

CPU NO. 956

23

**TWENTY - THIRD REPORT**  
**COMMITTEE ON PUBLIC UNDERTAKINGS**  
**(2012-2013)**

**(FIFTEENTH LOK SABHA)**

**EXPORT OF GOLD JEWELLERY BY MSTC LTD.**

**MINISTRY OF STEEL**

**[BASED ON PARA NO. 17.2 OF C&AG REPORT NO. 3 OF 2011-12]**



**Presented to Lok Sabha on 30.04.2013**

**Laid on the Table of Rajya Sabha on 30.04.2013**

**LOK SABHA SECRETARIAT**  
**NEW DELHI**

**APRIL 2013 / VAISAKHA 1935(S)**

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**COMPOSITION OF THE  
COMMITTEE ON PUBLIC UNDERTAKINGS  
(2012-2013)**

**Chairman**

**Shri Jagdambika Pal**

**Members, Lok Sabha**

2. Shri Hansaraj Gangaram Ahir
3. Vacant\*
4. Shri Bansa Gopal Chowdhury
5. Dr. Mahesh Joshi
6. Shri Shailendra Kumar
7. Dr. (Smt) Botcha Jhansi Lakshmi
8. Shri Vilasrao Baburaoji Muttemwar
9. Shri Adhalrao Shivaji Patil
10. Shri Ponnamp Prabhakar
11. Shri Rajendrasinh Rana
12. Shri Nama Nageswara Rao
13. Shri Uday Shri
14. Dr. Prabha Kishor Taviad
15. Shri Bhisma Shankar alias Kushal Tiwari

**Members, Shri Sabha**

16. Shri Anil Desai
17. Shri Janardan Dwivedi
18. Shri Naresh Gujral
19. Dr. V. Maitreya
20. Shri Mukhtar Abbas Naqvi
21. Shri T.M. Selvaganapathi
22. Dr. Janardhan Waghmare

**SECRETARIAT**

- |                         |                   |
|-------------------------|-------------------|
| 1. Shri A. Louis Martin | Joint Secretary   |
| 2. Shri Girdhari Lal    | Committee Officer |

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\* Vacancy caused due to passing away of Shri Ambica Banerjee, M.P. on 25 April, 2013.

## INTRODUCTION

I, the Chairman, Committee on Public Undertakings (2012-13) having been authorized by the Committee to submit the Report on their behalf, present this Twenty-third Report on Export of Gold Jewellery by MSTC Limited based on para No.17.2 of the Comptroller & Auditor General of India Report No. 3 of 2011-12 for the year ended March 2010, Union Government (Commercial).

2. The Committee took evidence of the representatives of Ministry of Steel and MSTC Ltd. on the subject at their sitting held on 19 April, 2012. The Committee also took evidence of the representatives of Central Bureau of Investigation and Enforcement Directorate at their sittings held on 26 April and 15 June, 2012 respectively before taking further evidence of the representatives of the MSTC Ltd., Ministry of Steel, CBI and ED on 31 July, 2012. Thereafter, the Committee took the evidence of Export Credit Guarantee Corporation and ex-CMD of MSTC Ltd. separately at their sitting held on 11 January, 2013.

3. The Committee on Public Undertakings considered and adopted the Report at their sitting held on 26 April, 2013.

4. The Committee wish to express their thanks to the representatives of Ministry of Steel, MSTC Limited; CBI; ED; ECGC and former CMD of MSTC for tendering evidence before them and furnishing the requisite information to them in connection with the examination of the subject.

5. The Committee would like to place on record their appreciation for the assistance rendered to them in the matter by the Office of Comptroller and Auditor General of India. The Committee also place on record their appreciation for the assistance rendered to them by the officials of the Lok Sabha Secretariat attached with the Committee.

6. For facility of reference and convenience, the Observations and Recommendations of the Committee have been printed in bold letters in Part-II of the Report.

**New Delhi  
29 April, 2013  
9 Vaisakha 1935 (S)**

**JAGDAMBIKA PAL  
Chairman  
Committee on Public Undertakings**

# REPORT

## PART I

### BACKGROUND ANALYSIS

#### Introductory

MSTC Limited is a Category-I Mini Ratna Public Sector Schedule B Company under the administrative control of the Ministry of Steel, Government of India. The Company was set up on 9 September 1964 to act as a regulating authority for export of ferrous scrap. MSTC became a subsidiary of SAIL in 1974. In 1982 it became an independent Company under the Ministry of Steel. It was a canalizing agency for import of ferrous scrap till 1992. The Company has now grown into a large multi product diversified trading Company.

#### Audit Paragraph

2. This report is based on para 17.2 of the C&AG's Report No. 3 (Commercial) of 2011-12 containing the review of the Company's records relating to export of Gold Jewellery during 2007-08 and 2008-09. The audit findings on the subject are reproduced at Appendix-I.

