

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% *Judgment Reserved on : February 18, 2013*
Judgment Pronounced on : March 05, 2013

+ **WP(C) 277/2013**

ISHAR GASOIL PVT. LTD. & ORS. Petitioners

Represented by: Mr.Mukul Rohatgi, Sr.Advocate
and Mr.Rajiv Nayar, Sr.Advocate
instructed by Mr.Vineet Malhotra,
Advocate.

versus

UNION OF INDIA & ORS. Respondents

Represented by: Mr.Rajeeve Mehra, Additional
Solicitor General instructed
by Mr.Jatan Singh,
Mr.AshishVirmani and Mr.Tushar
Singh, Advocates.

CORAM:

HON'BLE MR. JUSTICE PRADEEP NANDRAJOG

HON'BLE MS. JUSTICE VEENA BIRBAL

PRADEEP NANDRAJOG, J.

1. Notice Inviting Offers (NIO) for exploration of oil and natural gas pertaining to 34 exploration blocks required the bidder to have the requisite Financial Capability as per Condition No.VIII of the tender documents. Since the issue with which we are concerned relates to the 'NET WORTH CALCULATION' in the context of 'FINANCIAL CAPABILITY', we note said Condition No.VIII. It reads as under:-

VIII. INFORMATION OF FINANCIAL CAPABILITY

i) The bidder, in respect of each of the bidding company shall be required to furnish a certificate from the bidding company(ies) statutory auditors based on the latest completed year's audited annual accounts certifying that the net worth of the bidding company is equal or more than their share of expenditure of the Minimum Work Programme commitment (mandatory and biddable work programme)

ii) In case the certificate is based on the financial capability of the parent company, the parent company's financial and performance guarantee shall be required to be furnished by the company along with the annual report, annual accounts and net worth certificate in respect of parent company.

iii) In case a bidding company either bidding alone or as a consortium happens to be the best ranked bidder for two or more blocks, the net worth of the company shall be required to be equal to or more than its participating interest in the value of Minimum Work Programme commitment for all such blocks. In case, the company's net interest is less than its participating interest in the value of Minimum Work Programme commitment for such blocks, the bids will be considered in order of priority given by that company in their bids for respective blocks.

NET WORTH CALCULATION

The net worth of the bidding company/parent company shall be calculated in accordance with the method given below based on the latest completed year's audited annual account and annual report:

Name of the Company:

Sub-criteria	Amount * US\$MM
a) Paid up capital	
b) Reserve and surplus	

c) Miscellaneous expenditure to the extent not written off	
d) Equity = (a) + (b) = (c)	
e) Contingent liability on revenue account (details to be annexed) (i) (ii) (iii) Total contingent liability on revenue account	
f) Net worth = (d) – (e)	

Note : Exchange rate used, if applicable, to convert figure in US\$

**The above information should be provided for the year for which latest audited annual account and annual reports are available.”*

2. A reading of clause (i) of Condition No.VIII would reveal that the bidder should have a net worth, duly certified as per a certificate issued by the statutory auditor. The NET WORTH CALCULATION has to be as per the method prescribed i.e. (a) Paid Up Capital + (b) Reserve and Surplus – (c) Miscellaneous Expenditure to the extent not written off – (e) Contingent Liability on Revenue Account.

3. The petitioner submitted the offer as per bid documents.

4. All bids received were processed and were required to be considered by the Empowered Committee of Secretaries which met on September 02, 2011. The note put up by the Director General of Hydrocarbons (DGH) recommended rejection of petitioner’s bid on the opinion formed by the DGH that the petitioner did not have the requisite Net Worth since ‘Letter of Credit’ and ‘Bank Guarantees’ issued at the instance of the petitioner were required to be deducted being ‘**Contingent Liability on Revenue Account**’.

5. But the Finance Secretary was of the view that the Letters of Credit should not be considered as Contingent Liability.

6. The Empowered Committee of Secretaries took a decision at the meeting held on September 02, 2011 that advice from the Ministry of Corporate Affairs should be obtained : Whether the Letters of Credit have to be treated as Contingent Liability on Revenue Account?

