

## PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2010

### DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

Time allowed: 3 hours

Maximum marks: 100

**NOTE:** Answer SIX questions including Question No.1 which is COMPULSORY.

#### PART—A

##### Question 1

- (a) State, with reasons in brief, whether the following statements are correct or incorrect:
- (i) In the case of takeover, public announcement is required to be made by the acquirer either in all editions of an English national daily or in the Hindi national daily with wide circulation at the place where the registered office of the target company is situated.
  - (ii) Indian companies issuing Global Depository Receipts (GDRs) in America and Europe have to comply with the Securities and Exchange Board of India (SEBI) requirements.
  - (iii) A branch office of a foreign company is not allowed to carry out manufacturing activities on its own, but is permitted to sub-contract these to an Indian manufacturer. Branch office established with the approval of RBI may remit its profits outside India.
  - (iv) The stamp duty payable on transfer of shares varies from State to State.
  - (v) A company having a paid-up capital of Rs.2.5 crore is required to submit secretarial compliance certificate. (2 marks each)
- (b) Critically examine and comment on the following :
- (i) It is not the duty of the lead merchant bankers to ensure the despatch of share certificates/refund orders.
  - (ii) A remuneration committee may be set-up by the Board of directors as per clause 49 of the listing agreement relating to good corporate governance. (5 marks each)

##### Answer 1(a)(i)

##### Incorrect

Public announcement with respect to takeover is required to be made in

- all editions of one English national daily with wide circulation;
- one Hindi national daily with wide circulation and
- a regional language daily with wide circulation at the place where the registered office of the target company is situated and at the place of the stock exchange where the shares of the target company are mostly traded.

##### Answer 1(a)(ii)

##### Correct

FCCB and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003 requires unlisted companies floating GDRs, to get its shares simultaneously

listed in Indian exchanges, with respect to underlying shares of the company issuing GDR. Thus the companies issuing GDRs are required to comply with SEBI Requirements also in addition to SEC requirements and EU directives.

**Answer 1(a)(iii)**

**Correct**

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to sub-contact these to an Indian manufacturer. It may be noted that foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India only for the purposes specified under FEM (Establishment in India or branch or office or other place of business) Regulations 2000.

Branch Offices established with the approval of RBI, may remit outside India profit of the branch, net of applicable Indian taxes and subject to RBI Regulations, permission for setting up branch offices is granted by the Reserve Bank of India (RBI).

**Answer 1(a)(iv)**

**Incorrect**

In the case of transfer of shares the stamp duty is uniform throughout the country. In case of transfer of debentures or other securities the stamp duty payable on transfer thereof vary from state to state.

**Answer 1(a)(v)**

**Correct**

The Central Government in exercise of the powers conferred under Section 642 and Section 383A of the Companies Act, 1956 has amended the COMPANIES (APPOINTMENT AND QUALIFICATIONS OF SECRETARY) RULES, 1988. The amendment seeks to enhance the paid-up capital requirements for companies compulsorily required to appoint a whole time secretary to "five crore rupees". Under the amended rules a company having a paid up share capital of two crore rupees or more but less than five crore rupees may appoint any individual who is a member of the Institute of Company Secretaries of India as a whole-time secretary to perform the duties of a secretary under the Companies Act, 1956. Further, where a company has appointed a whole-time company secretary, possessing the qualification of membership of the Institute of Company Secretaries of India, such a company is not required to obtain a certificate from a secretary in whole-time practice under rule 3 of the Companies (Compliance Certificate) Rules, 2001. Hence, in the given case the paid up capital of the company being Rs.2.5 crores, the company is required to obtain compliance certificate unless it appoints a whole time company secretary possessing the qualification of membership of the Institute of Company Secretaries of India.

**Answer 1(b)(i)**

The statement is not correct.

As per SEBI (ICDR) Regulations 2009, the post-issue merchant banker is required to ensure that the despatch of refund orders, allotment letters and share certificates is done by way of registered post or certificate of posting, as may be applicable. The post-issue merchant banker shall also ensure payment of interest to

the applicants for delayed dispatch of allotment letters, refund orders, etc. as per the disclosure made in the offer document. If the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter alia to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the offer document

**Answer 1(b)(ii)**

The state is correct.

