

THE SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI) ACT, 1992

Question 1

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 ₹ 500 for a share of ₹ 10. Answer the following with reference to SEBI (Disclosure and Investor Protection) guidelines:

- (i) *What is the price band that may be indicated in the red herring prospectus?*
- (ii) *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.* (6 Marks) (Nov 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 [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:

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 SEBI 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 2

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? (6 Marks) (Nov 2008)

Answer

"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.

Question 3

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 ₹ 3.00 crores and its net worth as at 31st March, 2008 was ₹ 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 ₹ 4.00 crores, 4.50 crores and 5.00 crores respectively, out of which monetary assets were less than ₹ 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 ₹ 20 crores, 30 crores and 35 crores respectively.*

The company wants to make a public issue of shares to raise ₹ 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 segmentwise 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.

(6 Marks)(June 2009)

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 ₹ 4.00 crores, ₹ 4.50 crores, and ₹ 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 ₹ 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 ₹ 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 ₹ 1 crore in the preceding three full years. (paid-up capital since 1st April, 1999 is ₹ 3 crores and net worth as at 31st March, 2005 was ₹ 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. (₹ 20 crores is the proposed issue and pre-issue net worth is ₹ 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 ₹ 20.00 crores by issuing equity shares at premium.

Question 4

Excel Ltd., a public limited company listed with the The Stock Exchange, Mumbai wants to issue 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 Directors of the Company. Following information relevant to the preferential issue is available:

Total No. of equity shares to be issued: 50 lac equity shares of ₹ 10 each out of which 30 lac equity shares will be allotted shares will be allotted on 31st December, 2008 as fully paid up and balance 20 lac equity shares shall be allotted on the same date but paid up to ₹ 5 each and balance ₹ 5 shall be called upon at a later date and shall be paid up on 31st May, 2009.

- (i) *Out of the proposed allottees some persons are holding their shares in Excel Ltd. in physical form and not in dematerialized form and some persons had sold their entire shareholding in Excel Ltd. in July, 2008.*

- (ii) *The meeting of general body of shareholders for approving the preferential issue was held on 15th October, 2008.*

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

(6 Marks) (June 2009)

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 fully paid equity shares issued on 31st December, 2008 will have a lock-in period of 1 year from the date of allotment. ie. till 31st December, 2009. In respect of the second lot, of partly paid 20 lac equity shares, the lock in period will be till 31st May, 2010 being the date on which the calls shall be paid up on 31st May, 2009.

- (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 July, 2008 shall not be eligible for preferential allotment of shares.

Question 5

An Unlisted Public Company, having a paid-up equity share capital of ₹ 5 Crores consisting of 50,00,000 equity shares of ₹ 10 each fully paid-up, proposes to reduce the denomination of equity shares to less than ₹ 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 ₹ 10 and, if so, state the minimum issue price and other conditions to be fulfilled under the SEBI (Disclosure and Investor Protection) Guidelines, 2000. (6 Marks) (Nov 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 ₹ 500 or more, the issuer company shall have a discretion to fix the face value below ₹ 10 per share subject shall in no case be less than ₹ 1 per share and also it shall not be is decimal of a rupee.
- (b) If issue price is less than ₹ 500 per share the face value shall be ₹ 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 ₹ 10 per share only if the issue price is ₹ 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.

Question 6

A to Z Ltd. an unlisted public company, eligible to make a public issue, desires to get its securities listed on Mumbai Stock Exchange, pursuant to a public issue to be made shortly. The company seeks your advice in respect of the following:

- (a) Whether the company can freely price its equity shares; and

- (b) *Whether it can issue equity shares to those applicants in the firm allotment category at a price different from the price at which equity shares are offered to the public.*

Advise, keeping in view the SEBI Guidelines in this regard.

