BRIEF CASE

M J ANTONY

A weekly selection of key court orders

When arbitration moves at a snail's pace

Though arbitration is considered to be a speedy remedy, some cases might take decades to conclude. In the latest arbitration judgment delivered by the Supreme Court, the tender for a hydel scheme was floated in 1979 and the project was to be completed in 1982. Disputes arose between the contracting firm, Harish Chandra & Co and the Uttar Pradesh government over payment. Two sets of claims were referred to arbitration under the 1940 arbitration law, which has now been repealed. The award was passed in 1995 in favour of the contractor, which was challenged by the government before the civil judge. He confirmed the award in 1996. The government appealed to the high court in 2001. The judgment came in 2007. The contractor appealed to the Supreme Court the same year. It took nine years for the court to deliver its judgment, which upheld the contractor's claims. However, an appeal in another part of the arbitration proceedings is still pending. The present judgment was critical of the high court for going over facts and evidence decided by the arbitrator. The high court cannot act as an appeal court in arbitration matters and the award must be accepted unless it is totally arbitrary. New arguments cannot be raised in the high court. In this case, the high court violated these norms, the Supreme Court said.

Land compensation unpaid for decades

The strict conditions brought in by the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 have exposed irregularities in several proceedings. One of the grossest cases came to light in the Supreme Court, when the Delhi Development Authority (DDA) lost appeals against land owners. The judgment remarked: "The original owners' lands were notified for acquisition on October 24, 1961, of which possession was taken four decades later, in 2000; after which the land owners have yet to see the colour of the paltry amount of compensation offered, which has neither been tendered nor paid to them. In the facts disclosed by this case, there could not be stronger facts to hold such acquisition non-existent in accordance with the object sought to be achieved by Section 24 (2) of the 2013 Act." Explaining the new law, the court continued: "The state has no business to expropriate from a citizen his property if an award has been made and the necessary steps to complete acquisition have not been taken for a period of five years or more. These steps include taking physical possession of land and payment of compensation. The legislature is, in effect, telling the executive to put its house in order and complete acquisition proceedings within a reasonable time. Not having done so, even after a leeway of five years, would cross the limits of legislative tolerance, after which the whole proceeding would be deemed to have lapsed."

Appeals must raise question of law

The Supreme Court has emphasised that an appeal against the decision of the electricity regulatory commission would lie only if there is a "substantial question of law". In this case, Wardha Power Co vs Maharashtra State Electricity Distribution Co, the parties entered into an agreement under which the former would generate and supply power to the distribution firm. However, it could not keep up the schedule. So, it made an ad-hoc arrangement for purchase of power from other sources. Whether such ad-hoc supply should be at the actual cost incurred by the Wardha firm or the agreed rate was the dispute. The state commission and the appellate tribunal rejected the arguments of the Wardha firm. In the appeal, the Supreme Court said under Section 125 of the Electricity Act, an appeal would lie only if there is a substantial question of law. In this case, though the supplier raised 34 questions, none of them involved a question of law, the judgment stated while dismissed the appeal.

Tax same on bitumen in any form

Bitumen in its solid form and bitumen emulsion in the liquid form are scientifically the same commodity and cannot be taxed differently, the Supreme Court ruled in its judgment, Commissioner of Commercial Taxes vs A R Thermosets Ltd. VAT authorities maintained that emulsion was in the unclassified category, attracting a levy of 12.5 per cent. The firm that supplies bitumen for road building and other civil works brought scientific data to contend that they were the same thing and the end use was also the same. Therefore, emulsion should be taxed only at four per cent like bitumen. Mixing of certain material in the emulsified form would not 'manufacture' a new product. The composition is the same and the product in commercial parlance is understood as the same commodity in a different form. This view was accepted by the Supreme Court and it dismissed the appeal of the authorities against the Allahabad High Court verdict.