As per clause 49 of the listing agreement it is recommendatory for the company to have a remuneration committee. The board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment. This committee may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.

**Question 2**

- (a) *Choose the most appropriate answer from the given options in respect of the following:*
- (i) *When a charge on the assets of a company is created or modified, which one of the following forms is required to be filed with the Registrar of Companies—*
- (a) *Form No.21*
  - (b) *Form No.12*
  - (c) *Form No. 8*
  - (d) *Form No.15.*
- (ii) *All companies to which Companies (Compliance Certificate) Rules, 2001 apply are required to file with the Registrar of Companies the compliance certificate within —*
- (a) *60 Days from the date on which its AGM is held*
  - (b) *45 Days from the date on which its AGM is held*
  - (c) *30 Days from the date on which its AGM is held*
  - (d) *90 Days from the date on which its AGM is held.*
- (iii) *Which one of the following Acts does not come under the purview of securities laws—*
- (a) *Securities and Exchange Board of India Act, 1992*
  - (b) *Foreign Contribution (Regulation) Act, 1976*
  - (c) *Securities Contracts (Regulation) Act, 1956*
  - (d) *Depositories Act, 1996.*
- (iv) *Foreign investment which does not qualify under automatic route —*
- (a) *Will have to be cancelled and refunded*
  - (b) *Is prohibited*
  - (c) *Has to go for government approval*

- (d) *None of the above.*
- (v) *As per compliances under the listing agreement, the Audit Committee shall meet in a year atleast —*
  - (a) *Two times*
  - (b) *Three times*
  - (c) *Four times*
  - (d) *Five times.*
- (vi) *Maximum period of imprisonment for non-compliance of listing agreement is —*
  - (a) *One year*
  - (b) *Three years*
  - (c) *Five years*
  - (d) *Ten years.* (1 mark each)
- (b) *Distinguish between the following :*
  - (i) *'Horizontal merger' and 'vertical merger'; and*
  - (ii) *'Friendly takeover' and 'hostile takeover'. (3 marks each)*
- (c) *Write a note on 'pre-issue due diligence' and 'post-issue due diligence'. (4 marks)*

**Answer 2(a)(i)**

- (c) Form No. 8

**Answer 2(a)(ii)**

- (c) 30 days from the date on which its AGM is held.

**Answer 2(a)(iii)**

- (b) Foreign Contribution Regulations Act, 1976

**Answer 2(a)(iv)**

- (c) Has to go for government approval

**Answer 2(a)(v)**

- (c) Four Times

**Answer 2(a)(vi)**

- (d) Ten years

**Answer 2(b)(i)**

**Horizontal Merger**

This class of merger is a merger between business competitors who are manufacturers or distributors of the same type of products or who render similar or same type of services for profit. It involves joining together of two or more companies which are producing essentially the same products or rendering same or similar services or their products and services directly to compete in the market with each other. Horizontal mergers result into a reduction in the number of competing companies in an industry and increase the scope for economies of scale and elimination of duplicate facilities. However, their main drawback is that they promote

monopolistic trend in the industrial sector.

### **Vertical Merger**

In a vertical merger two or more companies are complementary to each other e.g. one of the companies is engaged in the manufacture of a particular product, the other is established and expert in the marketing of that product. In this merger the two companies merge and control the production and marketing of the same product. A vertical merger may result into smooth and efficient flow of production and distribution of a particular product and reduction in handling and stockholding costs. It also poses a risk of monopolistic trend in the industry.

### **Answer 2(b)(ii)**

#### **Friendly Takeover**

A friendly takeover is with the consent of taken over company. There is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company, which is referred to as friendly takeover bid.

#### **Hostile Takeover**

When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management such acts of acquirer are known as 'takeover raids' or hostile 'takeover bids'.

The main distinction between a friendly takeover and hostile takeover is whether there is a mutual understanding between the acquirer and the taken over company. When there is a mutual understanding, it is friendly takeover otherwise it is termed as hostile takeover.