(6 Marks) (May 2010)

Answer

According to Chapter III of SEBI Guidelines, an unlisted public company eligible to make a public issue and desirous of getting its securities listed on a recognized stock exchange pursuant to a public issue, may freely price its equity shares or any securities convertible at a later date into equity shares (vide para 3.2.1)

Further any unlisted company may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made provided that the price at which the security is being offered to the applicants in firm allotment category is higher than the price at which securities are offered to the public. The net offer to the public means the offer made to the Indian public and does not include firm allotments or reservations or promoters contributions. (Vide para 3.4.1)

Thus A to Z can follow the above stated guidelines while pricing its equity shares.

Question 7

ABC Company Ltd. an unlisted company, decided to offer Equity Shares through Initial Public issue. Under the provisions of SEBI Act, 1992, the company is required to file draft prospectus and other documents with SEBI and get the documents registered with the Registrar of Companies. Board of Directors of the company seek your advice about the conditions to be complied for the initial public offer (I.P.O.). You being a practicing Chartered Accountant, advise the Board.

(8 Marks) (Nov 2010)

Answer

An issuer making a public issue shall satisfy the conditions as stated below on the date of filing draft offer document with the SEBI and also as on the date of registering the offer document with the Registrar of Companies. Such an issuer company make an IPO, if:

1. It has net tangible assets of at least ₹ 3 crores in each of the preceding three full years of 12 months each, of which not more than 50% net held in monetary assets.
Provided that if more than 50% 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;
2. It has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least 3 out of the immediately preceding 5 years; Provided that extraordinary items shall not be considered for calculating distributable profits.
3. It has a net worth of at least ₹ 1 crore in each of the preceding three full years.
4. The aggregate of the proposed issue and all previous issues made in the same financial

year in terms of issue size does not exceed 5 times its pre-issue net worth as per the audited balance sheet of the preceding year.

5. If it has changed its name within the last one year, at least 50% of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

Question 8

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

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

What remedies are available to the companies against such orders under the Securities and Exchange Board of India Act, 1992? (8 Marks) (May 2011)

Answer

Orders of SEBI and Remedies: Under Section 11 of the SEBI Act, 1992 the basic duty of the SEBI is to protect the interests of investors in securities and regulate the securities market. Section 11A (1)(b) specifically empowers SEBI to prohibit any company from issuing prospectus, any offer document or advertisement soliciting money from the public for the issue of securities by general or special order if such prohibition is necessary for the purpose of protection of investors.

According to Section 11D, SEBI can issue, cease and desist order in respect of any listed company only if SEBI has reasonable grounds to believe that such company has indulged in insider trading or market manipulation.

Aggrieved companies may appeal against orders of SEBI made under SEBI Act, 1992, rules or regulations to the Securities Appellate Tribunal (SAT) under Section 15T of the said Act. Such appeal should be filed within 45 days from the date on which a copy of the order of SEBI is received by the company.

If the company is aggrieved by the order of SAT, further appeal against the order of SAT can be made to the Supreme Court within 60 days from the date of communication of the order of SAT on any question of law arising out of such order.

The appeal lies only on question of law. As far as facts are concerned, decision of the SAT is final. Further Section 20A of the said Act bars jurisdiction of Civil Court in respect of orders issued by the SEBI.

SECURITIES CONTRACTS (REGULATION) ACT, 1956

Question 1

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.
(6 Marks) (June 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 2

The Central Govt. has formed its opinion on certain grounds that the recognition granted to a Stock-Exchange be withdrawn. Examining the provisions of the Securities (Contracts)

Regulation Act, 1956, explain the procedure that must be followed by the Central Govt. to give effect to the above. Also state whether any such withdrawal of recognition shall affect the validity of the contracts already entered into by Stock-Exchange, before withdrawal of recognition.
(5 Marks) (Nov 2010)

Answer

The Central Government by virtue of powers as conferred upon it under Section 5 of the Securities Contracts (Regulation) Act, 1956, may withdraw the recognition after serving due notice on the governing Board of the Stock Exchange. Withdrawal however will not affect the validity of contracts entered into before the date of withdrawal of notification (sub-section 1).

