions, Foreign Exchange can be drawn with prior permission of the Central government while in case of some Current Account transactions, prior permission of Reserve Bank of India is required.
- (a) In respect of item (a), i.e., remittance to Nepal, such remittance is prohibited and the same is included in First Schedule to be Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, Mr. Atul cannot withdraw Foreign Exchange for this purpose.

- (b) The type of payment as envisaged in item (b) is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules 2000 and for withdrawing foreign Exchange exceeding 5% (five percent) of the inward remittance as commission to agent abroad for sale of commercial plot in India, Mr. Atul will require the prior permission of the Reserve Bank of India.

Question 18

Examine with reference to the provisions of the Foreign Exchange Management Act, 1999, the residential status of the branches mentioned below:

- (i) *NNM Ltd. an Indian Company having its registered office at Mumbai, India established a branch at New York USA on 1st April, 2005.*
- (ii) *DDI Ltd. a company incorporated and registered in London established a branch at Kanpur in India on 1st April 2005.*
- (iii) *DDI Ltd. has a branch office at Singapore which is controlled by its Kanpur branch.*

(November 2007)

Answer

As per Section 2(u) of the Foreign Exchange Management Act, 1999, 'person' includes the following:

- A Company
- Any agency, office or branch owned by a 'person'
- Section 2(v) defines a 'person resident in India' as to include:
- Any person or body corporate registered or incorporated in India
- An office, branch or agency in India owned or controlled by a person resident outside India
- An office, branch or agency in India owned or controlled by a person resident in India.
- Considering the provisions of the two section, the residential status is as follows:

NNM Ltd. as well as the New York branch of NNM Ltd. is a 'person'. Therefore, the residential status under FEMA shall be determined for each of them separately.

NNM Ltd. is incorporated in India. Therefore, it is a 'person resident in India'.

NNM Ltd. (a person resident in India) has established a branch outside India. Therefore, the New York branch of NNM Ltd. falls under the clause 'an office', branch or agency outside India owned or controlled by a person resident in India and so the New York branch is a 'person resident in India'.

- (a) DDI Ltd. (a foreign company) does not fall under any of the clauses of the definition of a 'person resident in India'. Therefore, DDI Ltd. is a 'person resident outside India'.

(b) The Kanpur branch of DDI Ltd. is a person resident in India' since it falls under the clause 'an office, branch or agency in India owned or controlled by a person resident outside India'.

(111) the Singapore branch of DDI Ltd., though not owned, is controlled by the Kanpur branch. The Singapore branch is a 'person resident in India' since it falls under the clause 'an office, branch or agency outside India owned or controlled by a person resident in India.

Question 19

Explain the meaning of "Capital Account Transactions" under the Foreign Exchange Management Act, 1999. State its categories and also examine whether the following transactions are permissible or not under the above act as Capital Account transactions:

- (i) *Investment by person resident in India in Foreign Securities.*
- (ii) *Foreign currency loans raised in India and abroad by a person resident in India.*
- (iii) *Export, import and holding of currency / currency notes.*
- (iv) *Investment in a Nidhi Company.*

(November 2007)

Answer

Meaning of Capital Account Transaction

It 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 a person resident outside India, and includes transactions referred to in sub-section (3) of Section 6 of FEMA Act, 1999.

The Reserve Bank of India has formed Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000. The provisions of these regulations are as under

Categories of Capital Account Transactions:

As per these regulations, capital account transactions may be classified under the following heads.

- (1) Permissible capital account transaction of persons resident in India (schedule 1)
- (2) Permissible Capital transactions of persons resident outside India (schedule II).
- (3) Prohibited capital account transactions.

A person resident in India may enter into any of the following capital account transactions provided the regulations specified by the Reserve Bank of India in respect of such capital account transactions are complied with.

In view of the above provisions: among five capital account transaction of question first three i.e. (i), (ii) and (iii) are permissible capital account transactions and rest two i.e., (iv) and v are prohibited capital transactions.

Question 20

TKM Exporter of New Delhi are engaged in Export Business. It made certain exports but failed to realise and repatriate to India the foreign exchange due on its exports. The Adjudicating Authority imposed a penalty under the provisions of Foreign Exchange Management Act, 1999 (FEMA). Being aggrieved by this penalty, the said exporter seeks your advice as to the authority to which appeal can be made and the time limit for making such appeals. You are required to advise on the matter. **(May 2008)**

Answer

Sections 17 and 19 of Foreign Exchange Management Act 1999 provide for appeals against orders of Adjudicating Authority. If the Adjudicating Authority is Assistant Director of Enforcement or Deputy Director of Enforcement, appeal will lie to Special Director (Appeals). Further appeal shall lie with Appellate Tribunal for foreign Exchange. However, the Adjudicating Authority is senior to the Assistant Director of Enforcement or Deputy Director of Enforcement, then the appeal shall lie directly to the Appellate Tribunal.

Appeal to Special Director (Appeals)

Appeal against order of Assistant Director of Enforcement or Deputy Director of Enforcement can be filed with Special Director (Appeals) under Section 17 of the said act within 45 days from the date on which the copy of the order made by the Adjudication Authority is received by the aggrieved person. The Special Director (Appeals) can condone the delay in filing the appeal if he is satisfied that there were sufficient cause for not filing the appeal within the stipulated time. Special Director (Appeals) will hear the parties and then pass his order. Copy of the order shall be sent to the concerned parties and the Adjudicating Authority.

Appeal to Appellate Tribunal

Appeal against the order of Adjudicating Authority being senior to Assistant Director of Enforcement or Deputy Director of Enforcement or against the order of Special Director (Appeals) can be made to the Appellate Tribunal for Foreign Exchange under Section 19 of Foreign Exchange Management Act, 1999 within 45 days from the date on which the copy of the order made by such Adjudicating Authority or Special Director (Appeals) is received by the aggrieved person. In this case also, the delay can be condoned by the Appellate Tribunal. In case of an appeal against the order imposing penalty, the appellant has to deposit the amount of such penalty with the authority prescribed by the Central Government. However, the Appellate Tribunal may waive such deposit to mitigate the likely hardship that may be caused to the appellant. After hearing of the appeal, the Appellate Tribunal shall pass a reasoned order.

It may be noted that the Tribunal is the final fact finding authority and no appeal lies against the facts determined by the Tribunal.

Question 21

Mr. Kale, an Indian National desires to obtain foreign exchange for the following purposes:

- (i) Remittance of US Dollar 50,000 out of winnings on a lottery ticket.*
- (ii) US Dollar 100,000 for sending a tour of a cultural group to USA.*
- (iii) US Dollar 50,000 for meeting the expenses of his business tour to Europe.*

Advise him, if he can get the Foreign Exchange and under what conditions. (May 2008)

Answer

Under provisions of Section 5 of the Foreign Exchange Management Act, 1999 certain rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central government or Reserve Bank of India.

- (i) Remittance out of lottery winnings, is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence Mr. Kale cannot withdraw Foreign Exchange for this purpose.*
- (ii) Foreign Exchange or meeting expenses of cultural tour can be withdrawn by any person after obtaining permission from Government of India, Ministry of Human Resources Development, (Department of Education and culture) as prescribed in Second Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, in respect of item (ii), Mr. Kale can withdraw the Foreign Exchange after obtaining such permission.*
- (iii) The type of payment as envisaged is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and for withdrawing foreign Exchange exceeding US Dollar 25,000 for a business tour irrespective of period of stay Mr. Kale will require the prior permission of the Reserve Bank of India.*

In all the cases, where remittance of Foreign Exchange is allowed, either by general or specific permission, the remitter has to obtain the Foreign Exchange from an Authorised Person as defined in Section 2(c) read with Section 10 of the Foreign Exchange Management Act, 1999.

Question 22

Mr. Guilt an Indian National realizes that a penalty may be imposed upon him for violation of the provisions of the Foreign Exchange Management Act, 1999. He therefore desires to compound his offences. Advise Mr. Guilt about the process and procedure of compounding of the offence. (November 2008)

Answer

Sections 15 of Foreign Exchange Management Act, 1999 (FEMA) authorizes the Reserve Bank of India and Enforcement Directorate to compound contravention on an application made by any person who has committed contravention. The process and procedure of compounding is as under:

- An application for compounding of a contravention under the FEMA may be submitted to the compounding authority either on being advised of a contravention or either through a memorandum or suo moto on being made or becoming aware of the contravention. The application should be as per format in the Foreign Exchange (Compounding proceeding) Rules.
- Application for compounding in prescribed form together with a copy of the memorandum wherever applicable with the prescribed fee has to be submitted with relevant facts and supporting documents to the compounding authority.
- The compounding authority may call for any information/record or any other documents relevant to the compounding proceedings.
- Where additional information/documents are called for, such information shall be submitted within thirty days or such additional period as may be given by the compounding authority from the date of the said letter. In case the contravener fails to submit additional information/document called for within the specified period, the application for compounding will be liable for rejection.
- On receipt of the application for compounding, the proceeding would be concluded and the order issued by the compounding authority within 180 days from the date of the receipt of the application for compounding.
- The sum for which contravention has been compounded shall be paid within 15 days from the date of order of compounding.
- The payment towards application fee and the sum for which contravention has been compounded shall be paid by demand draft in favour of compounding authority.

Thus Mr. Guilt will have to follow the above procedure for compounding his offences.

Question 23

Mr. Amit, a citizen of India, left India for employment in Australia on 1st June, 2007. Mr. Amit purchased a flat at New Delhi for Rs.15 lakhs in September, 2008. His brother, Mr. Sumit employed in New Delhi, also purchased a flat in the same building in September, 2008 for Rs. 15 lakhs. Mr. Sumit 's flat was financed by a loan from a housing finance company and the loan was guaranteed by Mr. Amit. Examine with reference to the provisions of Foreign

Exchange Management Act, 1999, whether purchase of flat and guarantee by Mr. Amit are capital account transactions and whether these transactions are permissible.

(November 2008)

Answer

A “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. It also includes following transactions referred to in sub-section (3) of Section 6 of Foreign Exchange Management Act 1999:

- (a) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
- (b) Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-

Thus purchase of flat at New Delhi and giving of guarantee would be considered as capital account transactions.

A capital account transaction is not permissible, unless otherwise provided in the Act, Rules or Regulations made there under, or with the general or special permission of Reserve Bank of India.

In the case referred, Mr. Amit left India for employment in Australia on 1st June 2007. Therefore, he becomes a person resident outside India from June 2007.

The purchase of flat by Mr. Amit is a capital account transaction. This is permissible in accordance with the regulation framed in this behalf i.e. The Foreign Exchange Management (Acquisition and Transfer of Immovable Property In India) Regulation, 2000. The Foreign Exchange Management (Acquisition and Transfer of Immovable property In India) Regulation, 2000 imposes restrictions on a person resident outside India from acquiring immovable property in India provided he fulfills both the following conditions:

- (a) the person resident outside India is citizen of India and
- (b) the immovable property acquired in India is not agricultural/plantation or farmhouse.

Therefore the purchase of flat by Mr. Amit is permissible under FEMA.

Guarantee involves a long term commitment which alters the assets and liabilities of a person and therefore it is considered as a “capital account transaction” and thus restricted under FEMA. Accordingly Mr. Amit can give a guarantee to the housing finance company in respect of purchase of flat by Mr. Sumit with the permission of Reserve Bank of India.

Question 24

Mr. Basu desires to draw foreign exchange for the following purposes:

- (i) *Payment related to “Call back services” of telephones*

- (ii) USD 1,20,000 for studies abroad on the basis of estimates given by the foreign university.
- (iii) USD 25,000 for sending a cultural troupe on a tour of Europe.

Advise him, whether he can get foreign exchange and, if so, under what conditions

(CA, Final, New Course, November, 2008)

Answer

Current Account Transactions:

The Central Government in consultation with RBI framed regulation known as Foreign Exchange Management (Current Account Transaction) Regulation, 2000. Under these Regulations certain transactions are prohibited, certain transactions require Central Government approval and certain transactions require RBI approval.

- (i) Payment related to 'call back services' of telephone is totally prohibited under Schedule I of Foreign Exchange Management (Current Account Transaction) regulations.
- (ii) Remittance of Foreign Exchange for studies abroad:

This is a Schedule III transaction. Foreign Exchange may be released for studies abroad up to a limit of USD 1,00,000 or the estimates from the institution abroad, whichever is higher. Above this limit RBI's approval is required. In this case USD 1,20,000 is required on the basis of estimates of the institution abroad. Hence no permission from RBI is required.

- (iii) Cultural troupe:

This is a Schedule II transaction. Irrespective of the amount involved prior approval of Central Government, Ministry of HRD (Dept. of Education and Culture) is required. However no permission is required in case of remittance out Of Resident Foreign Currency (RFC) Account or (Exchange Earner's Foreign Currency) EEFC Account.

Question 25

Answer any two of the following:

- (a) State the kind of approval required for the following transaction under the Foreign Exchange Management Act, 1999:
 - (i) L, a famous playback singer of India wants to perform a musical night in Paris for Indians residing there. Foreign exchange to the extent of US D 20,000 is required for this purpose.
 - (ii) M requires US D 5,000 to make payment related to 'call back services' of telephone.

- (iii) *N wants to pursue a course in business management in New York.. He wants to draw US D 50,000 towards expenses for studying abroad.*
- (iv) *R wants to draw US D 20,000 to make donation to a charitable trust situated in South Korea.*
- (b) *Mr. Raman is a software engineer of Armtek Ltd. The company sent him to Japan to develop a software programme there on deputation for 2 years. He earned a sum of US \$ 3,000 as a honorarium there. On his return to India he wants to hold this foreign currency with him. Whether Mr. Raman will be allowed to keep the foreign currency with him.*
(May 2009)

Answer

- (a) (i) Foreign exchange drawals for cultural tours require prior permission/approval of the Government of India irrespective of amount of foreign exchange required. Therefore, in the given case L, the singer is required to seek permission of the Government of India.
- (ii) Drawal of foreign exchange for payment related to 'call back services' of telephones is prohibited. Therefore 'M' can not draw foreign exchange.
- (iii) Release of foreign exchange for education abroad is permitted up to USD 100,000 on self declaration basis. Therefore 'N' can draw foreign exchange on self declaration basis for pursuing a course in business management in New York.
- (iv) Making donation exceeding USD 10000 per annum per beneficiary require Reserve Bank of India's prior approval. Therefore 'R' can draw USD 20000 to make donation after taking prior approval from Reserve Bank of India.