7. Accordingly, an opinion was sought from the Ministry of Corporate Affairs, which opined :-

“There is no consolidated or universally applicable definition of ‘Net Worth’ as a legal provision. A statement (Annexure-III) placed below illustratively gives definitions or constituents of ‘Net Worth’ for the purposes of the Companies Act, and the Regulations of the Reserve Bank of India and the Securities and Exchange Board of India (SEBI). This Ministry is not aware if any of these definitions or methodology can be applied to determine eligibility of a bidder with regard to ‘Net Worth’ in a bidding process where the ‘NIO’ stipulates how this qualification is to be ascertained. Accordingly, the question whether outstanding Letters of Credit may be considered for computing ‘Net Worth’ of a bidder on the ground that this is as per the stipulation of the NIO also falls beyond the purview of the Ministry.”

8. Since the advice received from the Ministry of Corporate Affairs threw no light on the subject, at the meeting held on October 17, 2011, the Empowered Committee of Secretaries decided:-

“ECS decided that a certificate may be obtained from all the bidders certified by their Statutory Auditors that in computation of Net Worth, the bidders have deducted all outstanding LCs and Bank Guarantees. Thereafter, decision made in the last meeting of ECS held on 2.9.2011 on recommendations would be reviewed, if required.”

9. The petitioner obtained an opinion from *S.R.Batliboi & Co.*, a reputed firm of Chartered Accountants, highlighting that as per Accounting Standard 29 (AS-29) the provision pertaining to Contingent Liability required only such liability to be treated as Contingent Liability where *‘a possible obligation may arise from past events and the 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 a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or a reliable estimate of the amount of the obligation cannot be made’*, and forwarded the same to the Ministry of Hydrocarbons, and in response received a letter dated December 31, 2011 (not wishing good wishes in the ensuing New Year 2012) requiring petitioner to obtain and furnish from the Statutory Auditor a certificate that while computing the Net Worth of the petitioner as on March 31, 2010, the stipulated date, amounts as per outstanding Letters of Credit and Bank Guarantees were deducted.

10. The petitioner furnished a list of all outstanding Letters of Credit issued by banks at the asking of the petitioner as also various Bank Guarantees issued at the asking of the petitioner, but simultaneously highlighted that the Letters of Credit pertained to goods which petitioner would be purchasing for purposes of trading in the goods; not being capital goods.

11. At the 3rd meeting of the Empowered Committee of Secretaries held on February 16, 2012, it was decided that the petitioner should clarify the specific nature of all Letters of Credit issued at its

behalf as also the bank guarantees issued at its instance and whether the same were on Revenue Account or not.

12. The petitioner gave the necessary information pertaining to the Letters of Credit and the Bank Guarantees while maintaining that the same could not be treated as its Contingent Liability and hence the question of the same being treated as Contingent Liability on Revenue Account did not arise.

13. By May 24, 2012, the Director General of Hydrocarbons obtained an opinion from a firm of Chartered Accountants :SARC & Associates, opining that the amount covered by all the Letters of Credit and Bank Guarantees opened/issued at the instance of the petitioner, as also all other bidders, should be treated as Contingent Liabilities on Revenue Account.

14. Treating the opinion of M/s.SARC& Associates as a correct reflection of what would be required to be treated as a Contingent Liability on the Revenue Account, deducting the limits of the Letters of Credit and the amounts reflected in the Bank Guarantees, the Empowered Committee of Secretaries decided at its 4th meeting held on July 09, 2012, that the petitioner did not meet the Net Worth criteria and thus a recommendation was made, to be considered by the Cabinet Committee of Economic Affairs; the final decision making authority, to treat petitioner as not technically qualified.

15. The petitioner came rushing to this Court by and under WP(C) No.4431/2012 praying that the decision taken by the Empowered Committee of Secretaries on July 09, 2012 be quashed and it be declared that while computing the Net Worth of the petitioner, the value of Letters of Credit and Bank Guarantees issued/opened on behalf of the petitioner

in favour of third parties be excluded inasmuch as they did not represent the Contingent Liability on Revenue Account as per AS-29.

16. Since the Cabinet Committee on Economic Affairs had yet to take a decision, the writ petition was disposed of as premature vide order dated August 27, 2012, but a direction was issued that the entire material on which the petitioner was relying and in particular AS-29 would be placed before the Cabinet Committee on Economic Affairs.