### **Answer 2(c)**

Due diligence spans the entire public issue process. Pre-IPO due diligence process will result in a gap analysis between the present status of the company and the company that should be floated i.e., a gap is an expectations gap, created as a result of how the market expects a listed company to conduct its affairs. In this scenario, once these gaps have been highlighted, the due diligence exercise should extend in advising the company on the processes and activities which are required to fill the gaps identified. The due diligence process aspires to achieve the following:

- to assess the reasonableness of historical and projected earnings and cash flows;
- to identify key vulnerabilities, risk and opportunities;
- to gain an intimate understanding of the company and the market in which the company operates such that the company's management can anticipate and manage change;
- to set in motion the planning for the post-IPO operations.

The scope of pre-issue due diligence includes compliance with regard to eligibility, pricing, disclosure, lock in requirements etc as prescribed under SEBI(ICDR) Regulations 2009.

Post issue due diligence includes post issue requirements like dispatch of share certificates, refund orders, basis of allotment, post issue monitoring reports, redressal of investor grievances, co-ordination with depositories, registrars, bankers etc.

### Question 3

- (a) *Ambitious Constructions Ltd., a listed company, is planning to acquire controlling interest in Fine Cements Ltd. As a Practising Company Secretary, you are required to advise the managing director of the acquirer company about the meaning of 'trigger point' and the different trigger points to be followed under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (10 marks)*
- (b) *Gokul Financial Services Ltd. has made a public issue for 25 crore shares of Rs.10 each at a premium of Rs.370 per share. The following information has been provided to you:*
- (i) The company has reserved 25% shares for retail category.*
  - (ii) The total issue was over-subscribed 3.5 times whereas the retail category was over-subscribed by 7.20 times.*
  - (iii) The company has fixed a minimum application/bid size as 15 shares. Applications can be made for a minimum of 15 shares and in multiples thereof.*
  - (iv) Three retail investors Ankur, Bobby and Varsha have applied for 225 shares, 105 shares and 90 shares respectively.*
- On the basis of above information, calculate the actual entitlement of shares by Ankur, Bobby and Varsha, if the company has finalised the allotment on proportionate basis. (6 marks)*

### Answer 3(a)

#### Trigger points

Trigger point is a point where provisions of SEBI (SAST) Regulations, 1997 i.e takeover code gets triggered and the acquirer is required to follow public announcement and other requirements as mentioned in the regulations in respect of further acquisition. Following are the trigger points where an acquirer is required to follow SEBI(SAST) Regulations, 1997.

#### *(i) 15% shares or voting rights:*

An acquirer who intends to acquire shares which alongwith his existing shareholding would entitle him to exercise 15% or more voting rights, can acquire such additional shares only after making a public announcement (PA) to acquire atleast additional 20% of the voting capital of Target Company from the shareholders through an open offer.

#### *(ii) Creeping acquisition limit:*

An acquirer together with persons acting in concert who holds 15% or more but less than 55% of shares or voting rights of a target company, can acquire such additional shares as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31 only after making a public announcement to acquire atleast additional 20% shares of target company from the shareholders through an open offer.

*(iii). Consolidation of holding:*

An acquirer who holds 55% or more but less than 75% shares or voting rights of a target company, can acquire further shares or voting rights only after making a public announcement to acquire atleast additional 20% shares of target company from the shareholders through an open offer.

**Answer 3(b)**

Calculation of allotment of shares on the basis of proportionate basis:

| <i>Sr. No.</i> | <i>Name of Investor</i> | <i>Total number of shares applied for</i> | <i>Total number of shares eligible to be allotted (No. of shares applied for/7.20)</i>                                                                                                                                                |
|----------------|-------------------------|-------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1.             | Ankur                   | 225 shares                                | $225/7.20 = 31.25$ shares rounded off to 31 shares                                                                                                                                                                                    |
| 2.             | Booby                   | 105 shares                                | $105/7.20 = 14.58$ shares rounded off to 15 shares i.e. minimum application size.                                                                                                                                                     |
| 3.             | Varsha                  | 90 Shares                                 | $90/7.20 = 12.5$ i.e. 13 shares application liable to be rejected as the entitlement is less than the minimum application size. However, the successful applicants out of the total applicants shall be determined by drawal of lots. |