Sub-section (2) provides that where the recognised stock exchange has not been corporatised or demutualised or it fails to submit the scheme referred to in sub-section (1) of Section 4B within the specified time therefore or the scheme has been rejected by the Securities Exchange Board of India under sub-section (5) of Section 4B, the recognition granted to such stock exchange under Section 4, shall, notwithstanding anything to the contrary contained in this Act, stand withdrawn and the Central Government shall publish by notification in the Official Gazette, such withdrawal of recognition.

Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Securities Exchange Board of India may, after consultation with the stock exchange, make such provisions as it deems fit in the order rejecting the scheme published in the Official Gazette under sub-section (5) of Section 4B.

Question 3

M/s Ganesham & Company is a member of recognized stock exchange. Nova Crafts Export Limited desires that shares of the company may be bought and sold by M/s Ganesham & Company on their own as well as on behalf of the investors.

Advise M/s Ganesham & company whether they can do so under the provisions of the Securities Contracts (regulation) Act, 1956.
(5 Marks) (May 2011)

Answer

Share Transactions by Member of Stock Exchange: Members of stock exchange normally carry out transactions on behalf of investors and hence principal-agent relationship between them exists. A member can enter into transactions 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 ensure written confirmation by such person or such consent within three days from the date of such contract.

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

Thus, M/s Ganesham & Company must bear in mind the above restrictions while entering into any transaction as principal with a non-member.

FOREIGN EXCHANGE MANAGEMENT ACT, 1999

Question 1

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.

(6 Marks) (Nov 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 Human Resources Development (Department 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 2

- (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 desires 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.
(6 Marks) (June 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 3

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?
(6 Marks) (Nov 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 in 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 4

- (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.* (3 Marks)
- (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.* (3 Marks) (May 2010)

Answer

- (i) **Penal provisions:** Section 11(3) of the Foreign Exchange Management Act, 1999 provides 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 ₹ 10,000/- and in the

case continuing contraventions with an additional penalty which may extend to ₹ 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 nationals 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.

Question 5

Examine the provisions of Foreign Exchange Management Act, 2002 and advise whether the approval of Central Govt. is needed in the following cases:

- (i) X wants to remit certain sum of money out of lottery winnings.
 (ii) Payment of Royalty in case it is 10% of local sales and 20% of exports and the lump sum payment of U.S. \$ 3 millions. (4 Marks) (Nov 2010)

Answer

- (i) X wants to remit certain sum of money out of lottery winnings: It is a current account transaction and prohibited as per Schedule I to the Foreign Exchange Management (Current Account Transactions) Rules, 2000.
 (ii) Payment of certain sum of money under the technical collaborate agreement is to be remitted :The payment of 10% of local sales and 20% of export sales and lump sum payment of US \$3 million is beyond the permissible limits. Hence, Central Government's prior approval is needed.
 (a) Permissible limit 5% of local sales
 (b) Permissible limit of 8% of export sales
 (c) lump sum payment limit is US \$ 2 million.

Question 6

During the financial year 2010-11 Mr. Bhattacharyya resided in India for a period of 180 days and thereafter went abroad. On 1st April, 2011 Mr. Bhattacharyya came back to India as an employee of a business organization. Decide the residential status of Mr. Bhattacharyya during the financial year 2010-11 under the provisions of the Foreign Exchange management Act, 1999. (4 Marks) (May 2011)

Answer**Residential Status under Section 2(v) of Foreign Exchange Management Act, 1999:**

In accordance with the provisions 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.

Mr. Bhattacharyya did not reside in India during the year 2010-2011 for more than 182 days and his residential status during the next year, i.e. 2011-2012 is non-resident even though he stayed in India from 1st April, 2011 as an employee. His residential status in 2010-2011 cannot be ascertained as his stay in India during the previous year 2009-2010 is not known.

THE COMPETITION ACT, 2002

Question 1

The Competition Act, 2002 deals with the agreement. Differentiate between Horizontal Agreement and Vertical Agreement.
(6 Marks) (Nov 2008)

Answer

Section 2(b) of Competition Act, 2002 defines the term “agreement” which 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 agreement, understanding or action is intended to be enforceable by legal proceedings;

Agreements may be horizontal agreements and vertical agreements.