- (b) As per Section 8 of Foreign Exchange Management Act, 1999 where any amount of foreign exchange is due or has accrued to any person resident in India, such person shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by Reserve Bank of India.

But as per section 9(e) of the said Act, this provision shall not apply to foreign exchange acquired from employment, business trade, vocation, service honorarium, gifts, inheritance or any other legitimate means up to such limit as the Reserve Bank of India may specify.

The Reserve Bank of India has specified the following persons with the limits for possession and retention of foreign currency by a person resident in India:

Any person may possess foreign coins without any restriction to the amount.

Any person resident in India is permitted to retain in aggregate foreign currency not exceeding USD 2,000 or its equivalent in the form of currency notes/bank notes or travelers cheques acquired by him;

Any person resident in India but not permanently resident therein is permitted to hold the foreign currency without limit, if the foreign currency was acquired when he was resident outside India and was brought into India and declared to the custom authorities.

In the given case as Mr. Raman earned a sum of USD 3000 as a honorarium when he was in employment in Japan. But in view of the restrictions under FEMA and the aforesaid regulation he can retain foreign exchange up to USD 2000 only and not more than that.

Question 26

- (i) *Mr. Sekhar resided in India for a period of 150 days during the financial year 2007-2008 and thereafter went abroad. He came back to India on 1st April, 2008 as an employee of a business organization. What would be his residential status under Foreign Exchange Management Act, 1999 during the financial year 2008-2009?*
- (ii) *Mr. Atul, an Indian National desire to obtain Foreign Exchange for the Following purpose:*
- (a) *Remittance of US Dollars 10,000 for payment for goods purchased from a party situated in Nepal.*
- (b) *US Dollars 10,000 for remitting as commission to his agent in U.S.A for sale of Commercial plot situated near Bangalore, consideration in respect of which was received by Mr. Atul by way of foreign currency inward remittance amounting to US Dollars 1,00,000.*

Advise him, if he can get the Foreign Exchange and under what conditions for making the above remittances. (CA, Final, New Course, May 2009)

Answer

- (i) According to the provisions of Section 2(v) of the Foreign Exchange Management Act, 1999, a person in order to qualify for the purpose of being treated as a "Person Resident in India" in any financial year, must reside in India for a period of more than 182 days during the preceding financial year. In the given case, Mr. Sekhar has resided in India for a period of only 150 days, i.e. less than 182 days, during the financial year 2007-2008. Hence he cannot be considered as a "Person Resident in India" during the financial year 2008-2009 irrespective of the purpose or duration of his stay.

- (ii) Under provisions of Section 5 of the Foreign Exchange Management Act, 1999 certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, drawal of Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account Transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions, prior permission of Reserve Bank of India is required.
- (a) In respect of item (a), i.e. remittance to Nepal, such remittance is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence Mr. Atul can not withdraw foreign Exchange for this purpose.
- (b) The type of payment as envisaged in item (b) is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and for withdrawing foreign Exchange exceeding 5% (five percent) of the inward remittance as commission to agent abroad for sale of commercial plot in India Mr. Atul will require the prior permission of the Reserve Bank of India.

Question 27

- (a) (i) *Mr. Ruchi resided for a period of 170 days in India during the financial year 2008 - 09 and thereafter went abroad. He came back to India on 1st April, 2009 as an employee of a business organization. What would be his residential status during financial year 2009-10 under the Foreign Exchange Management Act, 1999?*
- (ii) *Pamtop is a London based Company having several business units all over the world. It has manufacturing unit called Laptop with headquarters in Bengaluru. It has a branch in Seoul, South Korea which is controlled by the headquarters in Bengaluru. What would be the residential status under the FEMA, 1999 of Laptop in Bengaluru and that of Seoul branch?*
- (b) *Referring to the provisions of the Foreign Exchange Management Act, 1999, examine whether V, an exporter is bound to make declaration of the following goods exported from India to United Kingdom:*
- (i) *Exports software valuing Rs.50,000.*
- (ii) *V gifts certain items of jewellery valued at Rs.20,000 to his friend in Australia.*
- (iii) *V exports certain goods valuing US \$ 5,000 to Myanmar under Barter Trade Agreement.*

Answer

- (a) (i) Residential status of an individual for a particular financial year is determined with reference to his residence in India in the immediately preceding financial year. In the

given problem Mr. Ruchi resided in India for less than 183 days in the financial year 2008-09. Therefore for the financial year 2009-10 he is a person resident out side India. Unless a person resides in India for more than 182 days in the preceding financial year, he can in no case be termed as a person resident in India.

- (ii) Pamptop being a London based Company would be a person resident out side India .Section 2 (u) defines 'person' Under clause (vii) thereof 'person' would include any agency office or branch owned or controlled by such person. The term 'such person' appears to refer to person who is included in clauses (i) to (vi). Accordingly, a laptop unit in Bengaluru, being a branch of a Company, would be a 'person.'

Section 2(v) defines person 'resident in India', under clause (iii) thereof person 'resident in India', would include an office, branch or agency in India owned or controlled by a person resident outside India. Laptop unit in Bengaluru is owned or controlled by a person 'resident outside India' Hence, it would be a person 'resident in India'.

However Seoul branch 'though not owned' is controlled by Laptop unit in Bengaluru which is a person resident in India. Hence, prima-facie, it may be possible to hold a view that the Seoul branch is also a 'person resident in India'.

- (b) In accordance with provisions of the FEMA, 1999 as contained in Section 7 read with Section 8, it imposes on an exporter to make appropriate declaration of the value of the goods being exported and he is also required to repatriate the foreign exchange due to India in respect of such exports to India in the manner within the time as may be prescribed. Under Section 8, the exporter is under an obligation to realise and repatriate to India such foreign. However, if there is an delay in the receipt of export, it will not be a violation which shall be punishable. Section 8 applies to a resident who shall take all the reasonable steps, depending upon the individual case.

There are certain categories of export for which declaration need not be made. These are:

- (a) Export of goods/software no exceeding Rs.25,000 in value.
- (b) Export by way of gift not exceeding Rs.1 lac in value.
- (c) Export of goods not under exceeding US \$ 1000 or its equivalent per transaction to Myanmar under Barter Trade Agreement.

Taking into consideration the above, answer to the question are:

- 1. In the first case since the value is exceeding Rs.25,000 in value, therefore, declaration has to be completed.
- 2. In the second case since the value of gift of jewellery to V's friend in Australia is less than Rs.1 lac in value, the gift does not need any declaration to be completed.

3. In the third case since the value is more than U.S.\$ 1,000, therefore, the declaration has to be completed.

Question 28

A Company incorporated in United Kingdom established a branch at Chennai. What is the residential status of the Chennai branch? The Chennai branch proposes the purchase some immovable property at Chennai for the purpose of its business. Is it a 'Capital Account Transaction' within the meaning of Section 2(e) of the Foreign Exchange Management Act, 1999? Are there any restrictions under the Foreign Exchange Management Act, 1999 in respect of such acquisition?

(CA, Final, New Course, November, 2009)

Answer

According to section 2(v)(iii) of FEMA, 1999, person resident in India inter alia means an office, branch, or agency in India owned or controlled by a person resident outside India. The company incorporated in U.K is a person resident outside India [Section 2(v)(ii) read with section 2(w) of the FEMA] as it is not a body corporate registered or incorporate in India. As the Chennai branch is branch in India is owned and controlled by the U.K Company is resident outside India, the Chennai branch is resident is India under section 2(v) (iii) stated above.

Capital account transaction.

In the case of a resident in India, capital account transaction means a transaction which alters the assets or liabilities outside India. The Chennai branch (is resident in India) acquires immovable property at Chennai (is in India). Hence this acquisition is not a capital account transaction within the meaning of Section 2(e) of FEMA. Section 6(3) empowers RBI to restrict or regulate the acquisition of immovable property in India by a person resident outside India. Hence there is no restriction in acquisition of immovable property in India by Chennai branch.

Question 29

- (a) *The Reserve Bank of India receives a complaint that an authorized person has submitted incorrect statements and information to the Reserve Bank of India in respect of receipt and utilization of Foreign Exchange. Explain the powers of the Reserve Bank of India with regard to inspection of records of the above authorized person in respect of the above complaint.*

Referring to the provisions of Foreign Exchange Management Act, 1999, state the duties of the above authorized person.

- (b) *Referring to the provisions of the Foreign Exchange Management Act, 1999, state the kind of approval required for the following transactions:*
- (i) *M requires U.S. \$ 5,000 for remittance towards hire charges of transponders.*
 - (ii) *D requires U.S. \$ 14,000 per annum for donation to Mr. White in U.S.A.*

- (iii) *P requires U.S. \$ 2,000 for payment related to call back services of telephones.*
- (iv) *XYZ Limited, a company incorporated in India under the Companies Act, 1956, wants to withdraw U.S. \$ 5,00,000, for short-term credit to its overseas office situated in Australia.* **(May, 2010)**

Answer

- (a) As per Section 12 of the Foreign Exchange Management Act, 1999
 - (1) The Reserve Bank may, at any time, cause an inspection to be made by any officer of the Reserve Bank specially authorized in writing by the Reserve Bank in this behalf, of the business of any authorized person as may appear to it to be necessary or expedient for the purpose of:
 - (a) verifying the correctness of any statement, information or particulars furnished to the Reserve Bank;
 - (b) obtaining any information or particulars which such authorized person has failed to furnish on being called upon to do so;
 - (c) securing compliance with the provisions of this Act or of any rules, regulations, directions or orders made thereunder.
 - (2) It shall be the duty of every authorized person, and where such person is a company or a firm, every director, partner or other officer of such company or firm, as the case may be, to produce to any officer making an inspection under section 12 (1) such books, accounts and other documents in his custody or power and to furnish any statement or information relating to the affairs of such persons, company or firm as the said officer may require within such time and in such manner as the said officer may direct.
- (b) Under section 5 of the Foreign Exchange Management Act, 1999, and Rules relating thereto, some current account transactions require prior approval of the Central Government, some others require the prior approval of the Reserve Bank of India, some are free transactions and some others are prohibited transactions. Accordingly,
 - (i) It is a current account transaction, where M is required to take approval of the Central Government for drawal of foreign exchange for remittance of hire charges of transponders.
 - (ii) It is a current account transaction, which requires RBI's prior approval for donating US \$ 14,000 per annum to Mr. White in U.S.A., as the donation amount exceeds the ceiling of US \$ 10,000 per annum per beneficiary.

- (iii) Withdrawal of foreign exchange for payment related to call back services of telephone is a prohibited transaction. Hence, Mr. P will not succeed in acquiring US \$ 2,000 for the said purpose.
- (iii) Here, XYZ Limited has to take prior approval of the RBI for withdrawing US \$ 5,00,000 for short-term credit to its overseas office situated in Australia.

Question 30

- (i) *The Reserve Bank of India issued certain directions to Dream Construction Limited, an authorised person under the Foreign Exchange Management Act, 1999 to file certain returns. The Company failed to file the said returns. Decide, as to what penal provisions are applicable against the said authorised person under the said Act.*
- (ii) *Examine under the Foreign Exchange Management Act, 1999 whether "Payment of remuneration to foreign technicians" is a permissible transaction under the provisions of the said Act.*

(CA, Final, New Course, May, 2010)

Answer

- (i) **Penal provisions:** Section 11(3) of the Foreign Exchange Management Act, 1999 states that where any authorized person contravenes any direction given by the Reserve Bank of India under the said Act or fails to file any return as directed by the Reserve Bank of India, the Reserve Bank of India may, after giving reasonable opportunity of being heard impose a penalty which may extend to Rs. 10,000/- and in the case continuing contraventions with an additional penalty which may extend to Rs. 2,000/- for every day during which such contravention continues.
- (ii) **Foreign Technician:** Salary payable to a foreign technician is a current account transaction. According to Section 5 of the Foreign Exchange Management Act, 1999 any person can sell or draw foreign exchange to or from authorized person if such sale or drawal is a current account transaction. Reasonable restrictions on current account transactions can be imposed by the Central Government. Basically all current account transactions are free unless specifically restricted by the Central Government. Hiring of foreign nations as technicians is permissible without restriction. There is not ceiling on salary which can be paid as per contract. Their salary can be remitted abroad after tax deducted at source.

THE COMPETITION ACT, 2002

Question 1

How will the Chairperson and other members of the Competition Commission of India be appointed? State whether the Chairperson shall be only a person, who has been or is qualified to be, a Judge of a High Court.
(November, 2003)

Answer

Competition Commission of India

The Competition Commission of India shall consist of a Chairperson and not less than two and not more than six other members to be appointed by the Central Government (Section 8) while the appointment is made by the Central Government, the Chairperson and other members shall be selected in the manner as may be prescribed (Section 9).

The Chairperson and every other member shall be a person of ability, integrity and standing and who has special knowledge of, and such professional experience of not less than 15 years in international trade, economics, business, commerce, law, finance accountancy, management, industry, public affairs or competition matters including competition law and policy and which, in the opinion of the Central Government may be useful to the commission [Section 8(2)]. As the qualification prescribed in the Act is the same for chairperson and other members, chairperson of commission may or may not be a judicial person.

Question 2

An understanding has been reached among the manufacturers of cement to control the price of cement, but the understanding is not in writing and it is also not intended to be enforced by legal proceedings.

Examine whether the above understanding can be considered as an 'Agreement' with the meaning of Section 2(b) of the Competition Act, 2002.
(May, 2004)

Answer

Agreement

'Agreement' includes any arrangement or understanding or action in concert:

- (i) Whether or not, such arrangement, understanding or action is formal or in writing or

- (ii) Whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings. [Section 2(b)].

In view of the above definition of 'agreement', an understanding reached by the cement manufacturers to control the price of cement will be an 'agreement' within the meaning of Section 2(b) of the Competition Act, 2002 even though the understanding is not in writing and it is not intended to be enforceable by legal proceedings.

Question 3

Poly Ltd., (hereinafter referred to as "Seller"), manufacturer of footwears entered into an agreement with City Traders (hereinafter referred to as "purchaser"), for sale of its products. The agreement includes, among others, the following clauses:

- (i) *That the Purchaser shall not deal with goods, products, articles, by whatever name called, manufactured by any person other than the Seller.*
- (ii) *That the Purchaser shall not sale the goods manufactured by the Seller outside the municipal limits of the city of Secunderabad.*
- (iii) *That the Purchaser shall sale the goods manufactured by the Seller at the price as embossed on the price label of the footwear. However, the purchaser is allowed to sale the footwear at prices lower than those embossed on the price label.*

You are required to examine with relevant provisions of the Competition Act 2002, the validity of the above clauses. **(November, 2004)**

Answer

Provisions of section 3(1) of the Competition Act, 2002 prohibits any agreement for goods and/or services that may have an appreciable adverse effect on competition in India.