17. The Office of the Prime Minister of India directed on October 25, 2012, that the matter should be reconsidered by the Empowered Committee of Secretaries once again, and thus at the 5th meeting held on November 26, 2012 the Empowered Committee of Secretaries met and rejected the stand taken by the petitioner; taking the opinion:-

'After discussion and deliberations on the Net Worth Calculations Method given in format for submission of bids of the Notice Inviting Offer (NIO), ECS came to the conclusion that there is no uniform definition of Net Worth available from ICAI, guidance or notes with regard to deductibility of Contingent Liabilities such as LCs. NIO stipulates that all Contingent Liabilities on Revenue Account be deducted while arriving at Net Worth and there is no dispute that Letters of Credit and BG are contingent liabilities on revenue account. The methodology of such computation of Net Worth by deducting LCs was applied uniformly to all bidders namely RIL, HPCL, GAIL and laC in NELP-IX. Therefore, there is no need for any deviation on this account.

18. On January 10, 2013, the Cabinet Committee on Economic Affairs accepted the recommendations of the Empowered Committee of Secretaries resulting in the writ petitioner being held to be disqualified inasmuch as after deducting the amounts pertaining to all Letters of

Credit issued on behalf of the petitioner as also deducting amounts covered by the Bank Guarantees issued at the asking of the petitioner, the Net Worth fell.

19. Our job is simple. Has the Empowered Committee of Secretaries rightly opined that there is no uniform definition of Net Worth available with Institute of Chartered Accountants of India (ICAI) and further that it was an undisputed position that all Letters of Credit and Bank Guarantees would be Contingent Liabilities on Revenue Account. And we highlight that the view taken by the Committee is that : *‘there is no dispute that Letters of Credit and BG are contingent liabilities on revenue account.’*

20. The petitioner had filed before the Empowered Committee of Secretaries opinions rendered by the Expert Advisory Committee of the Institute of Chartered Accountants of India published on pages 10 to 12 of Volume 1 of the 3rd Edition of the COMPENDIUM OF OPINIONS, as per query No.1.9; and the opinion relating thereto which is as under:-

“1.9 *Query*

Classification and Definition of “Contingent Liability” – 1.

It is observed from published accounts of many a company that the following items is appended under the head “Contingent Liabilities”.

“In respect of guarantee and counter-guarantee given by the Company against guarantee given by a Bank on behalf of the Company.....”

The arrangement is that Bankers of the Company furnish guarantee to the third parties for the due performance of the contract by the Company, for which they in turn demand counter-guarantee from the Company.

To us, it appears that mention of the same as contingent liability of the Company is inappropriate. It would be the contingent liability of the Bank and not the Company, and as such, should have properly occurred in the Accounts of the Bank. In the event of breach of performance of the contract on the part of the Company, it would be an accrued and crystallized liability and not nearly a contingent liability.

What is the correct accounting procedure to be adopted in such case for the purpose of preparation of accounts of the Company in accordance with the requirements of the Companies Act, 1956?

July 15, 1962”

“Opinion

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 thereagainst 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.”

21. The petitioner had obtained and supplied to the Empowered Committee of Secretaries, the Guidance Note on the Revised Schedule VI to the Companies Act 1956, explaining in paragraphs 8.8.7.1 and 8.8.7.2 as under:-

“8.8.7.1 The provisions of AS-29 *Provisions, Contingent Liabilities and Contingent Assets*, will be applied for determining contingent liabilities.

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 contractual 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.”