Horizontal agreements referred to agreements among competitors and vertical agreements to an actual or potential relationship buying or selling to each other;

Horizontal agreements relating to prices quantities, bids and market sharing are particularly anti-competitive. Vertical agreements like tie in arrangements; exclusive supply/distribution agreements and refusal to deal are also generally anti-competitive.

Horizontal agreements are those agreements among competitors operating at the same level in the economic process i.e., enterprises engaged in the same activity. For example the agreements between the producers or between whole sellers or between retailers, dealing in similar kind of products.

Vertical agreements are those agreements between non competing undertakings operation at different levels of manufacturing and distribution process. For example, the agreements between manufacturers of components, manufacturers of products, between producers and whole-sellers or between producers, whole-sellers and retailers.

Horizontal agreements or agreement between two or more enterprises that are at the same stage of the production chain and in the same market. Horizontal agreements and membership of cartels lead to unreasonable restrictions of competition and may be presumed to have an appreciable adverse effect on competition.

Vertical agreements are agreements between enterprises that are at different stages or levels of the production chain and therefore in different markets. An example of this would be an agreement between a producer and a distributor. This includes tie in arrangements, exclusive supply arrangements, exclusive distribution arrangements, refusal to deal and resale price maintenance.

Question 2

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. (6 Marks) (Nov 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 3

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. (6 Marks) (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 competitors 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.

Question 4

What are the agreements prohibited under Section 3(1) of the Competition Act, 2002?

(4 Marks)(Nov 2010)

Answer

Agreements at different stage in different market are prohibited under section 3(1) of the Competition Act, 2002. Any agreement amongst enterprises or persons at different stage of the production chain in different markets, in respect of production, supply, distribution, storage, sale etc. shall be a void agreement likely to cause an appreciable adverse effect on Competition in India including:

- 1) Tie-in arrangement means any agreement requiring a purchaser of good, as a condition of such purchase some other good;
- 2) Exclusive supply agreement means 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;
- 3) Exclusive distribution agreement means any agreement to limit restrict or withhold the output or supply of goods or allocate any area or market for the disposal or sale of the goods;
- 4) Refusal to deal means any agreement which restrict, or is likely to restrict by any method the persons or class to whom goods are sold or from whom goods are bought;
- 5) Resale price maintenance means to sell goods on condition that the price to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

Question 5

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

(4 Marks) (May 2011)

Answer**Abuse of Dominant position:**

The Competition Commission while inquiring whether the enterprise ABC 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.

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 a Banking Company under the Banking Regulation Act, 1949? Explain.

(6 Marks) (Nov 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

- (i) *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.*
- (ii) *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.*
(6 Marks) (June 2009)

Answer

- (i) 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".
- (ii) 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 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. (6 Marks) (Nov 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

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? (6 Marks) (May 2010)

Answer

Appointment of Additional Director in a Bank by the RBI: Section 36AA of the Banking Regulation Act, 1949, provides that 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 Government 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 ₹ 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 of the said act, 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.

Question 5

The Board of Directors of VDV Ltd., a banking 'company incorporated in, India, for the accounting year ended 31-3-2010 transferred 15% of its net profit to its Reserve Fund. Certain shareholders of the company objects to the above act of the Board of Directors on the ground that it is violative of the provisions, of the Banking Regulation Act, 1949. Examine the provision of Banking' Act and decide:

- (i) *Whether contention of the Shareholders is tenable.*
- (ii) *Would your answer be still the same in case the Board of Directors transfer 30% of the company's net profits to Reserve Fund?* (8 Marks) (Nov 2010)

Answer

In accordance with the provisions of the Banking Regulation Act, 1949 as contained in 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 Government is empowered to exempt from this requirement on the recommendation of the RBI. Such exemption will be allowed only:

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

If the 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.