Provisions of section 3(2) of the said Act states that any agreement entered into in contravention of provision of section 3(1) of the said Act shall be void.

Sections 3(3) and 3(4) of the said Act enumerates the types of the agreements which are to be treated as contravening the provisions of the said section 3(1). According to section 3(4) of the said Act, any agreement among enterprises or persons at different stages of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services including the following shall be treated as agreements in contravention of the said section 3(1):

- (a) tie-in-arrangement ;
- (b) exclusive supply agreement ;
- (c) exclusive distribution agreement ;
- (d) refusal to deal

(e) re-sale price maintenance

The clauses of the agreement given in the question are covered by above mentioned provisions Clause at Sr. No.(i) comes under exclusive supply agreement; Clause at Sr. No.(ii) comes under exclusive distribution agreement and Clause at Sr. No.(iii) is covered by re-sale price maintenance.

Explanations to said section 3(4) explains the above terms.

According to Explanation (b), exclusive supply agreement includes any agreement restricting in any manner, the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person.

According to Explanation (c), exclusive distribution agreement includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods.

According to Explanation (e), "resale price maintenance" includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the price stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

In view of the above provisions of the Competition Act, 2002, validity of the clauses of the agreement as given in the question can be determined as follows:

Clause (i) restricts the purchaser to deal in the goods of manufacturers other than the seller. Hence this is in contravention of the provisions of section 3(1) of the said Act.

Clause (ii) restricts the purchaser to sell the goods within a specified area. Hence this is in contravention of the provisions of section 3(1) of the said Act

Clause (iii) stipulates the resale price, but it allows the purchaser to sell the goods at lower prices than the stipulated prices. Hence this is a valid clause.

But, the law states that any such agreement containing any of the prohibited clause shall be void. Therefore, even if the agreement contains some valid clauses, it shall still be termed as void if it contains even one prohibited clause.

Question 4

Mr. MKP was a member of the Competition Commission of India. He ceased to be such member on 31st March, 2005. Thereafter, he was offered the post of Executive Director with appropriate remuneration and perquisites in the following organisations to join his duties on and from 1st July, 2005:

- (i) *HLL Ltd., a private sector public limited company, whose case was disposed off by the Competition Commission under the provisions of the Competition Act, 2005 in the month of February, 2005.*
- (ii) *Life Insurance Corporation of India.*

You are required to state with relevant provisions of the Competition Act, 2002 the option available to Mr. MKP in respect of accepting the above offers. **(May 2005)**

Answer

The Chairperson and other Members shall not, for a period of two years from the date on which they cease to hold office, accept any employment in, or connected with the management or administration of, any enterprise which has been a party to a proceeding before the Commission under this Act. (Section 12 of the Competition Act, 2002)

Provided that nothing contained in this section shall apply to any employment under the Central Government or a State Government or local authority or in any statutory authority or any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956).

Based on the above provisions of the Competition Act, 2002, Mr. MKP will not be able to accept the offer of HLL Ltd. for two years from the date of his cessation as a member of the Competition Commission since the said company was a party to the proceedings before the Commission.

However, since Life Insurance Corporation of India is a Corporation established under the Central Act, the above restriction does not apply and Mr. MKP can accept the offer to join as the Executive Director of the said corporation with effect from 1st July, 2005.

Question 5

- (i) *In a proceeding before the Competition Commission of India involving two pharmaceutical companies, the plaintiff requested the presiding officer to call upon the services of experts from the pharmaceutical sector to determine the truth of the allegations leveled by it against the respondent. The respondent opposed the request on the ground that such action can not be taken by the Competition Commission. You are required to state with reference to the provisions of the Competition Act, 2002, whether the contention of the respondent is tenable.*
- (ii) *The Central Government has formed an opinion that Mr. CBM (a member of the Competition Commission of India) has acquired such financial interest that it may affect prejudicially his functions as a member of the Competition Commission and it wants to remove him from his office. You are required to state with reference to the provisions of*

the Competition Act, 2002, whether the Central Government can do so and if yes, how?
(November 2005)

Answer

- (i) As per provisions of Section 36(3) of the Competition Act, 2002, the Competition Commission may call upon such experts from the fields of economics, commerce, accountancy, international trade or other disciplines as it deems necessary, to assist the Commission in the conduct of any enquiry or proceeding before it. As per Regulation 54 of the Competition Commission (General) Regulations, 2004 made by the Commission under Section 64 of the Competition Act, 2002, it may draw up a panel of such experts.

In view of the above stated specific powers given to the Competition Commission, it can call upon the services of an expert from the pharmaceutical sector to determine the truth of the allegations levelled by the plaintiff against the respondent. Hence, the contention of the respondent is not tenable.

- (ii) Section 11(2) of the Competition Act, 2002 empower the Central Government to remove, by an order, a member of the Competition Commission of India from his office if such member has acquired such financial interest as is likely to affect prejudicially his functions as a Member of the Competition Commission. However, provisions of Section 11(3) of the said Act puts some restrictions on such powers of the Central Government. According to this section, in case as stated in the question, the Central Government wants to remove a member of the Competition Commission from his office on the above ground it has to make a reference to the Supreme Court. The Supreme Court shall hold an enquiry in accordance with the procedure formulated by it and then report that the member in question ought to be removed from his office on such ground.

Thus, the Central Government can remove a member of Competition from his office by following the above procedure.

Question 6

Examine with reference to the relevant provisions of the Competition Act, 2002 the following:

- (i) *Whether a Government Department supplying water for irrigation to the Agriculturists after levying charges for water supplied (and not a water tax) can be considered as an 'Enterprise'.*
- (ii) *Whether a person purchasing goods not for personal use, but for resale can be considered as a 'consumer.'*
(May 2006)

Answer

Enterprise: The term 'enterprise' is defined in Section 2(h) of Competition Act, 2002. Accordingly 'enterprise' means a person or a department of the Government, who or which is engaged in any activity, relating to the production, storage, supply, distribution, acquisition or

control of articles or goods, or the provision of services of any kind. But the term does not include any activity of the Government relating to sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Certain specific activities of Government departments like dealing with atomic energy, etc., and sovereign functions of the Government (like police, defence, etc.) are excluded from the purview of the said terms. Hence, a Government department engaged in the activity of providing service in the form of supply of water for irrigation to the agriculturists after levying charges can be considered as an 'enterprise' within the meaning of Section 2(h) of Competition Act, 2002.

Consumer: The term 'consumer' is defined in Section 2(f) of Competition Act, 2002. Accordingly 'consumer' means any person who buys any goods for a consideration, which has been paid or promised or partly paid and partly promised, whether such purchase of goods is for resale or for any commercial purpose or for personal use.

Hence, it is not necessary that a person must purchase the goods for personal use in order to be considered as a 'consumer' under Competition Act, 2002. Even a person purchasing goods for resale or for any commercial purpose will also be considered as a 'Consumer' within the meaning of Section 2(f) of Competition Act, 2002.

Question 7

- (i) *Mr. ZPM was appointed as a Member of the Competition Commission of India by Central Government. He has a professional experience in international business for a period of 12 years, which is not a proper qualification for appointment of a person as member. Pointing out this defect in the Constitution of Commission, Mr. YKJ, against whom the commission gave a decision, wants to invalidate the proceedings of the commission. Examine with reference to the provisions of the Competition Act, 2002 whether Mr. YKJ will succeed.*
- (ii) *ABC Ltd. made an initial public offer of certain number of equity shares. Examine whether these shares can be considered as 'Goods' under the Competition Act, 2002 before allotment.* **(November 2006)**

Answer

- (i) As per section 15 of Competition Act 2002 any act or proceeding of the Commission shall not be invalidated merely on the ground of:
- (a) any vacancy in, or any defect in the constitution of the Commission; or
 - (b) any defect in the appointment of a person acting as a Chairperson or as a member; or

- (c) any irregularity in the procedure of the Commission not affecting the merits of the case.

Here in this case Mr. ZPM should have professional qualification of not less than 15 years as per section 8 of the Act but this disqualification will not invalidate the proceeding of the Commission.

- (ii) Section 2(i) of Competition Act, 2002 defines 'goods' as follows:

'Goods' means goods as defined the Sale of Goods Act, 1930 and includes –

- (a) products manufactured, processed or mined;
- (b) debentures, stock and shares after allotment
- (c) in relation to goods supplied, distributed or controlled in India, goods imported into India.

Hence, debentures and shares can be considered as 'goods' within the meaning of section 2(i) of Competition Act, 2002 only after allotment and not before allotment.

Question 8

- (i) *Hon'ble Justice Mr. HCJ, a retired High Court Judge, attained the Age 61 years on 31st December, 2004. The Central Government appointed him as the Chairperson of the Competition Commission of India with effect from 1st January, 2005. You are required to state, with reference to the provisions of the Competition Act, 2002, the term for which he may be appointed as Chairperson of the Competition Commission of India. Whether he can be reappointed as such and till when he can remain as Chairperson of the Competition Commission of India ?*
- (ii) *After ceasing to be a member of the Competition Commission of India with effect from 31st March, 2007, Mr. MKP was offered the post of Executive Director with appropriate remuneration and perquisites in the following organizations with effect from 1st April, 2007:*
- (a) *HLL Ltd. a private sector public limited company, whose case was disposed off by the Competition Commission under the provisions of the Competition Act, 2002 in the month of February, 2007.*
 - (b) *Life Insurance Corporation of India.*

You are required to state with relevant provisions of the Competition Act, 2002, the option available to Mr. MKP in respect of accepting the offers. **(May 2007)**

Answer

- (i) According to Section 10(1) of the Competition Act, 2002, the Chairperson and every other Member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for re-appointment.

Provided that no Chairperson or other Member shall hold office as such after he has attained the age of sixty five years.

Based on the above provisions of the Competition Act, 2002, it can be concluded that Hon'ble retired Justice Mr. HCJ can be appointed as the Chairperson of the Competition Commission of India by the Central Government initially for a period of five years and he can also be re-appointed after his initial term of five years is over. But since he shall be attaining the age of 65 years as on 31st August, 2008, he will have to step down from the post on his attaining the age of 65 years.

- (ii) In accordance with the provisions of the Competition Act, 2002 as contained in Section 12, the Chairperson and other Members shall not, for a period of two years from the date on which they ceased to hold office, accept any employment in, or connected with the management or administration of, any enterprise which has been a party to a proceeding before the Commission under this Act:

Provided that nothing contained in this section shall apply to any employment under the Central Government or a State Government or local authority or in any statutory authority or any corporation established by or under any Central, State or Provincial Act or a Government company as declined in section 617 of the Companies Act, 1956 (1 of 1956).

Based on the above provisions of the Competition Act, 2002, Mr. MKP will not be able to accept the offer of HLL Ltd. for two years from the date of his cessation as a member of the Competition Commission since in a case of the said company, it was a party to the proceedings before the Commission.

However, since Life Insurance Corporation of India is a Corporation established under the Central Act, the above restriction does not apply and Mr. MKP can accept the offer to join as the Executive Director of the said corporation with effect from 1st April, 2007.

Question 9

- (i) *An arrangement has been made among the Cotton producers that the cotton produced by them will not be sold to mills below a certain price. The arrangement was in writing but it was not intended to be enforced by legal proceeding. Examine whether the above arrangement can be considered as an agreement within the meaning of Section 2(b) of the Competition Act, 2002.*
- (ii) *The Central Government has formed the opinion that Mr. CBM (A member of the Competition Commission of India) has abused his position which may be prejudicial to public interest as a member of the commission. Examine the powers of the Central Government in this regard*
- (November 2007)**

Answer

- (i) As per Section 2(b) of Competition Act, 2002 an 'agreement' includes any arrangement or understanding or action in concert, -
- Whether or not, such a arrangement or understanding or action is formal or in writing; or
 - Whether or not, such a arrangement or understanding or action is intended to be enforceable by legal proceedings.

In the given case the understanding reached among the cotton produces not to sell below a certain price shall amount to an agreement as defined under Section 2(b) notwithstanding the fact that arrangement is writing but no intended to enforce by legal proceeding.

- (ii) Section 11(2) (e) of the Competition Act, 2002 empowers the Central Government to remove by an order, a member of the Competition Commission of India from his office if such member has abused his position as to render his continuance in office prejudicial as a member of competition commission. However provision of Section 11(3) of the said act puts some restrictions on such powers of the Central Government. According to this section, in case as stated in the question, Central Government wants to remove a member or the Competition Commission from his office on the above ground, it has to make a reference to the Supreme Court. The Supreme Court shall hold an enquiry in accordance with the procedure formulated by it and then report that the member in question ought to be removed form his office on such ground. Thus the Central Government can remove a member of Competition Commission from his office by following the above procedure.

Question 10

- (i) *In a proceeding before the Competition Commission of India involving two Pharmaceutical companies, the plaintiff requested the presiding officer to call upon the services of experts from the pharmaceutical sector to determine the truth of the allegations leveled by it against the respondent. The respondent opposed the request on the ground that such action cannot be taken by the Competition Commission. You are required to state with reference to the provisions of the Competition Act, 2002, whether the contention of the respondent is tenable.*
- (ii) *The Central Government has formed as opinion that Mr. CBM (a member of the Competition Commission of India) has acquired such financial interest that it may affect prejudicially his functions as a member of the Competition Commission and it wants to remove him from his office. You are required to state with reference to the provisions of the Competition Act, 2002, whether the Central Government can do so and if yes, how?*

(May 2008)

Answer

- (i) As per provisions of Section 36(4) of the Competition Act, 2002 the Competition Commission may call upon such experts from the fields of economics, commerce, accountancy, international trade or other disciplines as it deems necessary, to assist the Commission in the conduct of any enquiry or proceeding before it. As per Regulation 54 of the Competition Commission (General) Regulations, 2004 made by the Commission under Section 64 of the Competition Act, 2002, it may draw up a panel of such experts.

In view of the above stated specific powers given to the Competition Commission, it can call upon the services of an expert from the pharmaceutical sector to determine the truth of the allegations leveled by the plaintiff against the respondent. Hence, the contention of the respondent is not tenable.

