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* IN THE HIGH COURT OF DELHI AT NEW DELHI

% Date of Decision: August 21, 2012

+ W.P.(C) 4431/2012

ISHAR GAS OIL PVT. LTD AND ORS. Petitioners
Represented by: Mr.N.K.Kaul, Senior Advocate
instructed by Mr.Vineet
Malhotra and Mr.Aseem
Chawla, Advocates.

versus

UNION OF INDIA & ORS. Respondents
Represented by: Mr.Rajeeve Mehra, A.S.G.
instructed by Mr.Jatan Singh,
Mr.Ashish Virmani and
Mr.Tushar Singh, Advocates.

CORAM:
HON'BLE MR. JUSTICE PRADEEP NANDRAJOG
HON'BLE MR. JUSTICE MANMOHAN SINGH

PRADEEP NANDRAJOG, J. (Oral)

CM No.10423/2012

1. Delay occasioned in filing counter affidavit is condoned. Counter affidavit is taken on record.
2. Application stands disposed of.

WP(C) 4431/2012

1. The debate between the parties centers on the meaning of the phrase: '*Contingent Liability on Revenue Account*'. The origin of the debate is the methodology prescribed in the Notice Inviting Tender to determine the 'Net Worth' of the bidder. The Net Worth has to be determined as follows:

- (a) Paid up capital.
- (b) Reserve and surplus.
- (c) Miscellaneous expenditure to the extent not written off.
- (d) $\text{Equity} = (a) + (b) - (c)$.
- (e) Contingent liability on revenue account.
- (f) $\text{Net Worth} = (d) - (e)$.

2. Whereas according to the writ petitioner, Contingent Liability to a Revenue Account would only be such sums as would be recorded in the balance-sheet which conform to the opinion dated July 15, 1962 of the Institute of Chartered Accountants of India in the following words:-

"The Committee is of the view that a contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations. However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", the committee is of the view that this does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance Sheet.

Section 126 of the Indian Contracts Act, 1872, defines a contract of guarantee as "a contract to perform the promise or discharge the liability, of a third person in case of his default". It is clear from this that the transactions of the kind referred to in the query are not guarantees.

For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit

etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due.

If, as a result of any such "guarantees" or undertakings given, an obligation has actually arisen, a provision should be made there against in the accounts e.g. if a company has "guaranteed" that a product manufactured and sold by it will give a certain performance, and the customer has claimed compensation because that level of performance has not been achieved, a provision for such liability should be made in the accounts. Again, if a company has "guaranteed" a loan given by bankers to a subsidiary company and the subsidiary has become insolvent, the company should make a provision in the accounts for the amount it may be called upon to pay. To take another example, it is customary for automobile manufacturers to "guarantee" the performance of the car for a period of time and to replace defective parts during that period. Such companies usually make a provision for contractual guarantee obligations in their accounts."

supplemented with a Guidance Note as per Para 8.8.7.2 in the Revised Schedule to the Companies Act 1956, issued by ICAI (as per December 2011 Edition) which reads as follows:-

"8.8.7.2

A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its

contractual obligations. However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance Sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers letters of credit etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities."

with additional argument based on Accounting Standard 29 which defines, as per the writ petitioner, Contingent Liability:

- (a) A possible obligation that arises from past events that existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
- (b) A present obligation that arises from past events but is not recognized because:
 - (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) A reliable estimate of the amount of the obligation cannot be made.

3. As per the writ petitioner the said aspect as to whether a guarantee issued for towards own obligations by the company towards payment of insurance premium deferred payment to suppliers and letters of credit are to be shown and treated as Contingent Liability is also dealt with the Guide to Company Balance Sheet Profit and Loss Account by Mr.V.S. Aggarwal wherein under the heading Contingent Liability it is noted as under:-

Guarantee given by Company

The company may in course of its business may stand guarantee for either persons including its directions or other officers. It is advisable to state, when practicable, the general nature and amount of each such contingent liability if material shall also be specified. However, where a company undertakes to perform its own obligations and for this purpose issue guarantee, it is not to be shown as contingent liability for example counter guarantee given to bank by a company for payment of insurance premium, deferred payment to foreign supplier, letter of credit etc."

4. The petitioner contends that letters of credit are executory contracts for purchase under which neither party has performed it's part of the contract. Executory contracts such as L/C's do not fall within the scope of AS-29. There is no probability of a liability being incurred and thus no question of a loss being estimated. Therefore a Letter of Credit is neither a liability nor a contingent liability and there is no requirement to record the L/C's in the Balance Sheet.

5. The petitioner submits that as a matter of prudence discloser is made, by way of foot note, in the balance sheet

which is in line with the prescription under Schedule-VI to the Companies Act, 1956.

6. Petitioner claims that Contingent Liability on Revenue Account is not defined in any Statute, Accountancy Book, Accounting Standards, Guidance notes and other pronouncements or in any publication issued by the Institute of Chartered Accountant of India (ICAI) and by National Advisory Committee on Accounting Standards (NACAS).

7. Thus, it is urged that since the phrase is not defined anywhere, to assimilate the phrase, "*Contingent Liability on revenue on account*", we can analyse the same by bifurcating it as following:

- i) Contingent Liability.
- ii) On Revenue Account.

8. The petitioner further urges that Contingent Liability, having been defined aforesaid, could be analyzed to the phrase 'On Revenue Account' as follows:-

(a) The term Revenue has been defined as follows, by various lexicons as under:

Black's Law Dictionary

Revenue. Gross income or receipts.

MITRA'S LEGAL AND COMMERCIAL DICTIONARY

Revenue. Gross income or receipts; earnings; intake; proceeds; return or yield.