Therefore, applying the above provisions:

1. Contention of share holders shall be tenable since the %age of transfer of profits to Reserve Fund is lower than statutory limits, as provided in the Act.
2. In the second case the contention of shareholders shall not be tenable, since 30% is more than the minimum statutory limit of 20% of the net profits.

Question 6

The Central Government acquired a Banking Company. The scheme of acquisition, apart from other matters, provided for the quantum of compensation payable to the shareholders of

acquired bank. Some shareholders are not satisfied with the amount of compensation fixed under the scheme of acquisition.

Is there any remedy available to the share holders under the provisions of the Banking Regulation Act, 1949?
(8 Marks) (May 2011)

Answer

Compensation to shareholders of the acquired bank: Under Section 36AE of the Banking Regulation Act, 1949, the Central Government has power to acquire the undertaking of Banking Companies. When a bank is acquired by the Central Government, a scheme for the acquired bank is made in consultation with the Reserve Bank of India.

Such Scheme also provides for compensation payable to the registered shareholders of the acquired Bank (Section 36AF).

Section 36AG of the Banking Regulation Act, 1949 states that compensation is paid to the registered shareholders in accordance with the principles provided in Section 5 of the said Act.

Any shareholder aggrieved with the amount of compensation may request the Central Government to refer the matter to Tribunal to be constituted under Section 36AH of the Act. If the number of representation received is not less than one-fourth of the total number of shareholders holding not less than one-fourth of the paid-up share capital of the acquired Bank, the Central Government shall constitute a Tribunal for the purpose. Thus, such matters can be resolved through the Tribunal by the Central Government and the amount of compensation determined by the Tribunal is final and binding on all concerned parties.

The Insurance Act, 1938

Question 7

- (i) *With reference the provisions of Insurance Act, 1938, what do you mean by "Life Insurance Business"?*
- (ii) *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?*
(6 Marks) (June 2009)

Answer

- (i) 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.
- (ii) 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.

Question 8

What are the provisions in the Insurance Act, 1938 regarding nomination by Life Insurance Policy holder? Whether a minor can be a nominee in a Life Insurance Policy?

(4 Marks) (May 2011)

Answer

Nomination by Life Insurance Policy Holder: 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 any time 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 Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

Question 9

Explain Asset Reconstruction, Financial Assets under the Securitization and Reconstruction of Financial Assets Enforcement of Security and Interest Act 2002. (4 Marks) (Nov 2010)

Answer

Asset Reconstruction: 'Asset Reconstruction' means acquisition by any securitization 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) Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002)

Financial Assets: Financial Assets' means debt or receivables and includes: a claim to any debt or receivables or part thereof, whether secured or unsecured; or any debt or receivables secured by mortgage of, or charge on, immovable property; or a mortgage, charge, hypothecation or pledge of movable property; or any right or interest in the security, whether full or part underlying such debt or receivables; or 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 any financial assistance. (Section 2(1)).

Question 10

RST Ltd. is a securitization and reconstruction company under SRFAESI Act, 2002. The certificate of registration granted to it was cancelled. State the authority which can cancel the registration and the right of RST Ltd. against such cancellation. (4 Marks) (May 2011)

Answer

Cancellation of Certificate of Registration under SRFAESI Act, 2002: The Reserve Bank of India may cancel a certificate of registration granted to a securitisation and reconstruction company for the reasons stated in Section 4 of SRFAESI Act, 2002.

RST Ltd., can prefer an appeal to the Central Government (Secretary, Ministry of Finance, Government of India) within a period of 30 days from the date on which order of cancellation was

communicated to it. The Central Government must also give such company a reasonable opportunity of being heard before rejecting the appeal. If RST Ltd., is holding investments of qualified institutional buyers at the time of cancellation of certificate of registration, it shall be deemed to be a securitisation and reconstruction company until it repays the entire investments held by it, together with interest if any, within such period as may be specified by the Reserve Bank.

PREVENTION OF MONEY LAUNDERING ACT, 2002

Question 1

Enumerate the obligations of banking companies under the Prevention of Money Laundering Act, 2002.
(6 Marks) (Nov 2008)

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:

- (i) 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;
- (ii) Furnish information of the above transactions to the Director appointed for the purpose of this Act within the prescribed time;
- (iii) 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.