- (ii) Provisions of Section 11(2) of the Competition Act, 2002 empower the Central Government to remove, by an order, a member of the Competition Commission of India from his office if such member has acquired such financial interest as is likely to affect prejudicially his functions as a Member of the Competition Commission. However, provisions of Section 11(3) of the said Act put some restrictions on such powers of the Central Government. According to this section, in case as stated in the question, the Central Government wants to remove a member of the Competition Commission from his office, it has to make a reference to the Supreme Court. The Supreme Court shall hold an enquiry in accordance with the procedure formulated by it and then report that the member in question ought to be removed from his office.

Thus, the Central Government can remove a member of Competition Commission from his office by following the above procedure.

Question 11

The Competition Commission of India has received a complaint that M/s. XYZ company has been abusing its dominant position in the food processing industry. Explain briefly the factors that will be considered by the commission to ascertain whether M/s. XYZ company enjoys a dominant position in the industry.

(November 2008)

Answer

The Competition Commission while inquiring whether the enterprise XYZ Company enjoys a dominant position or not under Section 4 of the Competition Act, 2002 will take the following factors into account:

- (a) market share of the enterprise

- (b) size and resources of the enterprise
- (c) size and importance of the competitors
- (d) economic power of the enterprise including commercial advantages over competitors.
- (e) vertical integration of the enterprises or sale or service net work of such enterprises.
- (f) dependence of consumers on the enterprise.
- (g) monopoly or dominant position whether acquired as result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise.
- (h) entry barriers including barriers such as regulatory barriers, financial risk , high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or services for consumers.
- (i) countervailing buying power.
- (j) market structure and size of market .
- (k) social obligations and size of market.
- (l) relative advantage, by way of contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition.
- (m) any other factor which the commission may consider relevant for the inquiry.

Question 12

The Central Government on the recommendation of selection committee appoints Mr. RKP aged 56 years as Member of the Competition Commission of India to be effective from 1st January, 2009. State with reference to the provisions of Competition Act, 2002 the term for which he will be appointed and whether he can be reappointed as such and also if he resigns after two years whether the vacancy can be filled up by the Chairman of the commission.

You are further required to mention the composition of the selection committee on whose recommendation the central Government appoints chairman and other members of the Competition Commission of India.

(May, 2009)

Answer

Term of office of chairperson and other members are contained in Section 10 of the Competition Act, 2002 : As per this section the chairperson and every other member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for re-appointment. They shall not hold office as such after attaining the age of sixty-five years. [Section 10(1)]

A vacancy caused by the resignation or removal of the chairperson or any other member by death or otherwise shall be filled by fresh appointment in accordance with the provisions of Sections 8 and 9 of the Act. [Section 10(2)]

Keeping the above provision in mind Mr. RKP can be appointed as member of the commission for a term of 5 years as he is aged 56 years on 1-1-09. He can also be reappointed but his reappointment will be only up to the age of 65 years. If Mr. RKP resigns as member after working for two years the resulting vacancy can be filled up by fresh appointment approved by the Selection Committee and the Chairman has no power to fill up the vacancy on his own.

Selection committee for chairperson and members of commission

The chairperson and other members of the commission shall be appointed by the Central Government from a panel of names recommended by a selection committee.

Selection committee shall consist of –

- (a) The chief justice of India or his nominee ----- as chairperson;
- (b) The secretary in the ministry of corporate affairs ----- as member;
- (c) The secretary in the ministry of law and justice ----- as member;
- (d) Two experts of repute who have special knowledge of, and professional experience in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters including competition law and policy as members. (Section 9)

Question 13

- (i) *An arrangement has been made among the cotton producers that the cotton produced by them will not be sold to mills below a certain price. The arrangement is in writing but it is not intended to be enforced by legal proceeding. Examine whether the said arrangement can be considered as an agreement within the meaning of Section 2(b) of the Competition Act, 2002.*
- (ii) *The orange producers of Nagpur have formed an association to control the production of oranges. Examine whether it will be considered as a cartel within the meaning of Section 2(c) of the Competition Act, 2002.* **(November, 2009)**

Answer

- (i) As per Section 2(b) of the Competition Act, 2002 an Agreement includes any arrangement or understanding or action in concert:-
 - (i) whether or not, such arrangement, understanding or action is formal or in writing; or
 - (ii) whether or not, such arrangement, or understanding or action is intended to be enforceable by legal proceedings.

In the given case the understanding reached among the cotton producers not to sell below a certain price shall amount to an agreement as defined under Section 2(b) notwithstanding the fact that through the arrangement is in writing but not intended to be enforced by legal proceeding.

- (ii) As per Section 2(c) of the Competition Act, 2002 the term “cartel” includes an association of producers, sellers, 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 term “cartel” has an inclusive meaning. Thus an association formed to control the production of oranges is within the aforesaid definition of a cartel. Hence the association of orange producers of Nagpur will be considered as a cartel under the provisions of the Act.

Question 14

Mr. Raj Behari retired as a Member of Competition Commission of India (CCI) on 31st October, 2008. He was offered the post of Chief Executive in M/s. LSD Ltd. which was earlier a party in the proceedings before CCI. Can he join the Company with effect from 1st November, 2009?

What will be the position if Mr. Raj Behari joins Oil & Natural Gas Commission Ltd. a Government Company with effect from 1st April, 2009? ONGC was also earlier a party in the proceedings before CCI.

(November, 2009)

Answer

Under Section 12 of the Competition Act, 2002, a Member of CCI shall not, for a period of two years from the date on which he ceased to hold office, accept any employment in any enterprise, which has been a party to a proceeding before the Commission. However, these provisions will not apply to any employment in a Government Company or Government or local authority or any Corporation established under any Central or state Act. In view of the aforesaid, Mr. Raj Behari cannot join M/s LSD Ltd on 1-11-2009 as only one year has expired from the date of his retirement. However, there is no bar for him to join ONGC on 1-4-2009 even earlier than two years of his retirement as it is a Government Company.

Question 15

The Competition Commission of India (CCI) has received a complaint from a State Government alleging that X Limited and Y Limited have entered into an informal agreement, not enforceable at law, to limit or control production, supply and market, to determine the sale price of their products. Such an action of these companies has an appreciable effect on competition.

Examining the provisions of the Competition Act, 2002:

- (A) *Decide whether the above agreement has appreciable effect on competition.*

- (B) *What factors shall the Competition Commission of India consider while taking the above decision?*
- (C) *What orders can the Competition Commission of India pass on completion of the inquiry?* **(May, 2010)**

Answer

- (A) The term 'agreement' as defined in Section 2 (b) of the Competition Act, 2002, includes any arrangement or understanding or action in concert.
- (i) whether or not such arrangement, understanding or action is formal or in writing, or
 - (ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

Thus agreement between X Ltd and Y Ltd satisfies the above ingredients of an agreement as per Section 2 (e) of the Act..

(B) Factors to be considered:

- (1) creation of barriers to new entrants in the market.
- (2) driving existing competitors out of the market.
- (3) foreclosure of competition by hindering entry into the market.
- (4) accrual of benefits to consumers.
- (5) improvements in production or distribution of goods or provision of services

(C) Orders of CCI:

If after enquiry by the Director General, the Commission finds the agreement entered into by X Ltd. and Y Ltd. are in contravention of section 3, it may pass all or any of the following orders:

- (1) direct X Ltd. and Y Ltd. to discontinue and not to reenter such agreement.
- (2) impose such penalty as it may deem fit which shall not be more than 10% of the average other turnover for the last 3 preceding financial years, upon each of such person or enterprises which are parties to such agreement or abuse;
- (3) direct that agreement shall stand modified to the extent and in the manner as may be specified in order by the commission
- (4) direct X Ltd and Y Ltd. to abide by such other orders as the commission may pass and comply with the directions including payment of cost, if any.
- (5) pass such other orders or issue such directions as it may deem fit.

Question 16

P Ltd. and Q Ltd. both dealing in chemicals and fertilizers have entered into an agreement to jointly promote the sale of their products. A complaint has been received by the Competition Commission

of India (CCI) stating that the agreement between the two is anti-competitive and against the interests of others in the trade. Examine with reference to the Provisions of the Competition Act, 2002, what are factors the CCI will take into account to determine whether the agreement in question will have any appreciable adverse effect on competition in the market. (CA Final, New Course, (May, 2010)

Answer

Factors determining appreciable adverse effect on competition: The Competition Commission of India (CCI), while determining whether an agreement is anti-competitive under Section 3 of the competition Act, 2002, will take into account the following factors.

- (a) creation of barriers to new entrants in the market
- (b) driving existing completions out of the market.
- (c) foreclosure of competition by hindering entry into the market.
- (d) accrual of benefits to consumers.
- (e) improvements in production or distribution of goods or provision of services and
- (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

OVERVIEW OF BANKING REGULATION ACT, 1949, THE INSURANCE ACT, 1938, THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT, 1999, THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002

THE BANKING REGULATION ACT, 1949

Question 1

In what way does the Reserve Bank of India regulate the determination of loans and advances which can be made by Banking Company under the Banking Regulation Act, 1949? Explain. CA Final New Course. (November, 2008)

Answer

POWERS OF RBI TO REGULATE DETERMINATION OF LOANS AND ADVANCES BY BANKING COMPANIES:

By virtue of provisions of Banking Regulations Act, 1949, as contained in Section 21 the RBI is empowered to issue directives to a banking company to determine the policy in relation to loans and advances. Such directions may relate to:

- (1) Purpose for which loan may or may not be made.
- (2) Margin stipulation.
- (3) Maximum amount of advances to any company, firm individual or association of persons (at present 15% for individual borrower without infrastructure project, if infrastructure project go by additional 10%, 40% for group borrower and for infrastructure project of group borrower it

may be up to 50% of bank's capital and reserve (presently tier-I and tier-II capital from capital adequacy point of view).

- (4) Maximum amount of guarantee liability on behalf of any individual firm /company.
- (5) The rate of interest and other terms and conditions on which such advances are made or guarantee given.

It may further be mentioned that in accordance with the provisions of Section 21A, rate of interest charged by banking company on the basis of loan contract between the bank and debtor is not to be subject to scrutiny by the court.

Question 2

Enumerate the obligations of banking companies under the Prevention of Money Laundering Act, 2002. **(6 Marks)**

Answer

Section 12 of Prevention of Money Laundering Act, 2002 provides for the obligation of Banking Companies, Financial Institutions and Intermediaries of securities market. Every banking company, financial institution and intermediary shall:

- (a) Maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within a month. Such records shall be maintained for a period of ten years from the date of cessation of the transactions between the clients and the banking company or financial institution or intermediary, as the case may be;
- (b) Furnish information of the above transactions to the Director appointed for the purpose of this Act within the prescribed time;
- (c) Verify and maintain the records of the identity of all its clients, in the prescribed manner.

If the principal officer of a banking company or financial institution or intermediary has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

Question 3

*XLR Bank Limited is not managing its affairs properly. Employees as well as depositors of the bank have complained to the Central Government from time to time about such mismanagement and requested the Central Government to acquire the undertaking of the Banking Company. Explain the powers of the Central Government in this regard under the **Banking Regulation Act, 1949.***

(November, 2009)

Answer

Under Section 36AE of the Banking Regulation Act, 1949, if the Central Government is of the opinion that a Banking company has failed to comply with the direction given by RBI relating to policy matters under section 21 and 35A and or the affairs of the Bank are being managed in a manner detrimental to the interest of depositors or that of the banking policy or for better provision of credit generally or of credit to any particular section of the community or in any particular area; it is necessary to the Government may after consultation with RBI, by notified order, acquire the undertaking of a Banking Company. In such a case, on the date specified in the notification, the undertaking of the Banking Company and its assets and liabilities shall stand transferred to and vest in Central Government. Before acquiring the undertaking, the Central Government shall give a reasonable opportunity of hearing to the Banking Company.

Question 4

*The promoters of a company to be registered under the Companies Act, 1956 having its main object of carrying on the business as manufacturers and stockists of Iron and Steel proposes that the name of the company is to be "ABC Steel Bank Limited". You are required to state with reference to the provisions of the **Banking Regulation Act, 1949** whether the said company with the proposed name can be registered.* (June 2009)

Answer

As per provisions of Section 7 of the Banking Regulation Act, 1949 no company other than a banking company can use, as part of its name, the word "Bank" unless it is a banking company as defined in Section 5(c) of the said Act. In view of such a legal provision, the promoters of the company having the main object of carrying on the business as manufacturers and stockists of iron & steel can not keep the name of the company as "ABC Steel Bank Limited".

Question 5

*Union Bank of India, a National Bank acquired on 1st January, 2002 a building, fully occupied by various tenants, from Mr. Rahul, the owner of the building, in discharge of a term loan advanced to Mr. Rahul, who had mortgaged the said building as security with the said Bank and failed to repay the loan. The said bank wants to keep the building permanently with it and earn the rent from tenants. You are required to state with reference to the provisions of the **Banking Regulation Act, 1949** whether the said bank can do so.* (June 09)

Answer

Union Bank of India being a nationalized bank is a banking company within the meaning of the Banking Regulation Act, 1949. As per provisions of Section 9 thereof, no banking company shall hold any immovable property, howsoever acquired, for a period exceeding seven years except:

- (i) If such property is required for banking company's own use.

- (ii) If the Reserve Bank of India extends the said period of seven years by up to another five years on the ground that such extension would be in the interest of the depositors of the banking company.

Accordingly, Union Bank of India in this case would normally be required to dispose off the building acquired from Mr. Rahul before 1st January, 2009. However, if the Reserve Bank of India on above stated ground grants the extension, then also the said Bank will have to dispose off the same before 1st January, 2014. But in no case, Union Bank of India can hold it permanently because the building is not for bank's own use.

Question 6

*In what way does the Reserve Bank of India regulate the determination of loans and advances which can be made by a Banking Company under the **Banking Regulation Act, 1949**? Explain.*
(November, 2008)

Answer

Powers of RBI to regulate determination of loans and advances by banking companies:

By virtue of provisions of Banking Regulations Act, 1949, as contained in Section 21 the RBI is empowered to issue directives to a banking company to determine the policy in relation to loans and advances. Such directions may relate to:

- (1) Purpose for which loan may or may not be made.
- (2) Margin stipulation.
- (3) Maximum amount of advances to any company, firm individual or association of persons (at present 15% for individual borrower without infrastructure project, if infrastructure project go by additional 10%, 40% for group borrower and for infrastructure project of group borrower it may be up to 50% of bank's capital and reserve (presently tier-I and tier-II capital from capital adequacy point of view).
- (4) Maximum amount of guarantee liability on behalf of any individual firm /company.
- (5) The rate of interest and other terms and conditions on which such advances are made or guarantee given.