**Question 4**

- Priyanka Ltd., a listed company wants to make an issue of securities through a rights issue where the aggregate value of securities including premium exceeds Rs.70 lakh. As the Company Secretary of Priyanka Ltd., how will you advise your company in respect of procedures to be followed? (6 marks)*
- Anjan has applied for shares under the Employees Stock Option Scheme and his option is granted. Now, Anjan wants to transfer his option to one of his friends, Sanjay. Examine the request of Anjan in the light of the SEBI Guidelines, 1999. (5 marks)*
- The managing director of Cautious Bank Ltd. invites you as a Practising Company Secretary to explain him about compilation and preparation of search report before lending funds to a private company. Explain briefly the issues involved in this regard. (5 marks)*

**Answer 4(a)**

SEBI (ICDR) Regulations 2009 are applicable to a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more. Accordingly an issuer making a rights issue, where the aggregate value of the specified securities offered is fifty lakh rupees or more, is required to file a draft offer document, along with fees as specified with SEBI through the lead merchant banker, at least thirty days prior to registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be. The following are important procedures to be followed with respect to a rights issue.

#### **1. Record Date.**

Ensure that the record date has been announced for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue.

#### **2. Restriction on rights issue.**

No issuer shall make a rights issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

#### **3. Letter of offer, abridged letter of offer.**

The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue. The letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard.

#### **4. Pricing**

The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.

#### **5. Period of subscription**

A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

#### **6. Pre-Issue Advertisement for rights issue.**

The issuer shall issue an advertisement for rights issue disclosing the following:

- (a) the date of completion of despatch of abridged letter of offer and the application form;
- (b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;

#### **7. Obligation of issuer/intermediaries**

The obligation of issuer/intermediaries for a rights issuer, with respect to advertisement, appointment of compliance officer, redressal of investor grievances, due diligence, post issue reports, post issue advertisements etc is same as the public



issue.

**Answer 4(b)**

As per Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, there shall be a minimum period of one year between the grant of options and vesting of option. However, in a case where options are granted by a company under an ESOS in lieu of options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period required. Further, the company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option. The employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option. No person other than the employee to whom the option is granted shall be entitled to exercise the option. The option granted to the employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner. Hence Anjan cannot transfer his options to his friend Sanjay.

**Answer 4(c)**

MCA-21 enables viewing of public documents of companies for which payment has been made by user. Form 8, Form 10, Form 17 and copies of certificates of registration thereof are available for inspection at the website. Before proceeding with the inspection it would be advisable to ensure that the format in which the search report is required.

Meticulous care will have to be taken in noting down the following particulars from the Register of Charges:

- (a) Date of registration (preferably with the serial number) of the document
- (b) Date and nature of the document creating the charge
- (c) Amount of the charge
- (d) Brief particulars of the property charged
- (e) Name and address of the person in whose favour the charge is created.

In respect of each of the charges created, it would be essential to identify the modifications effected from time to time by noting down carefully the following particulars:

- (a) Date of registration of the document (preferably with the serial number)
- (b) Nature and date of the instrument modifying the charge
- (c) Effect of Modification.

Each modification should be noted in chronological order and the above particulars should be compiled together for each charge.

As and when the charge is satisfied, fool-proof identification of the exact charge which is satisfied is of paramount necessity. The following particulars can be noted chronologically by way of modification by the Search Report.

- (a) Date of registration (preferably with the serial number) of the document
- (b) Date of satisfaction.

Non-essential particulars of charges comprise of the gist of terms and conditions with regard to (a) mode of repayment (b) rate of interest and (c) margin; these need not be given in the Search Report unless specifically so required by the client.

If the client requires particulars of the charges pending registration, it is advisable to give a separate report based on the verification of the registers and records maintained by or available with the company.