INTERPRETATION OF STATUTES, DEEDS AND DOCUMENTS

Question 1

Explain the 'Rule of reasonable construction' as may be applied in determining whether a particular act of a director of a company is 'ultra vires' or 'intra vires' of the objects of the company. (6 Marks) (Nov 2008)

Answer

As per the Rule of Reasonable Construction, the words of a statute must be construed 'ut us maquis valeat quampareat' meaning thereby that words of statute must be construed so as to lead to a sensible meaning. Generally the words or phrases of a statute are to be given their ordinary meaning. For example, in the case of *Dr. A.L. Mudiliar v. LIC of India* (1963) 33 Comp. Cas. 420 (SC), it was held that the Memorandum of Association of a company must be read fairly and its importance derived from a reasonable interpretation of the language which it employs. Further, in order to determine whether a transaction is intra vires the objects of a company, the objects clause should be reasonably construed: neither with rigidity nor with laxity. [*Waman Lal Chotanlal Parekh v. Scindia Steam Navigation Co. Ltd.* (1944)].

Thus, if the Court finds that giving a plain meaning to the words will not be fair or reasonable construction, it becomes the duty of the court to depart from the dictionary meaning and adopt the construction which will advance the remedy suppress the mischief provided the Court does not have to resort to conjecture or surmise. A reasonable construction will be adopted in accordance with the policy and object of the statute.

Question 2

Explain the principles of "Rule of Beneficial Interpretation". (6 Marks) (June 2009)

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 3

Briefly discuss the Rule of 'ejusdem generis' as applied in the interpretation of statute.

(6 Marks) (Nov 2009)

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 specific 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 4

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?
(6 Marks) (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 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 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 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.

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, the earlier part will prevail over the latter one which, therefore, be disregarded.

Question 5

Explain the Rule of "Reasonable construction under the interpretation of Statute, Deeds etc".

(4 Marks) (Nov 2010)

Answer

The rule of reasonable construction lay down that the words of a statute must be construed 'ut us maquis valeat quampareat' meaning thereby that words of statute must be construed so as to a sensible meaning. Generally the words or phrases of a statute are to be given their ordinary meaning. In the case of *Dr. A.L. Mudaliar vs. LIC of India (1963) (SC)*, it was held that the memorandum of Association of a company must be read fairly and its import derived from a reasonable interpretation of the language which it employs. Further, in order to determine whether a transaction is intra vires the objects of a company, the objects clause should be reasonably construed; neither with rigidity nor with laxity. [*Waman Lal Chotanlal Parekh vs. Scindia Steam Navigation Co. Ltd.(1944)*].

If the court finds that giving a plain meaning to the words will not be a fair or reasonable construction, it becomes the duty of the court to depart from the dictionary meaning and adopt the construction which will advance the remedy and suppress the mischief provided the court does not have to resort to conjecture or surmise. A reasonable construction will be adopted in accordance with the policy and object of the statute.

Question 6

"Associate words should be understood in common sense manner ". Explain the statement in the light of rules of interpretation of statutes.

(4 Marks) (May 2011)

Answer

Associated Words- Interpretation: When two words or expressions are coupled together one of which generally exclude the other, obviously the more general term is used in a meaning excluding the specific one. On the other hand there is the concept of "Noscitur A Sociis", that is to say, "the meaning of a word is to be judged by the company it keeps. When two or more words which are capable of analogous meaning are coupled together, they are to be understood in their cognate sense. They take, as it were, their colour from each other i.e. more general is restricted to a sense analogous to the less general. For example, in the expression 'commercial establishment means an establishment which carries on any business, trade or profession. The term 'profession' is construed with the associated words 'business' and 'trade' and it has been held that a private dispensary does not fall within the definition.

Similarly, the expression 'place of public resort' would have one meaning when coupled with the expression 'roads and streets' and the same expression 'place of public resort' would have quite different meaning when coupled with the word "houses".