It may further be mentioned that in accordance with the provisions of Section 21A, rate of interest charged by banking company on the basis of loan contract between the bank and debtor is not to be subject to scrutiny by the court.

Question 7

Explain the provision relation to Reserve Fund under the Banking Regulation Act, 1949.

Answer

(Section 17) – Every Banking Company incorporated in India must create a Reserve Fund and transfer a sum equal to not less than 20 % of its net profits. However, Central Govt. is empowered to exempt from this requirement on the recommendation of the RBI. Such exemption will be allowed only:-

- when the amounts in the reserve fund and the share premium account are equal to the paid-up capital of the banking company
- when the Central Govt. feel that its paid-up capital and reserves are adequate to safeguard the interest of the depositors

If a banking company appropriates any sum from the Reserve fund or the share premium account, it must be reported to RBI within 21 days explaining the circumstances leading to such appropriation

Question 8

What are the powers of RBI's to control loans & advances granted by banking company?

Answer

RBI is empowered to issue directives to a banking company to determine the policy in relation to loans and advances. Such direction may relate to:

- (i) Purpose for which loan may or may not be made
- (ii) Margin stipulation
- (iii) Maximum amount of advances to any company, firm, individual or association of persons(popularly known as exposure norms which is at present 15 % for individual borrower without infrastructure project, if infrastructure project it may go by additional 10%, 40% for group borrower and for infrastructure project of group borrower it may be upto 50 % of bank's capital and reserve (presently tier-I & Tier-II capital from capital adequacy point of view)
- (iv) Maximum amount of guarantee liability on behalf of any individual/ firm/ company (above exposure norm includes non-fund facilities like bank guarantee/ letter of credit etc)
- (v) The rate of interest and other terms and condition on which such advances are made or guarantee given

(It may be noted that at present, in this deregulated interest rate regime RBI gives directives on for loans and advances with sanctioned limit upto Rs. 2.00 lakhs where rate of interest should not exceed individual bank's Benchmark Prime Lending Rate(BPLR), BPLR is fixed by Bank's Board, Rate of interest for advances with sanctioned limit above Rs. 2 lakhs is determined according to credit rating exercise done by bank,

{RBI's stipulation on this score is rate of interest should not exceed BPLR+4) RBI exercise its power through its selective credit control though under selective credit control list, at present no item except sugar for buffer stock is kept. More}

[Moreover, with credit policy measures of RBI Cash Reserve Ratio, Bank Rate and Repo & Reverse Rate is announced on which Bank's BPLR is somehow depended]

Section 21A:- Rate of interest charged by banking company on the basis of loan contract between the bank and debtor is not to be subject to scrutiny by the court

Question 9

Explain the provision relating to audit of banking companies under the Banking Regulation Act, 1949.

Answer

Balance sheet & profit & loss account as prepared in terms of sec 29 are subject to audit by a person duly qualified under any law for the time being in force to be an auditor for auditing such balance sheet and profit & loss accounts. (These Auditors are known as Statutory Auditors for the said purpose and appointment /reappointment or removal is subject to prior approval of the RBI. Under these Statutory Auditors there are numbers of External Auditors who conduct audit operation of the branch accounts)

Further Reserve Bank can for special Audit of Banking Company, if it is of the opinion that it is in the public interest or in the interest of the depositors. The auditors shall comply with the directions given by the RBI and shall submit a report of the audit to RBI and also to the bank. The auditor shall have the powers and exercise the functions as specified in section 227 of the Indian Companies Act, 1956.

Apart from the above, the auditor is required to state in his report:

- Whether or not the information and explanation required by him have been found to be satisfactory
- The transactions of the bank which have come to his notice have been within the powers of the bank or not
- The return received from branch offices have been found adequate for the purpose of his audit
- Whether the profit and loss account shows a true balance of profit or loss for the period covered by such account
- Any other matter which he considers should be brought to the notice of the share holders of the company

{In addition to what have been stated here-in-above auditors are also required to audit and certify the statement of advances as prepared in terms of prudential accounting norms, required to certify

some other returns viz. Friday figure of 12 odd dates, utilization of govt. subsidies, payment of premium of deposit insurance & credit guarantee scheme, Long Form Audit Report, 3CB & 3CD Return as applicable and many others}

Section 31:- Submission of Balance Sheet & P&L :- Three copies of such returns along with auditors report shall be published in prescribed manner and submit to RBI within three months from the end of the period which they refer. The RBI may extend the period by a further of not exceeding three months.

Section 32:- Three copies of such accounts and balance sheet along with auditor's report shall be sent by the banking company to the ROC, at the same time while sending the same to RBI.

Section 35:- Power of RBI to inspect banks:- RBI is empowered to conduct inspection of any bank and to give them direction as it deems fit. All banks are bound to comply with such directions. Every directors or other officer of the bank shall produce all such books, documents as required by the inspector. The inspector may examine on oath any director or other officers

RBI shall supply the bank a copy of such inspection. RBI submits report to Central Govt. and the latter, on scrutiny, if is of the opinion that the affairs of the bank are being conducted detrimental to the interest of its depositors, it may, after giving an opportunity of being heard, to the bank, may order in writing prohibiting the bank from receiving fresh deposits, direct the RBI to apply section 38 for winding up of the bank

Apart from inspection under section 35 RBI is empowered to undertake inspection of a bank in terms/ for the purposes of the following sections:-

Section 11	Requirement as to maintaining paid-up capital & reserve
Section 22	Licensing of banks
Section 23	Restrictions on opening new and transfer of existing places of business
Section 37	Suspension of business
Section 38	Winding up by High Court
Section 44	Power of High Court in voluntary winding-up
Section 44A	Procedure for Amalgamation of banking companies
Section 45	Power of RBI to apply to Central Govt. for suspension of business by a bank and prepare scheme of reconstitution or amalgamation

Question 10

Mr. Gopal is a director in a Bank. The Reserve Bank of India terminates him on the ground that his conduct is detrimental to the interest of the depositors. Decide, whether the Reserve Bank of India can do so under the Banking Regulation Act, 1949. Can the Reserve Bank of India appoint additional Director in a Bank under the said Act?
(New, May, 2010)

Answer

Appointment of Additional Director in a Bank by the RBI: Under Section 36AA of the Banking Regulation Act, 1949, RBI can terminate any Chairman, Director, Chief Executive, other officials or any employee of the bank where it considers desirable to do so particularly when RBI is of the opinion that conduct of such persons is detrimental to the interest of the depositors or for securing proper management of the banking company. Before such termination concerned person should be given opportunity to be heard of. Such terminated officials can make appeal to the Central Govt. within 30 days from the date of communication of such termination order. The decision of the Central Government cannot be called into question. In case an order is issued pursuant to this section the concerned person shall cease to hold his office for a period of not exceeding 5 years as may be specified in the order. Contravention of the above provision shall be punishable with a fine, which may extend to Rs. 250 per day.

Any such order shall be valid for a period not exceeding three years or such further periods of not exceeding three years at a time as RBI may specify. Under section 36AB: RBI is empowered to appoint additional Directors for the banking company with effect from the date to be specified in the order, in the interest of the bank or that of depositors. Such additional directors shall hold office for a period not exceeding three years or such further periods not exceeding three years at a time.

THE INSURANCE ACT, 1938

Question 1

With reference the provisions of Insurance Act, 1938, what do you mean by "Life Insurance Business"?
(June 2009)

Answer

As per Section 2(11) of the Insurance Act, 1938, Life Insurance Business means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include:

- (a) The granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance.
- (b) The granting of annuities upon human life; and

- (c) The granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.

Question 2

*What are the provisions in the **Insurance Act, 1938** regarding nomination by of Life Insurance Policy holder? Whether a minor can be a nominee in a Life Insurance Policy? (June 09)*

Answer

As per Section 39 of the Insurance Act, 1938, the holder of a policy of life insurance on his own life may nominate a person or persons to whom the money secured by the life insurance policy shall be paid in the event of his death. Such nomination can be made either at the time of taking the policy or at any time before the maturity of the policy. Such nomination is either incorporated in the text of the policy or is stated as an endorsement on the policy document. The nomination can be cancelled or altered by the policyholder at anytime before the maturity of the policy. The insurer is required to communicate to the policyholder that it has recorded the nomination, its cancellation or alteration as the case may be. In case the policyholder survives the full term of policy, the insurer shall pay the maturity amount to him only and the nomination becomes redundant. In a case where the nominee dies before the maturity of the policy and if no new nomination is made, the maturity proceeds of the policy shall be paid to the policy holder and if dies before the maturity, to the legal heirs of the policy holders.

Minor as a nominee:

A minor can be nominated as a nominee in life insurance policy by its holder. The only other requirement as per proviso to Section 39(1) of the said Act is that the policyholder is to appoint, in the prescribed manner, an adult person to receive the money secured by the policy on behalf of the minor in the event of death of the policyholder during the minority of the nominee.

THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT, 1999

Insurance Regulatory and Development AUTHORITY: (Sections 3-12)

The Central Government by notification appoint such 'Authority' in the nature of body corporate enjoying all the characteristics of such entity along with contractual powers.

The Head Office of such 'Authority' is to be decided by the Central Government.

The members of such 'Authority' appointed by the Central Government depending upon their expertise and experience in the field of Insurance, Law, Economic Accountancy, etc.

The member consists of:

- (a) Chairman.
- (b) Five Whole Time members (maximum)
- (c) Four Part – Time members (maximum)

One of these members should have knowledge in Life Insurance, General Insurance and Actuarial Science.

The Chairperson shall hold office for a term of five years until he reaches sixty five years. And he is eligible for re – appointment. A whole time member however can hold office for up to sixty-two years.

Moreover a member can relinquish his membership by giving three month prior notice to the Central Government or he can be removed from office under provision of Sec – 6. A member may be removed from office if he became insolvent or insane or convicted for offence involving moral turpitude or illegally established financial interest in the 'Authority' or acting contrary to public interest.

The remuneration for each member shall be as per prescribed Law.

The chairperson and the Whole – time member shall within two years from the date of appointment, cannot hold office under Central Government or State Government or any Insurance Sector.

All decisions regarding administrative matters are taken by the Chairperson.

The procedural aspect of the meetings of the 'Authority' may be determined by regulations, Resolutions are passed by simple majority and chairperson may use casting vote in case of a tie. In case, chairperson unable to attend any meeting then members attending may appoint chairperson among themselves. Any act of the 'Authority' cannot be invalidated simply because of any defect in appointing a member or procedural irregularity.

From time to time, authority may appoint employees and officers for efficiency in their work.

Transfer of Assets, liabilities, etc. of Indian Insurance Regulatory Authority (IIRA) to Insurance Regulatory Development Authority (IRDA) (Section 13)

On any appointed day, all assets and liabilities shall stand transferred from IIRA to IRDA. Here, the assets may be movable or immovable. Along with it also includes attached

rights and powers. Before this, books of accounts, documents and other papers are also included.

All contractual obligations entered by IIRA with third parties till before the appointed day shall automatically transferred to IRDA.

Similarly all debts owed to IIRA also stands transferred to IRDA.

Also, legal proceedings including suits whether instituted by or against IIRA shall stand transferred to IRDA.

THE SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST ACT, 2002

Question 1

What do you understand by asset reconstruction under the SARFAESI Act, 2002?

Answer

"**asset reconstruction**" means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance. [Section 2(b)]

Question 2

What are financial assets?

Answer

"financial asset" means debt or receivables and includes-

- (i). a claim to any debt or receivables or part thereof, whether secured or unsecured; or
- (ii). any debt or receivables secured by, mortgage of, or charge on, immovable property; or
- (iii). a mortgage, charge, hypothecation or pledge of movable property; or
- (iv). any right or interest in the security, whether full or part underlying such debt or receivables; or
- (v). any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
- (vi). any financial assistance [Section 2(l)]

The use of the word 'future' in clause (v) of Section 2(l) means that the term financial asset includes a future debt also. It must be noted that a future debt does not refer to debt payable in future. In case of a debt repayable in future, the debt exists today but is payable in future, for example a loan given by the lender to the borrower. But in case of a future debt, the debt does not exist today. It seems difficult to imagine as to how one can transfer a future debt (which does not exist today). This becomes easy when we understand the principle used in the case of *Bharat Nidhi Limited v. Takhatmal* (1969) AIR SC 313. In case of a future debt, what exists today is an agreement to transfer and it will be possible to transfer the future debt when it actually arises, for example sales that will occur in future. In case of conditional receivable, the receivable is transformed into a financial asset after the fulfillment of the relevant conditions. Clause (vi) of Section 2(l) mentions 'any financial assistance'. The term financial assistance has already been defined in Section 2(k) supra.

Question 3

What are non-performing asset?

Answer

"non-performing asset" means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or under guidelines relating to asset classifications issued by the Reserve Bank [Section 2(o)]

Question 4

How are rights or interest in financial assets acquired under the SARFAESI Act, 2002?

Answer

Section 5 : Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial assets of any bank or financial institution-

- (a.) by issuing a debenture or bond or any other security in the nature of debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or
- (b.) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.

Debenture is we commonly know, is an acknowledgement of debt. Bond also refers to the same nature of instrument as a debenture. Both of them acknowledge a debt and hence an obligation to pay.

In case the bank or financial institution is a lender in relation to any financial assets acquired by the securitisation company or the reconstruction company, then such securitisation company or reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to the subject financial assets.

Unless otherwise expressly provided by this Act, all contracts, deeds, bonds, agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the securitisation company or reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, securitisation company or reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of securitisation company or reconstruction company, as the case may be.

If, on the date of acquisition of financial asset, any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third proviso to sub-section (1) of section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the securitisation company or reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the securitisation company or reconstruction company, as the case may be.

Question 5

How disputes are resolved under the SARFAESI Act, 2002?

Answer

Where any dispute relating to securitisation or reconstruction or non-payment of any amount due including interest arises amongst any of the parties, namely, the bank, or financial institution, or securitisation company or reconstruction company or qualified institutional buyer, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996, as if the parties to the dispute have

consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly.