Packing material not input for goods

The Supreme Court has ruled that packing materials cannot be considered raw materials for manufactured goods, nor are they components or inputs. Only those items that are integral to the manufacture of a product could be considered raw material, the court stated while dismissing the appeal, Hindustan Lever Ltd vs State of Karnataka. The firm produced tea of different varieties in its Dharwad unit, then newly started. It claimed exemption from entry tax for packing materials brought into local areas. Revenue authorities denied the claim, starting a series of litigation over tax liability for the period between 1994 and 1997. HLL lost everywhere, including the Karnataka High Court and now the Supreme Court.

Retired rich with wrong award

The Delhi High Court has upheld the dismissal of an employee of Johnson & Johnson Ltd, who had allegedly stolen confidential documents and threatened to circulate them to rival agencies. The labour court had awarded him ₹10.44 lakh in 2008 as compensation, with 18 per cent for illegal termination. The high court allowed the appeal of the firm, observing that the "act of the workman was subversive of discipline and good behaviour." He has now retired, gathering all statutory benefits from the company. Though the labour court award has been set aside, in view of his age, the court barred the management from recovering amounts already paid.

Direct selling: Clearing the haze

New norms will help the sector come out of the shadow of the PCMC Act, but compliance costs and legal scrutiny could rise

SUDIPTO DEY & SAYAN GHOSAL

Year 2014 is considered a watershed for India's ₹8,000-crore direct selling sector. William Pinckney, the then managing director of Amway India, one of the largest direct selling players, along with two other executives, was arrested. And, they had to spend a couple of weeks in jail on charges of "cheating distributors and unethical circulation of money", under provisions of the Prize Chits and Money Circulation Schemes (Banning) Act 1978 (PCMC Act).

The Act gives power to the police to seize, seal and arrest on the basis of a complaint. The direct selling sector's brush with provisions of this Act was not new, and it left many players with bruised egos for many years. The pet peeve of the sector has been that law enforcement agencies often failed to draw a distinction between the pyramid marketing schemes run by direct marketers, and those of fraudulent money-pooling schemes.

Following the Pinckney episode, industry players stepped up efforts to clear the regulatory landscape for the direct-selling segment. Last week, the central government for the first time came out with guidelines to regulate the sector. These included provisions to protect consumers and bringing the relationship between companies and their agents under the provisions of the Indian Contract Act, 1872. While stepping up compliance provisions for companies and their agents, the advisory to state governments was to set up a mechanism to monitor and supervise the activities of direct sellers. However, industry experts say this is just the beginning of a long journey for direct-selling players to give legal sanctity and protection to their business.

"These guidelines provide the definitional clarity to the direct selling sector," says Jitendra Jagota, chairman, Indian Direct Selling Association (IDSA), a self-regulatory body set up by industry players. The biggest takeaway from the guidelines, say industry players, is that it gives a clear definition of pyramid schemes, drawing a distinction between legitimate direct selling and the fraudulent money-pooling schemes. That takes care of a key concern of the sector with enforcement agencies often mistaking legitimate direct selling for fraudulent schemes.

As Jagota points out, it is too early for the sector to presume that the guidelines will give legal protection to direct selling. "The Department of Consumer Affairs has been named the nodal agency to deal with the issues related to direct selling and there has been reference to the Consumer Protection Act, 1986 in guidelines," says Jagota. But, this is yet to gain legal sanctity as the current Consumer Protection Act does not define direct selling.

According to consumer rights activist Bejon Kumar Misra, founder of Consumer Online Foundation, more clarity on the functioning of the direct selling sector will emerge only after the government includes the provisions of the guidelines in the proposed Consumer Protection Bill, 2015 which is expected to be taken up in the winter session of Parliament.

Moreover, action on implementation of these guidelines will shift to the states that have to come up with the mechanism to monitor and supervise the activities of direct sellers. "The next important step is to ensure the states adopt these guidelines quickly as that is where the implementation will happen," says Anshu Budhraja, CEO of Amway India.