22. The petitioner had annexed Accounting Standard (AS) 29 issued in the year 2003 containing the definition of ‘**CONTINGENT LIABILITY**’, which reads as under:-

“A contingent liability is :

(a) a possible obligation that arises from past events and the 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.”*

23. The same very documents were relied upon during hearing of the writ petition.

24. As noted by us above, the Empowered Committee of Secretaries has opined, which opinion has been accepted by the Cabinet Committee on Economic Affairs to reject the bid of the petitioner, that it is undisputed that Letters of Credit and Bank Guarantees are Contingent Liabilities on Revenue Account. But, Shri Rajeev Mehra, learned Additional Solicitor General of India representing the respondents conceded that this statement was incorrect. On the contrary, the stand taken by the respondents was that there is no authoritative text defining what would be a '*Contingent Liability on Revenue Account*'. But since AS-29 defined what a Contingent Liability would be, learned Additional Solicitor General rightly urged that the determination of 'Contingent Liability on Revenue Account' required a determination : Whether or not a particular item falls as being a '*Contingent Liability*' and if it did, only then the second question would have to be considered : '*Whether it was on the Revenue Account.*'

25. Learned Additional Solicitor General pointed out that as per petitioner's balance-sheet, for the period ending March 31, 2010, all Letters of Credit and Bank Guarantees were disclosed in the '*Notes of Account*', and thus it was urged that this would be an admission on the part of the petitioner that all Letters of Credit and Bank Guarantees issued at its instance would be Contingent Liabilities to the Revenue Account.

26. Learned Additional Solicitor General had conceded that a Capital Expenditure is an amount spent to acquire or improve a long term asset such as an equipment or a building which may be used for an '*enduring benefit of trade*' and a Revenue Expenditure would be an amount that is expensed immediately and matched with the revenue in the

current accounting period and would include expenditures incurred in the normal course of business i.e. trading of goods.

27. This makes our task simple.

28. Black's Law Dictionary defines REVENUE to mean 'gross income or receipts'. As explained in the decision 150 LT 361 London Midland v. Anglo-Scottish Railways, 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 an incidental to the normal working of the undertaking.

29. Thus, 'Revenue Account' would mean 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, the Capital Account and Revenue Account are to be treated as separate accounts. Thus, if we look at the concept of a Revenue and a Revenue Account we do get suggested that 'Contingent Liability on Revenue Account' would mean any Contingent Liability which would directly impact the profit and loss account.

30. But as the learned Additional Solicitor General conceded, that the analysis of the phrase '*Contingent Liability to Revenue Account*' is a two stage analysis, requiring firstly to determine as to what would be a 'Contingent Liability', we cannot but overlook the fact that an Expert Body in the field of Specialized Knowledge i.e. the Institute of Chartered Accountants of India, has opined that only such guarantees could be treated as Contingent Liabilities when the company issues the guarantee to another person on behalf of a third party. Similar is the concept under

clause 8.8.7.2 of AS-29, which further clarifies that Letters of Credit cannot be treated as Contingent Liabilities.

31. It has to be highlighted that the Letters of Credit issued at the asking of the petitioner pertained to trading goods.

32. The matter can be looked at from another angle. The moment the beneficiary of the Letter of Credit raises the Bill of Exchange under the Letter of Credit (the same would be on simultaneous dispatch of the goods) the bank pays the credit and simultaneously debits the account of its client. No doubt, the Revenue outgoing would be reflected in the Revenue Account i.e. in the Expenditure column of the account book of the company, but at the same time the goods acquired would be duly entered in the stock register and for the purposes of the balance sheet of the company the value of the goods would be reflected as a 'Stock in Trade'. In the Net Worth calculation of the company, the value of the goods as a Stock in Trade would have to be taken into account and thus with respect to Letters of Credit which pertain not to capital goods but trading goods, the question of the value of the Letters of Credit being shown as Contingent Liabilities to the Revenue Account would not even arise.

33. We find that in the opinions formed by the Empowered Committee of Secretaries, repeated emphasis is being laid that there is no uniform definition of Net Worth and that it is an undisputed position that Letters of Credit and Bank Guarantees are Contingent Liabilities on Revenue Account. The former i.e. there is no uniform definition of Net Worth may be a correct opinion for the reason it would be open to any party which wants to conduct business with a third party to stipulate how it would like to determine the Net Worth of the opposite party, but the

opinion that it is an undisputed position that Letters of Credit and Bank Guarantees are Contingent Liabilities on Revenue Account is wrong.