Question 6

Explain briefly the procedure relating to Enforcement of security interest

Answer

(Section 13) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.

Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any installment thereof, and his account in respect of such debt is classified by the secured creditor as on-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4) of Section 13. This notice shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower. The procedure for the service of the notice is prescribed in the Security Interests (Enforcement) Rules.

Sub-section (4) of Section 13 provides that if the borrower fails to discharge his liability in full within the above specified period, the secured creditor may take recourse to one or more of the following measures to recover his secured debt:-

- (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
- (b) take over the management of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realise the secured asset;
- (c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
- (d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

Question 7

Explain Manner and effect of take over of management.

Answer

(Section 15): When the management of business of a borrower is taken over by a secured creditor, the secured creditor may, by publishing a notice in a newspaper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many persons as it thinks fit-

- (a) in a case in which the borrower is a company under the Companies Act, 1956, to be the directors of that borrower in accordance with the provisions of that Act; or
- (b) in any other case, to be the administrator of the business of the borrower.

On publication of the above notice, all persons holding office as directors of the company (if the borrower is a company) and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the above notice, shall be deemed to have vacated their offices. Any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the above notice, shall be deemed to be terminated. The directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the above notice.

All directors appointed in accordance with the above notice shall, for all purposes, be the directors of the company of the borrower and such directors or the administrators (if the borrower is other than a company) appointed under section 15, shall only be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source.

Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956, is taken over by the secured creditor, then, notwithstanding anything contained, such borrower in the said Act or in the memorandum or articles of association of such company -

- (a) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
- (b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

- (c) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

The secured creditor is under an obligation to restore the management of the business of the borrower, on realisation of his debt in full, in case of take over of the management of the business of a borrower by such secured creditor.

PREVENTION OF MONEY LAUNDERING ACT, 2002

DEFINITIONS

Major Definitions

Question 1

What is Money – Laundering?

Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering.

Question 2

What are Proceeds of crime?

Section 2(1)(u) defines "proceeds of crime" as any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence or the value of any such property.

Question 3

What is Payment System? (As introduced by the Amendment Act, 2009)

In terms of clause (rb) of section 2 "payment system" means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them. It includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations;

Question 4

What is the punishment for the offence of money laundering?

Chapter II comprises of Sections 3 and 4. Section 3 deals with the offence of money laundering which has been discussed in the definition part above. Section 4 provides for the punishment for Money-Laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine which may extend to five lakh rupees. But where the proceeds of crime involved in money-laundering relates to any offence specified

under paragraph 2 of Part A of the Schedule, the maximum punishment may extend to ten years instead of seven years.

Question 5

*Enumerate the obligations of banking companies under the **Prevention of Money Laundering Act, 2002**. (Nov 08)*

Answer

Section 12 of Prevention of Money Laundering Act, 2002 provides for the obligation of Banking Companies, Financial Institutions and Intermediaries of securities market. Every banking company, financial institution and intermediary shall:

- (a) Maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within a month. Such records shall be maintained for a period of ten years from the date of cessation of the transactions between the clients and the banking company or financial institution or intermediary, as the case may be;
- (b) Furnish information of the above transactions to the Director appointed for the purpose of this Act within the prescribed time;
- (c) Verify and maintain the records of the identity of all its clients, in the prescribed manner.

If the principal officer of a banking company or financial institution or intermediary has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

Question 6

How the trials under PMLA are conducted in special courts? Is the offence under PMLA areailable?

Sections 43 – 47 deals with provision relating to Special Courts. Section 43 empowers the Central Government (in consultation with the Chief Justice of the High Court) for trial of offence of money laundering, to notify one or more Courts of Sessions as Special Court of Special Courts for such area or areas or for such cases as may be prescribed in the notification to this effect. Section 44 clearly provides for the offences triable by Special Courts. It overrides the provisions of the Code of Criminal Procedure, 1973 and provides that –

- (i) *the schedule offence and the offence punishable under section 4 shall be triable only by the Special Court constituted for the area in which the offence has been committed;*

- (ii) *a Special Court may, upon a complaint made by an authority authorised in this behalf under this Act take cognizance of the offence for which the accused is committed to it for trial. The requirement of police report of the facts which constitute an offence under this Act is no more applicable.*

Answer

The provisions of Section 44 shall not be deemed to affect the special powers of the High Court regarding bail under section 439 of the Code of Criminal Procedure, 1973 and the High Court may exercise such powers including the power under clause (b) of sub-section (1) of that section as if the reference to "Magistrate" in that section includes also a reference to a "Special Court" designated under section 43.

Section 45 provides that the offences under the Act shall be cognizable and non-bailable. Notwithstanding anything contained in the Code of Criminal Procedure, 1973, no person accused of an offence punishable for a term of imprisonment of more than three years under Part A of the Schedule shall be released on bail or on his own bond unless-

- (i) The Public Prosecutor has been given an opportunity to oppose the application for such release and
- (ii) Where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

In case of any person who is under the age of 16 years or in case of a woman or in case of a sick or infirm person, the Special Court can direct the release of such person on bail.

The Special Court cannot take cognizance of any offence under the Act, unless a complaint in writing is made by:-

- (a) The Director or
- (b) Any officer of the Central Government or a State Government, authorised in writing in this behalf by the Central Government by a general or special order made in this behalf by that Government.

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, or any other provision of this Act, no police officer shall investigate into an offence under this Act unless specifically authorised, by the Central Government by a general or special order, and, subject to such conditions as may be prescribed.

Section 45 has been amended by the Amendment Act of 2005 and it is interesting to observe, how the law grants the right of bail to the accused but avoids the misuse of this right by providing for adequate safeguards in the Section. The suo motto authority of the police officer

in investigating an offence under the Act has been done away with. An authority from the Central Government by a general or special order, and fulfillment of the prescribed conditions has been introduced by the Amendment Act - is in right spirit. There is always a fear of such powerful legislation being misused unless adequate safeguards are provided as in the instant case.

Section 46 provides that the provisions of the Code of Criminal Procedure, 1973 (including the provisions as to bails or bonds) shall apply to the proceedings before a Special Court and the Special Court shall be deemed to be a Court of Session and the persons conducting the prosecution before the Special Court, shall be deemed to be a Public Prosecutor.

Section 47 empowers the High Court to exercise (so far as applicable) all the powers granted by Chapter XXIX or Chapter XXX of the Code of Criminal Procedure 1973 on Special Court within its jurisdiction

RULES AND INTERPRETATION OF STATUTES DEEDS AND DOCUMENTS

Question 1

Explain the rule of 'beneficial construction' while interpreting the statutes quoting an example (May, 2000)

Answer

Where the language used in a statute is capable of more than one interpretation, the most firmly established rule for construction is the principle laid down in the Heydon's case. This rule enable, consideration of four matters in constituting an act:

- (1) what was the law before making of the Act,
- (2) what was the mischief or defect for which the law did not provide,
- (3) what is the remedy that the Act has provided, and
- (4) what is the reason for the remedy.

The rule then directs that the courts must adopt that construction which 'shall suppress the mischief and advance the remedy'. Therefore even in a case where the usual meaning of the language used falls short of the whole object of the legislature, a more extended meaning may be attributed to the words, provided they are fairly susceptible of it. If the object of any enactment is public safety, then its working must be interpreted widely to give effect to that object. Thus in the case of Workmen's Compensation Act, 1923 the main object being provision of compensation to workmen, it was held that the Act ought to be so construed, as far as possible, so as to give effect to its primary provisions.

However, it has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are ambiguous and are reasonably capable of more than one meaning [*CIT v. Sodra Devi* (1957) 32 ITR 615 (SC)].

Question 2

What is meant by 'disclaimer of onerous property' and how the same is exercised during winding up". Explain the circumstances under which such a disclaimer is not allowed. (May, 2000)

Answer

The provisions relating to disclaimer of onerous property will arise during the winding up of the company. The liquidator, may, with the leave of the court disclaim any onerous property within 12 months of the commencement of the winding up. If the existence of any disclaimable property does not come to the knowledge of the liquidator, within one month after the commencement of the winding up, he can disclaim at any time within 12 months after he has become aware of it. The Court has, however, the power to extend the time.

An onerous property may consist of (a) land of any tenure burdened with onerous covenants (b) shares or stocks in companies (c) any other property which is unsaleable or not readily saleable (d) unprofitable contracts.

The liquidator's right to disclaim is lost if within 28 days or such extended period as may be allowed by the court, of receiving a demand from any interest person to make his decision, he does not give notice that he intends to apply to the court for leave to disclaim [Section 535(4)].

Question 3

How far are (i) title, (ii) preamble and (iii) marginal notes in an enactment helpful in interpreting any of the parts of an enactment?
(May, 2001)

Answer

(i) **Title:** An enactment would have what is known as 'Short Title' and also a 'Long Title'. The short title merely identifies the enactment and is chosen merely for convenience. The 'Long title' describes the enactment and does not merely identify it.

The Long title is a part of the Act and, therefore, can be referred to for ascertaining the object and scope of the Act.

(ii) **Preamble:** It expresses the scope and object of the Act more comprehensively than the long title. The preamble may recite the ground and the cause for making a statute and or the evil which is sought to be remedied by it. The preamble like the Long title can legitimately be used for construing it. However, the preamble cannot over ride the provisions of the Act. Only if the wording of the Act gives rise to doubts as to its proper construction (e.g., where the words or a phrase has more than the one meaning and doubts arises as to which of the two meanings is intended in the Act) the preamble can and ought to be referred to to arrive at the proper construction.

(iii) **Marginal notes:** As held in *CIT Ahmed Bhai Umar Bhai Company HJR 1950, SC (134, 141)* marginal notes applied to the section cannot be used for construing the section.

However, marginal notes appended to the Articles of the Constitution have been held to be part of the constitution and therefore, have been made use of in construing the articles.

Question 4

Explain the principles of grammatical interpretation vis-à-vis logical interpretation especially in the context that the duty of the Court is to administer the law as it stands and not to find out whether the law is just or reasonable. (November, 2001)

Answer

Interpretation may be either grammatical or logical. Grammatical interpretation concerns itself exclusively with the verbal expression of law. It does not go beyond the letter of the law. Logical interpretation on the other hand, seeks more satisfactory evidence of the true intention of the legislature. In all ordinary cases, the grammatical interpretation is the sole form allowable. The court cannot take from or add to modify the letter of the law. However, where the letter of the law is logically defective on account of ambiguity, inconsistency or incompleteness, the court is under a duty to travel beyond the letter of law so as to determine from the other sources, the true intentions of the legislature. Further a statute is enforceable at law, however, unreasonable it may be. The duty of the court is to administer the law as it stands. It is not within its jurisdictions to see whether the law is just or unreasonable. However, if there are two possible constructions of a clause, one a mere mechanical construction based on the rules of grammar and the other which emerges from the setting in which the clause appears and the circumstances in which it came to be enacted and also the words used therein, the courts may prefer the second construction which though may not be literal may be a better one. (*Arora vs. State of U.P.*)

Question 5

Explain the significance of the definition clause in a Statute. The definition of a word may be either restrictive or extensive. Elaborate this with particular reference to the following definition of 'Book and Paper' as contained in the Companies Act, 1956:

"Book and Paper" include accounts, deeds, vouchers, writings, and documents. (May, 2002)

Answer

When a word is defined as having a particular meaning in the enactment, it is that meaning alone which must be given to it in interpreting the said section of Act unless there be anything repugnant in the context. When a word is defined to "mean" such and such, the definition is *prima facie* restrictive and exhaustive and it restricts the meaning of the word to that given in the definition section. But where the word is defined to "include" such and such the definition is *prima facie* extensive. Again when the word is defined as "means" and includes such and such, the definition would be exhaustive.

'Book and paper'

It is an inclusive definition and as such the definition is *prima facie* extensive i.e. the word defined is not restricted to the meaning assigned to it but has extensive meaning which also

includes the meaning assigned to it in the definition section. It includes all registers, book and other papers maintained by the company and as such the directors who are entitled to inspect the books of accounts and other books and papers can have access to all the registers and other documents maintained by the company.

Question 6

Explain the meaning of the word "Statute" and discuss the need for interpretation of any statute citing an example in the case of holding the annual general meeting of a company where more than one prescribed time is given in the Companies Act, 1956. (May, 2002)

Answer

The word 'Statute' generally means the laws and regulations of every sort without considering from which source they emanate. It has been defined as the written will of the legislature solemnly expressed according to the forms necessary to constitute it the law of the State. Normally, the term denotes an Act enacted by the legislative authority (e.g. Parliament of India).

Even though the Laws are drafted by legal experts, yet they are expressed in language and no language is so perfect as to leave no ambiguities. Since a statute is an edict of the legislature, many a time the intent of the legislature has to be gathered not only from the language but the surrounding circumstances that prevailed when the law was enacted. Further if any provision is open to two interpretations, the Court has to choose that interpretation which represents the time intention of the legislature.

In the case of holding an annual general meeting of a company three different periods have been given as stated.

- (a) The meeting should be held in every calendar year (section 166(i))
- (b) The gap between the two meetings should not be more than 15 months (Section 166(i))
- (c) The meeting should be held with 6 month from the close of the financial year of the company (section 210(3))

The above said three requirements are cumulative and separate. Failure to comply with any of them constitutes an offence. Therefore to give effect to all the provisions, they are to be interpreted harmoniously.

Question 7

Explain the rules relating to interpretation of the terms 'subject to' and 'notwithstanding' used in the provisions of an Act. State the effect of the term 'notwithstanding anything contained in this Act' used in Section 408 of the Companies Act empowering the Central Government to prevent oppression or mismanagement. (May, 2003)

Answer

Interpretation of the terms 'notwithstanding' and 'subject to'

The word 'notwithstanding anything contained' characterise the non obstante clause. It is generally included to give an overriding effect to the clause over the other. If there is any inconsistency or departure between the non obstante clause and another provision, it is the non obstante clause which will prevail (*K. Parasuramaiah v. Pakari Lakshman*, A/R 1965 AP 220).

But the word 'subject to' conveys the idea of a provision yielding place to another provision or provisions to which it is made 'subject to'. Hence the effect of non obstante clause (i.e. notwithstanding) is the opposite of a provision which states 'subject to'.