#### **Question 5**

- (a) *The Board of directors of National Food Corporation Ltd., a listed company decides to go for issue of shares through the Employees Stock Purchase Scheme (ESPS). As a professional, the Board has asked you to draft a due diligence check-list on the following issues :*
- (i) *Eligibility to participate in the scheme;*
  - (ii) *Shareholders approval; and*
  - (iii) *Pricing and lock-in period. (10 marks)*
- (b) *State the procedure for viewing of public documents of companies on MCA portal. (6 marks)*

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

##### **Eligibility to Participate in the Scheme**

- (i) An employee eligible to participate in the scheme should be:
  - (a) a permanent employee of the company working in India or out of India; or
  - (b) a director of the company, whether a whole time director or not;
  - (c) an employee as defined in sub-clauses (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.
- (ii) Check that the employee is not a promoter nor belongs to the promoter group.
- (iii) Ensure that a director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating, as he is not eligible to participate in the scheme.

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

##### **Shareholder Approval**

- (i) Check that the Scheme has been approved by the shareholders by passing a special resolution in the meeting of the general body of shareholders.
- (ii) Check that the explanatory statement to the notice has been sent to the shareholders and it specifies—
  - (a) the price of the shares and also the number of shares to be offered to each employee;
  - (b) the appraisal for determining the eligibility of employee for the scheme;
  - (c) total number of shares to be issued.
- (iii) The number of shares offered may be different for different categories of employees.
- (iv) Check that special resolution states that the company shall conform to the

accounting policies as specified in Schedule II of the SEBI (Employee Stock Option Scheme and Stock Purchase Scheme) Guidelines, 1999.

- (v) Check that approval of shareholders have been obtained by way of separate resolution in the general meeting in case of—
  - (a) allotment of shares to employees of subsidiary or holding company and;
  - (b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

#### **Answer 5(a)(iii)**

##### **Pricing and Lock-in-period**

- (i) The company has the freedom to determine price of shares to be issued under an ESPS, provided they comply with the accounting policies specified.
- (ii) Check that the shares issued under an ESPS are subject to lock-in for a minimum period of one year from the date of allotment.

Also ensure that in a case where shares are allotted by a company under a ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in-period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in required under this clause.

- (iii) If the scheme is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees under the scheme are not subject to any lock-in-period.

#### **Answer 5(b)**

MCA-21 offers the facility to view documents and also search and other facilities of public documents. This facility is handy for users and banks and financial institutions while sanctioning loans.

This facility enables viewing of public documents of companies for which payment has been made by user. The document can be viewed only within 7 days after the payment has been confirmed. Also, the documents are available for only 3 hours after the user has started viewing the first document of the company.

- (a) User has to access My MCA portal and login to the My MCA portal.
- (b) Click on the 'My Documents' tab after logging into the system.
- (c) List of company names will be displayed, for which user have already paid for public viewing. It also displays
  - (i) Date of request i.e. the date, when user made the request to view the company document.
  - (ii) Status of the request i.e. whether viewed or to view.
- (d) Click on the view link under status field.
- (e) The documents are grouped under five categories i.e. user has to click on the desired category under which the document falls.
- (f) If more than one document is listed, the user can arrange them name wise or date wise.

- (g) On clicking the document name, the document shall be displayed for viewing.

The public documents under this facility are available for viewing by public on payment of requisite fee. Public documents include Incorporation documents, charge documents, annual returns and balance sheet, change in directors and other documents.

#### **Question 6**

- (a) *Draft a note to the Board of directors on the major compliances for public issue/listing of securitised debt instruments on the recognised stock exchange under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008. (8 marks)*
- (b) *Draft a check-list for an issue of Indian Depository Receipts (IDRs) under Chapter VI-A of the SEBI (Disclosure of Investor Protection) Guidelines, 2000 with respect to the following:*
- (i) *Eligibility for issue of IDRs;*
  - (ii) *Investors; and*
  - (iii) *Minimum subscription. (8 marks)*

#### **Answer 6(a)**

Major compliances for public issue and/or listing of securitized debt instruments on the recognized stock exchange under SEBI(Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008:

1. Ensure that special purpose distinct entity files draft offer document with SEBI at least 15 days before proposed opening the issue;
2. Ensure that special purpose distinct entity has made arrangements with Registered Depositories for dematerialisation of the securitised debt instruments.
3. Ensure that special purpose distinct entity has made an application for listing to one or more recognized exchanges in terms of 17A (2) of SCRA.
4. Ensure that credit rating is obtained from at least two registered credit rating agencies and the same is disclosed in the offer document.
5. Ensure that the contents of offer document has the required details and does not contain any misleading information.
6. Ensure to file necessary information/reports post issue as directed by SEBI from time to time.
7. Ensure that the special purpose distinct entity complies with its obligation relating to Minimum public offering for listing, continuous listing conditions etc

#### **Answer 6 (b)(i)**

##### **Eligibility for issue of IDRs**

Check whether the issuer of IDR

- (a) fulfils the eligibility criteria as specified in rule 4 of the IDR Rules;
- (b) is listed in its home country;
- (c) has not been prohibited to issue securities by any Regulatory Body; and
- (d) has good track record with respect to compliance with securities market

regulations.

#### **Answer 6 (b)(ii)**

##### **Investors**

- (a) Check that at least 50% of the IDRs issued has been subscribed to by QIBs; and
- (b) The balance 50% has been made available for subscription by non-institutional investors (i.e., investors other than QIBs and retail individual investors) and retail individual investors, including employees. IDRs shall be allocated among non institutional investors, retail individual investors and employees at the discretion of the issuer. The manner of allocation shall be disclosed in the prospectus for IDRs.
- (c) Check that application amount in an IDR is not less than Rs. 20,000.
- (d) Check that Procedure to be followed by each class of applicant for applying has been mentioned in the prospectus

#### **Answer 6 (b)(iii)**

##### **Minimum subscription**

*For non-underwritten IDR issues:*

"If the issuing company does not receive the minimum subscription of 90 per cent of the issued amount on the date of closure of the issue, or if the subscription level falls below 90 per cent. after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received. If the issuing company fails to refund the entire subscription amount within 15 days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of 15 per cent per annum for the period of the delay"

*For underwritten IDR issues:*

"If the issuing company does not receive the minimum subscription of 90 per cent of the net offer to public including devolvement of Underwriters within 60 days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of 15 per cent per annum for the period of the delay beyond 60 days."

#### **Question 7**

- (a) Write notes on **any two** of the following :
  - (i) Escrow account
  - (ii) Foreign direct investment
  - (iii) Compliance management. (4 marks each)
- (b) Distinguish between **any two** of the following :
  - (i) 'Operational due diligence' and 'strategic due diligence'.
  - (ii) 'Transposition of shares' and 'transmission of shares'.
  - (iii) 'Level-I ADR' and 'Level-II ADR'. (4 marks each)

#### **Answer 7(a)(i)**

##### **Escrow Account**

The escrow amount shall be calculated in the following manner, as specified in the sub-regulation 2 of regulation 28 of SEBI(SAST) Regulations 1997,—

- (a) For consideration payable under the public offer,—
- |                                    |                                                              |
|------------------------------------|--------------------------------------------------------------|
| up to and including Rs. 100 crores | 25 per cent;                                                 |
| exceeding Rs. 100 crores           | 25 per cent up to Rs. 100 crores and 10 per cent thereafter. |

(b) For offers which are subject to a minimum level of acceptance, and the acquirer does not want to acquire a minimum of 20 per cent, then 50 per cent of the consideration payable under the public offer in cash shall be deposited in the escrow account.

The escrow account referred to in sub-regulation (1) shall consist of,—

- (a) cash deposited with a scheduled commercial bank; or
- (b) bank guarantee in favour of the merchant banker; or
- (c) deposit of acceptable securities with appropriate margin, with the merchant banker; or
- (d) cash deposited with a scheduled commercial bank in case of clause (b) of sub-regulation (2) of regulation 28, as mentioned in the abovesaid paragraphs.