The word 'revenue' is a word of somewhat indefinite import, but in its ordinary sense in relation to a business undertaking it connotes those incomings of the undertaking which are the products of or are incidental to the normal working of the undertaking. [London, Midland

etc. V. Anglo-Scottish Railways, etc. 150 LT 361].

Revenue Account. *The account of a firm or a company showing the result of its operations and what profit or loss it has made. For the purpose of ascertaining profits arising from the business of a company, capital account and revenue account are prima facie to be treated as separate accounts. The credit balance of revenue account is applicable for dividend.*

WHARTONS LAW LEXICON

Revenue – *Income, annual profit received from land or other funds;*

Revenue Account *is thus the profit and loss account annually drawn by the enterprise.*

(b) A collective and conjoint reading of the said connotations do suggest that Contingent liability on Revenue account would thus mean any contingent liability which would directly impact the profit and loss account.

To illustrate the same:

a. Estimation of warranties by a Car Company.

b. On account of past experience a Car Company would estimate that one of ten thousand cars would have an engine failure in warranty which would be required to be replaced free. Accordingly a provision would have to be made in the profit and loss account (Revenue Account). The same would not be regarded as Contingent Liability, considering the provision has been made. The same is an ascertained liability and not Contingent Liability.

The Supreme Court in *Bharat Earth Movers Vs. Commissioner of Income Tax, Karnatak* as reported in 2000 (6) SCC 645 relying upon its

earlier decision rendered in the case of Metal Box Company Vs. Workmen held as under:-

“4. The law is settled: if a business liability has definitely arisen in the accounting year; the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in present though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain.”

(c) Further to explain the said distinction between the following examples have been illustrated hereinbelow:

Contingent Liability on Capital Account:

Suppose a company is in the manufacture of car decides to sell its surplus land, the sale is challenged either by buyer or somebody else stating that the company has not title.

Transaction of sale may get annulled at a future point of time. This transaction would therefore be one of the Contingent Liability on Capital Account Act.

Contingent Liability on Revenue Account.

Suppose a company is in the manufacture of cars, sells a car to a person the car has frequent break downs as per the buyer. The buyer sues the company for damages. It is impossible to estimate the result of the claim/court case. If damages are found against the manufacturer and payment has to be made, the same would result in an expenditure which would be a

charge on profits. The liability crystallize upon final decision of the case, till such time it shall remain as Contingent Liability on Revenue Account.

9. But, according to the respondents, amounts which ultimately would be debited to the Revenue would have to be treated as Contingent Liability on Revenue Account.

10. We note that the officers concerned with the Notice Inviting Tender have held various deliberations, minutes whereof have been recorded from time to time and as regards the two rival viewpoints pertaining to the writ petitioner, in the minutes of the 4th meeting of the Empowered Committee of Secretaries (ECS) held on July 09, 2012 have noted on the subject with respect to the balance-sheet of the writ petitioner, to be specific, in para 2.3.1 of the minutes as under:-

“2.3.1. M/s. Ishar Gasoil Pvt. Ltd. clarified that LCs were obtained for the purpose of procurement of goods for trading and BGs were obtained as surety or guarantee to statutory organizations. M/s. Ishar Gasoil Pvt. Ltd. in their letter dated 03.05.2012 stated that “contingent liability on revenue account is nil and share application money received as subscription against issued share capital is non refundable. This was certified by their statutory auditors and the net worth certificate was given for Rs.134.32 crore (US\$ 30.01 million). Contingent liability on revenue account means on account of any amount of demand created by revenue authority such as Income Tax, Sales Tax, etc.” Head (NELP), DGH clarified that as per NIO “contingent liability on revenue account” should be deducted for calculation of net worth. Accordingly, both LC and BG reported under the head contingent liability were deducted by DGH from equity and net worth was evaluated to be insufficient. Except contingent liability on account of “Capital Commitments” disclosed by the bidders in their Annual Reports, all other items of contingent

liability reported by the bidders in their Annual Reports as per Accounting Standard (AS-29) issued by ICAI were considered for the purpose of net worth sufficiency. ECS was apprised that there has been no definition in any ICAI standards that contingent liability on revenue account means on account of any amount of demand created by revenue authority such as Income Tax, Sales Tax, etc. Further, Share Application Money, against which shares were not issued as on 31.03.2010, being not a part of Paid-up Capital as per Companies Act, 1956 Part-I, Schedule VI was not considered for evaluation of net worth and the same is in line with the method given in the NIO. Head (NELP) informed ECS that the view of DGH on calculation of net worth has been supported by audit firm M/s. SARC & Associates who have concluded that the evaluation of net worth of M/s. Jay Polychem (India) Limited done by DGH is in accordance with the NIO. Any deviation from the said provisions would result in denial of level playing field to all bidders and could result in litigation."

11. It is apparent that as reflected, the minutes have recorded a stand which is against the one projected by the writ petitioner.

12. However, these are mere opinions. The final decision has to be taken by the Cabinet Committee on Economic Affairs.

13. It is trite that a decision making authority is bound to consider all the relevant material which has a bearing on the decision to be taken, and on the facts of the instant case, would mean the rival viewpoint projected by the writ petitioner and the respondents, and as extracted by us herein above.

14. Since the Cabinet Committee on Economic Affairs is yet to take a decision we hold the writ petition to be premature, but would simultaneously impress upon the

respondents to ensure that petitioner's viewpoint is placed before the Cabinet Committee on Economic Affairs and since the viewpoint stands crystallized by us in the present order, a copy of the present order be also placed before the Cabinet Committee on Economic Affairs.

15. Writ petition is dismissed as premature.

16. No costs.

Copy of the order be supplied dasti under signatures of the Court Master to learned counsel for the parties.

(PRADEEP NANDRAJOG)
JUDGE

(MANMOHAN SINGH)
JUDGE

AUGUST 21, 2012
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