Section 408 of the Companies Act, 1956 opens with the words 'notwithstanding anything contained in this Act. This is a non obstante clause which vests overriding powers in the Government to nominate directors to prevent mismanagement or oppression (*Oriental Industrial Investment Corporation Ltd vs. Union of India* (1981) 52 Com cases 487, 493 (Del)). This expression indicates that the appointment of directors under this section is not to be controlled by the maximum number or other proportion, if any, fixed by any provisions of the Act. Further, they cannot be removed by the company at general meeting under section 284 of the Companies Act.

Question 8

Explain the usefulness of 'Heading and Title of a chapter in an Act and marginal notes of a Section' as internal aids in interpreting the provisions of a Statute. (November, 2003)

Answer

Heading and Marginal Notes: A number of sections in an Act applicable to any particular object are grouped together, sometimes in the form of chapters, pre-fixed by Heading and/or Titles. Marginal notes means titles to the section.

In *Uttam Das Chela Sunder Das v. SGPC* AIR 1996 SC 2133, it was observed that 'Marginal notes or captions undoubtedly, part and parcel of legislative exercise and the language employed therein provides the key to the legislative intent. The words employed are not mere surplusage'. Marginal note is legislative and not editorial exercise C *Bhagirath v. Delhi Admn.* AIR, 1985 SC 1050. It gives an indication as to what was exactly the mischief that was intended to be remembered and throws light on the intention of legislature. It is relevant factor to be taken into consideration in construing the ambit of the section. *Shree Sajjan Mills Ltd. (v) CIT* (1985) 156 ITR 585(SC). Heading, title and marginal notes can be referred to if the words are ambiguous. If there is any doubt in the interpretation of words in a section, the headings help to resolve the doubt. But they cannot control the plain words of a statute.

To sum up, heading, title and marginal notes can be used to understand the legislative intent, but cannot limit or restrict the clear word used in a section.

Question 9

Explain the effects of a proviso to a section in a statute.

(May, 2004)

Answer

Proviso: Some times a section in a statute contains a proviso. The normal function of a proviso is to except something out of the enactment to qualify something stated in the enactment which would be within its purview of the proviso were not there. The effect of the proviso is to qualify the preceeding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute embraces only the field which is covered by the main provision. It carries out an exception to the main provision to which it has been enacted as a proviso and to no other (*Ram Narain Sons Ltd v. Asst. Commissioner of Sales Tax AIR 1955 Sc. 765*).

Question 10

Explain briefly the distinction between “Mandatory” and “Directory” provisions in a statute. How the Court deals with them differently?

(November, 2004)

Answer

The distinction between a provision which is mandatory and one which is 'directory' is that when it 'mandatory', it must be strictly complied with, when it is 'directory', it would be sufficient that it substantially complied with. Non-observance of mandatory provisions involves the consequences invalidating. But non-observance of directory provision does not entail the consequence of invalidating, whatever other consequences may occur.

No general rule can be laid down for deciding whether any particular provision on a statute is mandatory or directory. In each case the court has to consider not only the actual word used, but has to decide the legislatures intent. For ascertaining the real intention of the legislature, the court may consider, amongst other things, the following

1. The nature and design of the statute.
2. The consequence, which would flow from construing one-way or the other.
3. The impact of other provisions by resorting to which the necessity of complying with the provision in question can be avoided.

4. Whether or not the statute provides any penalty if the provision in question is not complied with
5. If the provision in question is not complied with, whether the consequences would be trivial or serious.
6. Most important of all, whether the object of the legislation will be defeated or furthered.

Where a specific penalty is provided in a statute itself for non-compliance with the particular provision of the Act no discretion is left to the court to determine whether such provision is directory or mandatory - it has to be taken as mandatory.

Question 11

- (i) *Explain the rule of 'ejusdem generis' with regard to interpretation of statutes. (4 Marks)*
- (ii) *Sunrise Industries Ltd. has paid Rs.1,00,000 to a political party as its contribution to fight elections. Can it do so under the provisions of the Companies Act, 1956? (4 Marks)*

Will it make any difference if the company has advertised its products in the monthly magazine published by the political party?
(May 2005)

Answer

- (i) the term 'ejusdem generis' means 'of the same kind or species'. This rule can be explained as follows:
 - (a) Where any Act enumerates different subjects, general words following specific words are to be construed with reference to the words that precede them. Those general words are to be taken as applying to things of the same kind as the specific words previously mentioned, unless there is something to show that a wider sense was intended. Thus, this rule means that where specific words are used and after them some general words are used the general words would take their colour from the specific words used earlier.

Where there was prohibition on importation of arms, ammunition or gun -powder or any other goods', the words' any other goods' will be construed as referring to goods similar to 'arms, ammunition or gun powder – A.G. Brown (1920)/KB. 773.
 - (b) If the particular words used exhaust the whole genus (category), then the general words are to be construed as covering a larger genus.
 - (c) This rule applies only where the specific words are of the same nature. When they are of different categories than the meaning of the general words following these specific words remains unaffected. The general words then would not take colour from the earlier specific words.

Courts have discretion whether to apply this rule in a particular case or not. For example, the 'just and equitable' clause under Section 433 of the Companies Act is held to be not restricted by the first five situations in which the court may wind up a company.

- (ii) Under section 293A of the Companies Act, 1956, a company may contribute any amount not exceeding 5% of its average net profits during 3 immediately preceding financial years, to any political party or for any political purpose. For the purpose, Board may pass a resolution in this behalf and the amount contributed and the name of the party be disclosed in the Profit and Loss Account of the company. However, a Government company is prohibited to make any such political contribution.

Sunrise Industries Ltd. may contribute the amount of Rs.1 lakh subject to the above restrictions provided it has been in existence for more than three years.

As per section 293A(3)(b) of the Act, the amount of expenditure incurred on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by a political party shall also be deemed to be a contribution to a political party. Publication of advertisement of the products of the company in the monthly magazine of the political party will be covered by the general words 'or the like and will also be deemed to be a contribution to the political party for the purposes of section 293A of the Act.

Question 12

- (i) *Explain the rules relating to interpretation of Statutes, when the terms “notwithstanding” and “Subject to” are used in any provision of an Act.*
- (ii) *State the effect of the words “notwithstanding anything contained in this Act” used in Section 408 of the Companies Act, 1956, which vests certain powers in the Central Government to prevent oppression or mismanagement* **(November 2005)**

Answer

- (i) The term “notwithstanding” used along with the words “anything contained” in an Act characterises the non obstante clause. It is used in a provision of an Act when the intention of the legislature is to give an over-riding effect to that provision over other provisions of that Act and/or over provisions of other Acts as may be specified later in such provision. If there is any inconsistency or departure between the non obstante clause and other provisions, then the provisions as contained in the non obstante clause shall prevail. [*K. Parasuramaiah Vs. Pakari Lakshman AIR (1965) AP 220*].

As against the above non obstante clause, the term “subject to” is used in a provision of an Act to convey the intention of the legislature that the particular provision is yielding place to another provision or provisions to which is made “subject to”. Thus, it

can be concluded that the effect of non obstante clause (i.e., notwithstanding) is the opposite to a provision or provisions which includes the term "subject to".

- (ii) Section 408 of the Companies Act, 1956 starts with the words "notwithstanding anything contained in this Act". This is a non obstante clause which vests over-riding powers in the Central Government to nominate directors to prevent mismanagement or oppression. [*Oriental Industrial Investment Corporation Ltd. Vs. Union of India (1981) 52 Comp. Cas. 487, 493*]. This expression indicates that the appointment of the directors under this section is not to be controlled by other provisions of the Companies Act, 1956 such as maximum number or other proportion, if any fixed by the said Act. Further, the directors so appointed are also not liable to be removed by the company at general meeting under the provisions of section 284 of the Companies Act, 1956.

Question 13

What are the Internal and External aids to interpretation of statutes? Give five examples each of Internal and External aids.
(May 2006)

Answer

Internal aids to interpretation / construction are those which are found within the text of the statutes. On the other hand external aids of interpretation are those factors which are external to the text of the statute but are of great help.

Examples of internal aids to interpretation:

1. Definitional sections and clauses
2. Illustrations
3. Provisos
4. Long title and short title
5. Preambles
6. Heading and title of chapter
7. Marginal notes
8. Explanations
9. Schedules
10. Reading the statute as a whole

Examples of external aids to interpretation:

1. Historical setting (Background)
2. Consolidating statute & Previous law

3. Usage
4. Earlier & later analogous acts
5. Earlier acts explained by the later act
6. Reference to repealed acts
7. Dictionary definition
8. Use of foreign decisions

Question 14

There is an apparent difference between section 292 of the Companies Act, 1956, which permits the board to delegate its power to make loans and section 372A of the Companies Act, which requires approval of loan by a resolution passed at a board meeting with the consent of all the directors present at the meeting. How would you interpret these two provisions applying the rule of harmonious construction? **(November 2006)**

Answer

Rule of Harmonious Construction

Where there are in an enactment two or more provisions which cannot be reconciled with each other, they should be so interpreted, wherever possible, as to give effect to all of them. This is what is known as the Rule of Harmonious Construction. Importance should not be attached to a single clause in one section overlooking the provisions of another section. If it is impossible to avoid inconsistency, the provision which was evaluated or amended later in point of time must prevail. The rule of Harmonious Construction is applicable only where there is real and not merely apparent conflict between the provisions of an Act, and one of them has not been made subject to the other.

Every loan falling within the purview of Section 372 A of the Companies Act, 1956 must be sanctioned by a resolution of the Board of Directors passed at its meeting (Section 372 A(2)). Every such resolution must be passed with the consent of all the directors present at the Board meeting, that is no one dissenting or unanimously.

Every loan covered by Section 372 A falls within the purview of Section 292 (i)(e). That section permits delegation by the Board of its power of making loans vide proviso to Section 292 (i), subject to the conditions stipulated in Section 292(3). The condition that the resolution delegating the power must specify the total amount upto which loans may be made by the delegate, the purposes for which the loans may be made and the maximum amount of loans which may be made for each purpose in individual cases.

However, by harmonious interpretation of both the provisions of Section 292 and 372A and in absence of specific prohibition in Section 372A against delegations, the Boards

power under Section 372A may be delegated in accordance with the provisions of Section 292 by passing unanimous resolution of the Board. Any other interpretation will make provisions of Section 292 redundant.

Question 15

- (i) What is the effect of proviso ? Does it qualify the main provisions of an Enactment?
- (ii) Does an explanation added to a section widen the ambit of a section ? Support your answer with an example from the Companies Act, 1956.
- (iii) *What do you understand by the term 'Preamble' and how does it help in interpretation of a statute ?*
(May 2007)

Answer

- (i) Normally a Proviso is added to a section of an Act to except something or qualify something stated in that particular section to which it is added. A proviso should not be, ordinarily, interpreted as a general rule. A proviso to a particular section carves out an exception to the main provision to which it has been enacted as a Proviso and to no other provision. [*Ram Narian Sons Ltd. Vs. Commissioner of Sales Tax AIR (1955) S.C. 765*]
- (ii) Sometimes an explanation is added to a section of an Act for the purpose of explaining the main provisions contained in that section. If there is some ambiguity in the provisions of the main section, the explanation is inserted to harmonise and clear up and ambiguity in the main section. Something may added to or something may be excluded from the main provision by insertion of an explanation. But the explanation should not be construed to widen the ambit of the section.

For example, Section 294AA of the Companies Act, 1956 gives power to the Central Government to prohibit the appointment of Sole Selling Agents of a company in certain cases. An explanation has been added to that section which states that an "appointment" includes "re-appointment". By inclusion of this explanation, the legislature has only clarified the main provisions of that section and has not widened the ambit of the powers of the Central Government.
- (iii) The "Preamble" expresses the scope, object and purpose of the Act. It may recite the ground and the cause making a statue and the evil, which is sought to be remedied by it. It is a part of the statute and can legitimately be used for construing it. However, it does not over-ride the plain provisions of the Act, but if the wording of the statute gives rise to the doubts as to its proper construction, e.g., where the words or phrase have more than one meaning and a doubt arises as to which of the two meanings is intended in the Act, then the Preamble can and ought to be referred to in order to arrive at the proper construction.

Question 16

“When two or more provisions of the same statute are repugnant to each other, the court will try to construe the provisions in such a manner, if possible, as to give effect to all”. Examine the statement with reference to the provisions of sections 166 and 210 of the Companies Act, 1956 which appear to be seemingly contradictory to each other for compliance.

(November 2007)

Answer

The statement in question is relates to an important rule of interpretation that is ‘Rule of Harmonious Construction of a statute. According to this rule when there is doubt about the meaning of the words of a statute, these should be understood in the sense in which they harmonise with the subject of the enactment and the object which the legislature had in view their meaning is found not so much in strictly grammatical or etymological propriety of language, nor even its popular use, as in the subject or in the occasion on which they are used and the object to be attained.

Where there are in an enactment two or more provisions which cannot be reconciled with each other, they should be so interpreted whichever possible as to give effect to all of them. This is what is known as the Rule of Harmonious Construction. Let us take an example: according to Section 166(i) of the Companies Act, 1956 there must be not more than fifteen months between tow consecutive annual general meetings of a Company. Section 210 requires the Board of Directors to lay at every annual general meeting of a company a profit and loss account, which must cover the period since the preceding account and must be made up to date not earlier than the date of the meeting by more than six months.

The account is required to be accompanied by a balance sheet as at the date to which the profit and loss account is made up. For some special reasons, however, the Registrar may give an extension for not more than 3 months to hold the meeting.

In such a case, the accounts must relate to a period not earlier than the date of the meeting by more than six months plus the extension period. From this, we can easily make out that except the first annual general meeting which is subject to different rules on annual general meeting is to be held subject to the following rules:

- (i) The meeting must be held in each year
- (ii) It must be held not later than 15 months (18 months if extension is granted) from the date of the previous general meeting.
- (iii) Further, it must be held later than six months (or six months + extension) of the date of balance sheet.

These three requirements are cumulative and separate; failure to comply with any of them constitutes an offence. We would note that even where a company may hold its annual general meeting within the time limit of 15 months (or 18 months, if extension is granted) it may still be guilty of contravention of Section 210. Therefore, to give effect to both the sections, they are to be interpreted harmoniously and in fixing the date of the annual general meeting Section 166 as well as 210 are to be taken into account. The following illustration will make things clear – the financial year of a company ends on 31st March each year, presumption that the annual general meeting to adopt the accounts etc. relating to the year ended on 31st March, 2006 was held on 30th September, 2006 under Section 166 (i) the next general meeting need not be held till 31st December, 2007. But the relevant accounts would be those of the year ended on 31st March, 2007 which would be more than six months before the date of meeting. Therefore, the last date for holding that meeting would be 31st September, 2007.