In case the escrow account consists of deposit with a scheduled commercial bank, the acquirer has to ensure while opening the account that the merchant banker appointed for the offer is empowered to instruct the bank to issue a banker's cheque or demand draft for the amount lying to the credit of the escrow account, as provided in the regulations.

If the escrow account consists of bank guarantee, such bank guarantee must be in favour of the merchant banker and shall be valid at least for a period commencing from the date of public announcement until twenty days after the closure of the offer.

In case there is any upward revision of offer, consequent upon a competitive bid or otherwise, the value of the escrow account must be increased to equal at least 10 per cent of the consideration payable upon such revision.

#### **Answer 7(a)(ii)**

Investment in Indian companies can be made both by non-resident as well as resident Indian entities. Any non-resident investment in an Indian company is direct foreign investment. Investment by resident Indian entities could again comprise of both resident and non-resident investment. Thus, such an Indian company would have indirect foreign investment if the Indian investing company has foreign investment in it. The indirect investment can be a cascading investment i.e. through multi-layered structure also. Foreign Direct Investments (FDI) can be made under the following two routes

1. Automatic Route and
2. Government Route/Approval Route.

**Answer 7(a)(iii)**

A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc. and in other words it is called compliance solution.

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management. Installing proper compliance process is a must for the success of compliance programme. Systematic approach helps in chalking out a plan of action in right direction. Installing a process presupposes planning for the activity, identification of desired objective and resources, detailed plan of action with provision for eventualities and continuous monitoring and corrective measures.

**Answer 7 (b)(i)***(i) Operational due diligence*

Operational due diligence aims at the assessment of the functional operations of the target company, connectivity between operations, technological upgradation in operational process, financial impact on operational efficiency etc. It also uncovers aspects on operational weakness, inadequacy of control mechanisms etc.

*(ii) Strategic due diligence*

Strategic due diligence tests the strategic rationale behind a proposed transaction and analyses whether the deal is commercially viable, whether the targeted value would be realized. It considers factors such as value creation opportunities, competitive position, critical capabilities.

**Answer 7(b)(ii)****Transposition**

In the case of joint-shareholders, one or more of them may require the company to alter or rearrange the serial order of their names in the register of members of the company. In this process, there will be need for effecting consequential changes in the share certificates issued to them. If the company provides in its articles that the senior-most among the joint-holders will be recognised for all purposes like service of notice, a copy of balance sheet, profit and loss account, voting at a meeting etc., the request of transposition may be duly considered and approved by the Board or other authorised officer of the company. Since no transfer of any interest in the shares takes place on such transposition, the question of insisting on filling transfer deed with the company, may not arise. Transposition does not also require stamp duty.

**Transmission**

'Transmission by operation of law' is not a transfer. It refers to those cases where a person acquires an interest in property by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the shareholder or by purchase in a Court-sale, while a transfer is effected by act of parties. This is known as transmission or transfer by operation of law, or involuntary

assignment. Thus, transmission of shares takes place when the registered shareholder dies or is adjudicated as an insolvent, or if the shareholder is a company, it goes into liquidation.

#### **Answer 7(b)(iii)**

Level I ADR(unlisted/OTC Traded/pink Sheets) This is the least expensive level to provide for issuance of shares in ADR form in the US. The company issuing ADRs has to comply with the Securities and Exchange Commission (SEC) registration requirements but can be exempted from full SEC reporting requirements under certain circumstances. It can only be traded over the counter and cannot be listed on a national exchange in the US. The electronic OTC markets are also called pink sheets which is a centralized quotation service that collects and publishes market maker quotes for OTC securities in real time.

Level II ADR (US Listed Non capital raising transaction. i.e., without going for public issue): This programme gives more liquidity and marketability as it enables listing of ADRs in one or more of the US exchange. Under this programmes the company has to comply with registration requirements reporting requirements of SEC.