State governments will need to adopt and implement these guidelines locally through regulation, which will have the legal force and effect, says Upasana Rao, partner, Trilegal.

IDSA's Jagota says that the PCMC Act still remains a concern at the state level. "We have to make the enforcement agencies in the states aware of the current guidelines," he adds. Moreover, relevant amendments are needed in the PCMC Act to clear schemes run by direct-selling companies from the scope of the Act.

Legal experts point out that while the guidelines make it easier for consumers to approach the consumer courts and obtain relief, they also provide a formal framework for players when it comes to their obligation towards consumer protection. Direct-selling entities are required to register themselves, have a physical office location and follow prescribed practices in engaging and training direct sellers. Moreover, direct sellers will be remunerated based on actual sales, and not recruitment of members. They are also expected to enter into written contracts directly or indirectly with the direct-selling entity.

There are some grey areas, too. "There is ambiguity as to whether a direct seller will fall under the definition of trader or consumer who buys goods for self-employment. Difficulties exist in proving the inter-se contractual arrangements and rights and obligations," says Akila Agarwal, partner, Shardul Amarchand Mangaldas & Co.

However, once the regulatory framework falls in place, industry players need to get their act in place. Ajay Khanna, country head, Herbalife International India, says the new guidelines will entail higher compliance costs for companies. "We need to educate our associates, and align our systems and processes in line with the new provisions."

The upside for the direct-selling sector, according to Vivek Katoch, director (corporate affairs) at Oriflame India, is that the lifting of regulatory haze and the resultant transparency in the operations will give Indian and foreign companies more confidence to invest and expand in the Indian market.

THEN, NOW & THE ROAD AHEAD

Direct selling is marketing of products & services directly to consumers in a person-to-person manner, bypassing fixed retail outlets

Market size

The market has grown at a CAGR of 16 per cent over the five year period from 2009-10 to 2013-14

(₹ cr)

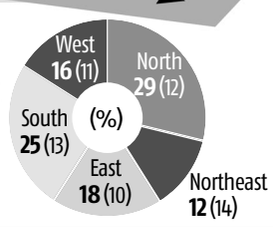
2009-10	4,100
2010-11	5,200
2011-12	6,400
2012-13	7,200
2013-14	7,500

- The industry has the potential to reach a size of ₹64,500 crore by 2025
- Globally, direct selling industry operates in over 100 countries with a market size of $167 billion

ILLUSTRATION: BINAY SINHA

North is largest market for direct selling, followed by South

Figures in brackets are growth rate



What do the guidelines entail

- Proposes to bring direct selling under the ambit of Consumer Protection Act, 1986
- Defines pyramid schemes, drawing a distinction between legitimate direct selling and fraudulent schemes
- Agreements between a direct selling company and its agents should comply with provisions of the Indian Contract Act, 1872
- State governments to set up a mechanism to monitor/supervise the activities of direct sellers

What next

- Guidelines need legal sanctity by incorporating its provisions under the Consumer Protection Act
- Prize Chits and Money Circulation Schemes (Banning) Act, 1978, still remains a concern at the state level
- Sensitise the enforcement agencies in the states of the provisions of the guidelines
- Companies have to align their business structures to comply with the guidelines

Sources: IDSA Annual Survey, 2013-14; Ficci Direct Selling Task Force, Ficci-KPMG Report Direct 2015

'Joint audit offers multiple advices for the same fee'

Recently a group of Indian audit firms, led by KS Aiyar & Co, arguably the oldest chartered accountancy firm in the country, pitched for making the practice of joint audit mandatory. **RAGHU AIYAR**, CEO & senior partner, KS Aiyar & Co, explains to **Sudipto Dey** how joint audit could help in curbing the growing influence of multinational audit firms in the country. Edited excerpts:

Q&A

RAGHU AIYAR

CEO & senior partner, KS Aiyar & Co

What is joint audit?