Question 17

- (i) *Explain the rules relating to interpretation of statutes when the terms “notwithstanding” and “Subject to” are used in any provision of an Act.*
- (ii) *State the effect of the words “notwithstanding anything contained in this Act” used in Section 408 of the Companies Act, 1956 which vests certain powers in the Central Government to prevent oppression or mismanagement. (May 2008)*

Answer

- (i) The term ‘notwithstanding’ used along with the words ‘anything contained’ in an Act characterises the non obstante clause. It is used in a provision of an Act when the intention of the legislature is to give an over-riding effect to that provision over other provisions of that Act and/or over provisions of other Acts as may be specified later in such provision. If there is any inconsistency or departure between the non-obstante clause and other provisions, then the provisions as contained in the non-obstante clause shall prevail. [*K Parsuramaiah Vs. pakari Lakshman AIR (1965) AP 220*].

As against the above non obstante clause, the term ‘subject to’ is used in a provision of an Act to convey the intention of the legislature that the particular provision is yielding place to another provision or provisions to which is made ‘subject to’. Thus, it can be concluded that the effect of non obstante clause (i.e., not withstanding) is the opposite to a provision or provisions which includes the term “subject to”.

- (ii) Section 408 of the Companies Act, 1956 starts with the words “notwithstanding anything contained in this Act”. This is a non obstante clause which vests over-riding powers in the Central Government to nominate directors to prevent mismanagement or oppression. [*Oriental industrial Investment Corporation Ltd. Vs. Union of India (1981) 52 Comp. Cas. 487, 493*]. This expression indicates that the appointment of the directors under this section is not to be controlled by other provisions of the Companies

Act, 1956 such as maximum number or other proportion, if any, fixed by the said Act. Further, the directors so appointed are also not liable to be removed by the company at general meeting under the provisions of Section 284 of the Companies Act, 1956.

Question 18

The analysis of the language of Section 292 and Section 372A of the Companies Act, 1956 apparently discloses a conflict because the former provision permits the Board of Directors to delegate its powers to make loans whereas the latter provision requires approval of loan by resolution passed at a board meeting with the consent of all the directors present at the said meeting. To what extent the rule of "Harmonious construction" can be applied for the purpose of interpreting these two provisions of the companies Act, 1956.

(November 2008)

Answer

HARMONIOUS CONSTRUCTION: Where there are in an enactment two or more provisions which can not be reconciled with each other, they should be so interpreted, wherever possible so as to give effect to all of them. This is what is known as the rule of Harmonious Construction. Importance should not be attached to a single clause in one section overlooking the provision of another section. If it is impossible to avoid inconsistency the provision which was enacted or amended later in point of time must prevail. The Rule of Harmonious Construction is applicable only when there is a real and not merely apparent conflict between the provisions of an Act and one of them has not been subject to the other.

Every loan falling within the preview of Section 372A of the Companies Act, 1956, must be sanctioned by a resolution of the Board of Directors passed at its meeting. Every such resolution must be passed with the consent of all the directors present at the Board meets unanimously so that there is no one dissenting.

Every loan covered by Section 372A falls within the preview of Section 292(1)(e). The Section permits delegation by the Board of Directors of its powers of making loans vide proviso to Section 292(1), subject to the conditions stipulated in Section 292(3). The condition is that the resolution delegating the power must specify the total amount up to which loans may made by the delegate, the purpose for which the loans may be made and the maximum amount of loans which may be made for each purpose in individual cases.

However by harmonious interpretation of both the provisions of Section 292 and Section 372A and in the absence of specific prohibition in Section 372A against delegation, the Board's power under Section 372A may be delegated in accordance with the provisions of Section 292 by passing unanimous resolution of the Board. Any other interpretation will make provisions of Section 292 redundant.

Question 19

The word “May” doesn’t mean “Shall”. Yet the word ‘May’ under certain circumstances means “Shall”. Discuss the statement in the context of interpretation of statutes and the importance of distinction between mandatory and directory provisions. (May 09)

Answer

The use of the word ‘may’ in a statutory provision will not by itself show that the provision is directory in nature. In some cases the legislature may use the word ‘may’ as a matter of pure conventional courtesy and yet intend a mandatory force. Therefore, in order to interpret the legal import of the word ‘may’ we have to consider various factors, e.g. the object and the scheme of the Act, the context or background against which the words have been used, the purpose and advantages of the Act sought to be achieved by use of this word and the like.

Coming to the word ‘shall’ the use of the word ‘shall’ would not of itself make a provision of the Act mandatory. It has to be construed with reference to the context in which it is used. Thus, as against the government the word ‘shall’ when used in a statute is to be construed as ‘may’ unless a contrary intention is manifest. Hence, a provision in a criminal statute that the offender shall be punished as prescribed in the statute is not necessary to be taken as against the government to direct prosecution under that provision rather under some other applicable statute.

The distinction between a provision which is mandatory and one which is directory is that when it is mandatory, it must be strictly complied with; when it is ‘directory’, it would be sufficient that it is substantially complied with. Non-observance of mandatory provision involves the consequences of invalidity. But non-observance of directory provisions does not entail the consequence of invalidity, whatever other consequences may occur.

No general rule can be laid down for deciding whether any particular provision in a statute is mandatory or directory. In each case the court has to consider not only the actual words used, but has to decide the legislative intent. For ascertaining the real intention of the legislature, the court may consider, amongst other things, the following:

- (i) The nature and design of the statute.
- (ii) The consequence which would flow from construing from one way or the other.
- (iii) The impact of other provisions by resorting to which the necessity of complying with the provisions in question can be avoided.
- (iv) Whether or not the statute provides any penalty if the provision in question is not complied with.
- (v) If the provision in question is not complied with, whether the consequences would be trivial or serious.

(vi) Most important of all, whether the object of the legislation will be defeated or furthered.

Where a specific penalty is provided in a statute itself for non-compliance with the particular provision of the act, no discretion is left to the court to determine whether such provision is directory or mandatory – it has to be taken as mandatory.

Question 20

Explain the principles of “Rule of Beneficial Interpretation”.

Answer

While framing the language of a statute, generally, the care is taken to make it in such a manner that there does not remain any confusion in its interpretation. But sometimes, the language of the statute may be capable of more than one interpretation. In such cases the most firmly established rule of construction is the principle laid down in the Heydon's case. This rule is also called the “mischief rule”. This rule enables construction of four matters in construing an Act as stated below:

- (i) What was the law before the making of the Act.
- (ii) What was the mischief or defect for which the law did not provide;
- (iii) What is the remedy that the Act has provided; and
- (iv) What is the reason for the remedy.

The rule then directs that the courts must adopt that construction which ‘shall suppress the mischief and advance the remedy’. Therefore, even in a case where the usual meaning of the language used falls short of the whole object of the legislature, a more extended meaning may be attributed to the words, provided they are fairly susceptible of it. If however, the circumstances show that the phraseology in the Act is used in a larger sense than its ordinary meaning then that sense may be given to it. If the object of a statute is public safety then its working must be interpreted widely to give effect to that object. Thus the legislature having intended, while passing the Workmen's Compensation Act, the main object being provision of compensation to workman, it was decided that the act ought to be so construed, as far as possible, so as to give effect to its primary provisions.

It has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are reasonably capable of more than one meaning.

This rule does not normally apply to a fiscal statute like Income tax Act,. While construing a fiscal statute the words of the statute are given their plain meaning. If a tax payer is within the plain meaning of the terms of an exemption, he cannot be denied the benefit by resorting to any supposed intention of the exempting authority. This was held by the Supreme Court in the case of *Hemraj Gordhandas vs. H.H. Dave*.

Question 21

- (i) *Many a time a proviso is added to a Section of the enactment. Explain the function of such a proviso while carrying out the interpretation?*

Discuss the rules of interpretation of deeds and documents

(Nov 09)

Answer

- (i) The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as it stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision. It carves out an exception to the provision to which it has been enacted as a proviso and not to the other. (Ram Narain Sons Ltd. Vs. Assistant Commissioner of Sales Tax., A.I.R., 1995 Sc 765)

An explanation is at times appended to a Section to explain the meaning of the text of the section. An explanation may be added to include something within the Section or to exclude something from it. An explanation should normally be so read as to harmonise with and clear up any ambiguity in the main section. It should not be so construed as to widen the ambit of the section.

- (ii) The rules regarding interpretation of deeds and documents are as follows:

First and the foremost point that has to be borne in mind is that one has to find out what a reasonable man, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

It is inexpedient to construe the terms of one deed by reference to the terms of another. Further, it is well established that the same word cannot have two different meanings in the same document, unless the context compels the adoption of such a rule.

The Golden Rule is to ascertain the intention of the parties to the instrument after considering all the words in the document/deed concerned in their ordinary natural sense. For this purpose, the relevant portions of the document have to be considered as a whole. The circumstances in which the particular words have been used have also to be taken into account. Very often, the status and training of the parties using the words have also to be taken into account as the same words may be used by a ordinary person in one sense and by a trained person or a specialist in quite another sense and a special sense. It has also to

be considered that very many words are used in more than one sense. It may happen that the same word understood in one sense will give effect to all the clauses in the deed while taken in another sense might render one or more of the clauses ineffective. In such a case the word should be understood in the former and not in the latter sense.

It may also happen that there is conflict between two or more clauses of the same document. An effort must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect to. If, however, it is not possible to give effect to all of them, then it is the earlier clause that will over ride the latter one.

Similarly, if one part of the document is in conflict with another part, an attempt should always be made to read the two parts of the documents harmoniously, if possible. If that is not possible, then the earlier part will prevail over the latter one which, therefore, be disregarded.

Question 22

Briefly discuss the Rule of 'ejusdem generis' as applied in the interpretation of statute. (6 Marks)

Answer

When particular words pertaining to a class or genus are followed by general words, the general words are construed as limited to things of the same kind as those specified. This rule which is known as Rule of ejusdem generis reflects an attempt 'to reconcile incompatibility between the specie and general words in view of the other rules of interpretation that all words in the statute are given effect if possible, that a statute is to be construed as a whole and that no words are presumed to be superfluous. For instance, where an Act permits keeping of dogs, cats, cows, buffaloes and other animals the expression 'Other animals' would not include animals like lions and tigers, but would mean, only domesticated animals like horses etc.

The rule applied when (i) the statute contains an enumeration of specific words: (ii) the subjects of enumeration constitute a class or category: (iii) that class or category is not exhausted by the enumeration; (iv) the general terms follow the enumeration; and (v) there is no indication of a different legislative intent. If the subjects of enumeration belong to a broad based genus as also to narrower genus, there is no principle that the general words should be confined to the narrower genus.

The rule is applied extensively in interpreting the various statutes. The rule of ejusdem generis has to be applied with care and caution. It is not an inviolable rule of law, but only permissible reference in the absence of an indication, to the contrary, and where the context and the object and mischief of the enactment do not require restricted meaning to be attached to word of general import, it becomes the duty of the courts to give words their plain and ordinary meaning. The rule of ejusdem generis has no inverse application. General words preceding the enumeration of specific instances are not governed by this rule and their import cannot be limited by such words.

Question 23

- (i) Explain the rules relating to interpretation of the terms 'Subject to' and 'Notwithstanding' as used in the different provisions of the Acts. What is the effect of the term 'Notwithstanding anything contained in this Act' used in Section 408 of the Companies Act, 1956 empowering the Central Government to prevent oppression and mismanagement ?
- (ii) In what way are the following terms considered as 'internal aid' in the interpretation of statutes?
- (A) Illustrations
- (B) Explanation. (May, 2010)

Answer

The word 'notwithstanding anything contained' characterize the non obstante clause. It is generally included to give an overriding effect to the clause over the other. If there is any inconsistency or departure between the non obstante clause and another provision, it is the non obstante clause which will prevail (*K. Parasuramaiah Vs. Pakari Lakshman, A/R 1965 AP 220*). But the word 'subject to' conveys the idea of a provision yielding place to another provision or provisions to which it is made 'subject to'. Hence the effect of non obstante clause (i.e notwithstanding) is the opposite of a provision which states 'subject to'.

Section 408 of the Companies Act, 1956 opens with the words 'notwithstanding anything contained in this Act. This is a non obstante clause which vests overriding powers in the Government to nominate directors to prevent mismanagement or oppression (*Oriental Industrial Investment Corporation Ltd. vs. Union of India (1981) 52 Com Cases 487, 493(Del)*). This expression indicates that the appointment of directors under this section is not to be controlled by the maximum number or other proportion, if any, fixed by any provisions of the Act. Further, they cannot be removed by the company at general meeting under section 284 of the Companies Act, 1956.

- (ii) (A) **Illustrations:** Illustrations form a part of the statute and considered to be of relevance and value in construing the text of the section. However, illustration can not have the effect of modifying the language of the section and can neither curtail nor expand the ambit of the section.
- (B) **Explanation:** An Explanation may be added to include something or to exclude something from it. Explanation should normally be read as to harmonise with and clear up any ambiguity in the main section. It should be construed as to widen the ambit of the section

Question 24

Gaurav Textile Company Limited has entered into a contract with a Company. You are invited to read and interpret the document of contract. What rules of interpretation of deeds and documents would you apply while doing so? (New, May, 2010)

Answer

The rules regarding interpretation of deeds and documents are as follows:

First and the foremost point that has to be borne in mind is that one has to find out what reasonable man, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

It is inexpedient to construe the terms of one deed by reference to the terms of another. Further, it is well established that the same word cannot have two different meanings in the same documents, unless the context compels the adoption of such a rule.

The Golden Rule is to ascertain the intention of the parties of the instrument after considering all the words in the documents/deed concerned in their ordinary, natural sense. For this purpose, the relevant portions of the document have to be considered as a whole. The circumstances in which the particular words have been used have also to be taken into account. Very often, the status and training of the parties using the words have also to be taken into account as the same words maybe used by a ordinary person in one sense and by a trained person or a specialist in quite another sense and a special sense. It has also to be considered that very many words are used in more than one sense. It may happen that the same word understood in one sense will give effect to all the clauses in the deed while taken in another sense might render one or more of the clauses ineffective. In such a case the word should be understood in the former and not in the latter sense.

It may also happen that there is a conflict between two or more clauses of the same documents. An effect must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect. If, however, it is not possible to give effect of all of them, then it is the earlier clause that will over ride the latter one.