#### **Question 8**

*Critically examine and comment on **any four** of the following:*

- (i) Indian companies are allowed to make payments for foreign technology collaboration under automatic route subject to certain limits under the FEMA Regulations.*
- (ii) As part of good corporate governance practices under clause 49 of the listing agreement, a company is required to make disclosures on certain aspects.*
- (iii) Securities audit is a mechanism relieving the company and its directors from the consequences of unintended non-compliance by timely corrective actions.*
- (iv) The legal due diligence process varies depending upon the scope of work dictated by the client, the focus, special areas of weakness, the type of business, etc.*
- (v) Where a company desires to roll over the debentures issued by it, a copy of the notice of the resolution is to be filed with SEBI. (4 marks each)*

#### **Answer 8(i)**

Indian Companies are allowed to make the payment for foreign technology collaboration under automatic route subject to the following limits under the FEMA Regulations:

- (a) The lump sum payments not exceeding US\$ 2 million.
- (b) Royalty payable is being limited to 5% for domestic sales and 8% for exports, without restriction on duration of royalty payments. The royalty limits are net of taxes and are calculated according to standard conditions;
- (c) Payment of royalty upto 2% for exports and 1% for domestic sales is allowed under automatic route for use of trade marks and brand name of the foreign collaborator without technology transfer.

#### **Answer 8(ii)**



## **Disclosures under the Clause 49 of Listing Agreement**

### *Basis of related party transactions;*

Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same.

### *Disclosure of Accounting Treatment.*

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report

### *Board disclosures on risk management*

The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

### *Proceeds from public issues, rights issues, preferential issues etc.*

When money is raised through an issue (public issues, rights issues, preferential issues etc.), it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and place it before the audit committee.

### *Remuneration of Directors.*

All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.

### *Management*

As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on certain matters Industry structure and developments, Opportunities and Threats, Risks and concerns etc.

### *Disclosures to shareholders.*

Disclosures to directors pertains to information like resume of director with respect to his appointment, Disclosure of relationships between directors inter-se etc

## **Answer 8(iii)**

Securities Audit is a mechanism relieving the company and its directors from the consequences of unintended non-compliance by timely corrective actions. There are several penal provisions in the Companies Act, 1956, Securities and Exchange Board of India Act, 1992, Foreign Exchange Management Act, 1999, Securities Contracts

(Regulations) Act, 1956 and other securities related laws. As securities audit ensures the timely and proper compliances of all statutory provisions and early detection of errors and frauds, it provides trustworthy mechanism relieving the company and its directors from the consequences of unintended non-compliances of statutory provisions. Securities Audit is also a powerful tool for proper compliance of all obligations and also for investors' protection.

#### **Answer 8(iv)**

A legal due diligence is scrutiny of all, or specific parts, of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision, with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters. It also improves the buyer's bargaining position and ensures that necessary precautions are taken in relation to the transaction proposed.

The scope of due diligence depends on the purpose and objectives of due diligence and may vary from case to case. The scope of due diligence by a large institutional investor will vary from the scope of due diligence by the company which proposes to acquire a target company. Thus it is not possible to define the scope of due diligence specifically. However, certain mandatory issues that should be covered in any type of legal due diligence are as follows:

1. Regulatory compliance
2. Contractual compliance
3. Compliance under intra-corporate aspects
4. Financial aspects
5. Non financial aspects
6. Cultural aspects

Especially in case of cross border transactions, compatibility and adaptability of corporate cultures are to be analysed to eliminate the problems that may arise out of cultural differences.

#### **Answer 8(v)**

As per the chapter X of erstwhile SEBI(DIP) Guidelines, 2000, if the company desires to roll over the debentures issued by it, it has to file with SEBI a copy of the notice of the resolution to be sent to the debenture-holders for the purpose, through a merchant banker prior to dispatching the same to the debenture-holders. The notice shall contain disclosures with regard to credit rating, necessity for debenture-holders resolution and such other terms which SEBI may specify.

As per SEBI(ICDR) Regulations 2009, the non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees, may be rolled over without change in the interest rate, subject to compliance with the provisions of section 121 of the Companies Act, 1956 and the following conditions:

- (a) seventy five per cent. of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;
- (b) the issuer has, along with the notice for passing the resolution, sent to all

holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;

(c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution;

(d) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the roll over;

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