Joint audit is an eminent tradition that has stood the test of time. It is systematically visualised in Indian auditing standards. This includes allocation of work between joint auditors, their responsibilities, escalation of major issues (only) for joint discussion, and the opportunity to disagree by a separate report if one of the two or more auditors fails. The mechanics of joint audit are well set in not just the standards, but also in practice. Needless to say, joint audit is useful for larger companies.

How many countries have adopted this practice?

The joint audit approach has been tried and tested in several countries. This includes France, northern Europe, and our own public sector undertakings and nationalised banks, among others. Good governance is a natural by-product of the joint audit practice. Large corporations and their shareholders stand to gain.

Could you be more specific on the benefits of joint audit?

Firstly, two minds are always better than one. Audit is based on judgment, it is an opinion. Audit is not an accounting exercise. Businesses need auditors who are balanced. Two or more views provide better perspective. Moreover, joint audit has a built-in safeguard — it mitigates systemic risks. The objective of "rotation of firms" is accomplished directly, through a simple mechanism. Also, joint audits are more cost efficient. Joint audit doesn't double the cost while doubling the advice. Fees are a function of time. Work is divided. Fees under joint audit are substantially static. Joint audit defeats dangerous and corrosive anti-competitive concentration of work which is against India's national interest.

How will bringing in joint audit help in mitigating the adverse impact of audit concentration?

This is a burning issue for the Indian audit firms (IAFs) and joint audit is the solution proposed by IAFs. The multinational audit firms (MAFs) in India have cornered audit revenues in excess of ₹5,000 crore. The number of IAFs with more than 12 listed audits has reduced to only 20. Even these firms are unviable and weak. They are neither cross-subsidised by consulting, nor flush with foreign direct investment, nor do they enjoy a surrogate global brand power. All these issues were identified in two reports of the Institute of Chartered Accountants of India (in 2003 and 2011) as illegal. The total revenue of the top 20 IAFs is perhaps under ₹200 crore. IAFs are therefore on the verge of being wiped out. Undercutting (of fees) by the MAFs is rampant ever since it came to be considered "ethical" a few years back. Adding to this, MAFs plan to make ingresses into IAFs' client base with the upcoming practice of firm rotation. Joint audit, with the requirement of at least one IAF when the other is an MAF, redistributes work amongst hundreds of local and regional Indian audit firms which get oxygen for survival.

Why are MAFs resisting this proposal?

The reasons are quite obvious — joint audit takes a swipe at their fee. It provides an eminent, long-term alternative to the MAF monopoly.

If joint audit is made mandatory, would IAFs be open to sharing their clients with MAFs?

If a firm meets the requirements of the rule calling for mandatory joint audit, it would be equally applicable to all clients, be it of IAFs or MAFs.

How do you respond to the criticism that IAFs have not invested enough in systems and processes to build up scale?

The IAFs have been stressed financially since the entry of the MAFs through the consulting route and surrogate branding. There has been pressure on the IAFs of losing their best clients, best partners and best staff to the global MAFs who enjoy deep pockets. When the house is on fire, there is very little bandwidth — financially, and even less headroom, to do the rest. Given a level-playing field, IAFs can perform better than MAFs while maintaining the high standards they are known for.

Five constitutional conundrums in GST

SUJIT GHOSH

The Constitution (122) Amendment Bill enabling the introduction of the goods and services tax (GST) has recently been enacted. It is a landmark reform considering the sweeping changes it brings about in the indirect tax regime in India as well as in distribution of powers between the Centre and states vis-à-vis such taxes. Unfortunately, upon minute review of the amendments read with the provisions of the draft Model GST law, several constitutional issues emerge.