34. The concept of Revenue Account is well-defined. The concept of Contingent Liability for Accounting Standards has to be determined with reference to AS-29 and for which we have referred to paras 8.8.7.1 and 8.8.7.2 above. We have also referred to the opinion of an Expert Body in the field i.e. the Expert Advisory Committee of the Institute of Chartered Accountants of India, as per which the Letters of Credit and Bank Guarantees in question (being not issued by the petitioner on behalf of a third party) cannot be treated as Contingent Liabilities and thus the amounts thereof cannot be treated as 'on Revenue Account'.

35. The submission that the Chartered Accountant of the petitioner had, in the 'Notes of Accounts' to the Audited Balance Sheets, made a disclosure of the Letters of Credit and the Bank Guarantees and hence the same have to be treated as Contingent Liabilities overlooks that the amounts reflected in the Letters of Credit and the Bank Guarantees are disclosed 'Below the Line' in the balance sheets and not as an item in the balance sheet.

36. An economic event is known as a happening of consequence to a business organization which consists of transactions measurable in monetary terms. A written record of the economic events measurable in monetary terms would be an 'Account'.

37. In the year 1941, The American Institute of Certified Public Accounts (AICPA) had defined accounting as the art of recording, classifying and summarizing in a significant manner, in terms of money, transactions and events which are, in part at least, of financial character,

and interpreting the result thereof. With greater economic development resulting in changing role of accounting, its scope became broader. IN the year 1966, the American Accounting Association (AAA) defined accounting as '*The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of information.*' In the year 1970, the Accounting Principal's Board of AICPA emphasized that the function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions.

38. Accounting can therefore be defined as the process of identifying, measuring, recording and communicating the required information relating to the economic events of an organization to the interested user of such information.

39. Over the centuries, accounting has remained confined to the financial record-keeping functions of the accountant. But, today's rapidly changing business environment has forced the accountants to re-assess their roles and functions, both within the organization and the society. The role of an accountant has now shifted from that of a mere recorder of transactions to that of the member providing relevant information to the decision-making team. Broadly speaking, accounting today is much more than just book-keeping and the preparation of financial reports. Accounts are now capable of working in exciting new growth areas such as : forensic accounting (solving crimes such as computer hacking and the theft of large amounts of money on the internet); e-commerce (designing web-based payment system); financial planning, environmental accounting, etc. This realization came due to the fact that accounting is capable of providing the kind of information that managers

and other interested persons need in order to make better decisions. This aspect of accounting gradually assumes so much importance that it has now been raised to the level of an information system. As an information system, it collects data and communicates economic information about the organization to a wide variety of users whose decisions and actions are related to its performance.

40. Since many users need financial information in order to make important decisions, it would be useful to note that today users are divided into two broad categories : *Internal Users* and *External Users*. Internal users would be : Chief Executive, Financial Officer, Plant Managers, Store Managers, Business Unit Managers, Line Supervisors etc. External users would include : present and potential Investors (Shareholders), Creditors (Banks and other Financial Institutions, Debenture-Holders and other Lenders), Tax Authorities, Regulatory Agencies (Department of Company Affair, Registrar of Companies, Securities Exchange Boards, Labour Unions, Trade Associations, Stock Exchange and Customers etc.). Since the primary function of accounting is to provide useful information for decision-making, it is a means to an end, with the end being the decision that is helped by the availability of accounting information. Thus, providing accounting information '*Below the Line*' in the balance-sheets of a company has got nothing to do with the concept of 'Contingent Liability on Revenue Account'.

41. The writ petition is accordingly allowed and the decision taken to treat the Letters of Credit issued by the petitioner for purchasing trading goods is held to be premised on wrong assumptions and ignoring the known accounting principles. At this stage, we would like to note that ShriMukulRohatgi, learned senior counsel for the writ petitioner

stated that though the writ petitioner does not accept the position that the Bank Guarantees issued on behalf of the writ petitioner would be Contingent Liabilities but an analysis thereto may be ignored and the amount reflected therein may be deducted while computing the Net Worth of the petitioner on the assumption that the said amount would be a Contingent Liability on Revenue Account since the amount was petty and made no difference is included.

42. The matter would now be placed once again before the Cabinet Committee of Economic Affairs along with the present decision. The tender would be finalized only thereafter.

43. No costs.

(PRADEEP NANDRAJOG)
JUDGE

(VEENA BIRBAL)
JUDGE

MARCH 05, 2013
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