Definition of goods

The first challenge emerges in the form of the definition of 'goods' and 'services' under the Model GST law. Since inception, 'goods' was defined in the Constitution in a broad manner. Judicial decisions have thus far held goods to include intangible property such as off-the-shelf software, trademarks, and the sales tax levied on them. The definition of 'services' has now been added in the Constitution as "anything other than goods". While the Model GST law uses a similar definition for 'services', in a well intentioned move, it has deemed 'services' to include (and 'goods' to exclude) intangibles. While this was probably meant to mitigate tax-litigation/double-taxation on software, the question is when the Constitution has already defined the term 'goods' — which has been interpreted by the Supreme Court to include 'intangibles' — can the draft Model GST law deviate from the definition provided in the Constitution? Clearly, a plenary legislation such as the GST Act, cannot override the meaning ascribed to the words 'goods' in the Constitution and any derogation from such definition will make the plenary legislation ultra vires. Similar issues arise on actionable claims.

Taxing immovable property

That apart, when services are defined (in the Constitution) as anything other than goods, it clearly gives an impression that immovable property can fall within the ambit of services (for it is not goods). Under such a situation, there is a great apprehension, that where the power to levy GST has been conferred on supply of services, technically, the central government can levy GST on supply of land (in all its forms including a sale/transfer thereof) — giving rise to another controversy on legislative propriety qua enactment of laws relating to land.

Dispute resolution

The third challenge is apropos the GST Council, which is expected to be formed no later than November 12, 2016. According to the newly introduced Article 279A (11) of the Constitution, the GST Council shall establish a mechanism to adjudicate disputes between Union and states. At the same time, under our Constitution, any dispute between the Centre and states, or among the states themselves, has to be adjudicated by the Supreme Court of India under Article 131 under its original jurisdiction. Further, the Constitution envisages only two specific scenarios (under Articles 262 and 263) for resolution of disputes by Tribunals other than the Supreme Court. This raises serious concerns about the constitutional ability of the GST Council to adjudicate disputes. As it stands, the GST Council's power to frame dispute adjudication mechanism should be read merely as power to establish procedural conditions and certainly not any power to confer jurisdiction on any forum. To adjudicate such disputes, the adjudicatory power already vests with the SC under Article 131.

A reform as landmark as GST needs greater attention to detail from lawmakers

Power to levy CST

The fourth challenge emerges from the retention of Entry 92 A of List I (legislative powers of the central government) of the Constitution, which grants the power to levy central sales tax (CST) despite the recent constitutional amendment for GST. Retention of Entry 92A in its entirety essentially leads to the inference that the central government has retained the power to levy CST on all goods even after the coming into force of GST. It is interesting to note that in the recent constitutional amendment for GST, while Entry 84 of List I (which deals with excise duty) and Entry 54 of List II (which deals with sales tax) have been amended to restrict these duties (excise and sales tax) to only six goods, outside the GST purview, no such restriction has been made vis-à-vis Entry 92 A of List I (which deals with the power to levy CST).

In other words, unless the CST Act is abrogated, there is nothing that legally permits assessees from not paying CST in addition to GST, on all interstate sales. Are we, therefore, staring at an unintended dual tax regime on interstate supplies, namely CST and integrated GST?

Tax on declared goods

The fifth challenge can lead to significant surprise for the industry. It pertains to the fact that "declared goods" has had a special status under the Constitution and according to specific drill prescribed under Article 286(3), the state governments were restrained from taxing them at a rate higher than four per cent. This article has, however, been deleted by the 122 constitutional amendment Act, meaning that the states are now free to levy tax on 'declared goods' at any rate as it chooses, which can be as high as the rates applicable to general goods, namely, 12.5 per cent or more. On its own, this amendment has no negative effect, for all goods would be liable to GST, which does not contemplate any concept of declared goods. However, those goods which were declared goods and would not be within GST — such as petroleum crude and aviation turbine fuel for turbo props — can now be subject to value-added tax by the state governments, at a higher rate.

A reform as landmark as GST needs greater attention to detail from lawmakers. It would be unfortunate if 'one nation, one tax' leads to many litigations and worse still, a constitutional logjam.

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