3. According to the Audit, the Company on being approached by three merchant exporters/ traders (associates) decided in July 2007 to enter into a new business of export of gems and gold jewellery on post-shipment basis without opening letter of credit. As per the arrangement agreed for new business, the associates were required to select foreign buyers, obtain export orders and export the articles in the name of the Company and the Company was required to pay up to 80 percent of the export bill to the associates as advance by discounting the bills from the bank and the balance 20 percent was released to the associates on collecting the full value of the export proceeds from foreign buyers. During 2007-08, gold jewellery worth Rs.260.63 crore was exported to 29 foreign buyers in Dubai under the above arrangement with the three associates and the entire export proceeds were fully recovered. The Company received Rs. 3.91 crore as service charges in the above business. In 2008-09, six associates (including three of 2007-08) exported gold jewellery worth Rs. 638.20 crore to 47 foreign buyers with the insurance coverage from Export Credit Guarantee Corporation of India Limited (ECGC) and ICICI Lombard (ICICIL). 46 foreign buyers did not pay their dues amounting to Rs.598.63 crore. An amount of Rs. 611.79 crore remained unrecovered from the associates towards the advances paid to them and related financial charges incurred by the Company. The Company lodged claims with the insurers for non-payment of dues by the foreign buyers. However, the claims were rejected by both the insurers.

4. The various aspects relating to the subject matter in the light of audit observations have been dealt with in the succeeding paragraphs of this Report.

#### A. New business of export of Gold Jewellery

5. According to the information furnished to the Committee, MSTC had appointed a firm of consultant viz. National Productivity Council (NPC) to prepare a Corporate Plan for short, medium and long term (10-12 years horizon) and the report was submitted by NPC in April, 2007.

6. In their subsequent note, the Ministry of Steel stated that the Corporate Planning study submitted by National Productivity Council in April 2007 was approved by the Board of Directors in their 225th meeting held on 28.09.2007 (Item no. 225/19). The NPC analysis revealed prospects for trading in various commodity groups and accordingly MSTC diversified into many commodities and sale figures during the relevant financial years are as mentioned below:

Sl. No.	Commodity	Sale ( Rs. In Crore )				
		07-08	08-09	09-10	10-11	11-12
1.	Coal	1219.35	2078.72	2064.81	2517.35	2019.9
2.	Steel	1445.40	1518.39	555.63	1354.09	1883.8
3.	Iron Ore	1053.42	1266.27	1374.90	1830.75	450.83
4.	Manganese Ore	-	9.72	-	152.43	68.23
5.	Oil & Natural Gas	2626.27	3019.44	2157.52	-	-
6.	Petroleum Products	-	-	205.19	-	1294.0
7.	Gems & Jewellery	260.63	638.21	-	-	-

7. On being enquired about the steps taken by the company to familiarize itself before entering in the new business of export of gold jewellery, the Company in its written note, *inter-alia* stated as under:

- a) The proposal for diversification of business to export gems and gold jewellery was discussed in several meetings among the officials of MSTC. In the meeting a detail report of NPC was discussed and the proposal was accepted.
- b) A workshop was organized on credit insurance, in the office of MSTC on 13/06/2007 where Insurance consultant of MSTC, representative of M/s. Willis BA (insurance broker empanelled by ECGC) and the representative of The Oriental Insurance Company Ltd. were present. Several rounds of discussion took place and correspondences were exchanged between officials of ECGC, The Oriental Insurance Company Ltd and MSTC before entering the export business on D/A (Documents on Acceptance) basis.
- c) The MOA entered into by State Trading Corporation (STC) and the party and the export documents such as export Invoices, Packing List, Hall marking certificate, Air Way Bill, GR Form, Valuation Certificate, Transit Insurance Certificate, Copy of Export Order and Forex Realization Certificate were examined and MOA was drafted which was an improvement upon the STC MOA as it was envisaged in MSTC MOA that the document would be routed through the banking channel.
- d) There was inherent risk in exporting on DA basis. After the presentation made by the Insurance Co and Consultant, it was then decided to obtain approval of the Board and formulate a policy of Export of Gems and Gold Jewellery. The New Business in the Export Front was placed before the Board in its meeting held on 19.06.2007. Board while agreeing the proposal in Principle, wanted a separate note on risk management and payment procedure with reference to RBI guidelines which was circulated to all directors.

- e) After analysis of the risk and payment procedure as per RBI guidelines, the item was again placed before the Board of Directors in the form of Resolution by circulation. Perceptible risks involved in the transaction were annexed to the note. The resolution was passed by circulation. Accordingly resolution was passed on 07.07.2007.”

8. In the light of the fact that the decision to enter into the new business was taken through a resolution by circulation rather than placing the same before the Board of Directors in a meeting, the Committee desired to know about the procedure generally followed in similar cases, the Secretary, Ministry of Steel in his deposition before the Committee on 19<sup>th</sup> April, 2012 stated as under:

“ Sir, the correct procedure is that ‘by circulation’, only those extremely urgent and routine types of matters should be brought up for circulation..... My personal view is that such a serious decision should have been done after a lot of discussion amongst the Board Members but unfortunately it was just circulated.”

9. When asked why the important matter relating to risk management and payment procedures for new business was not discussed and deliberated upon in formal Board meeting, the then CMD of MSTC during his deposition before the Committee on 11 January, 2013 stated as under:

“As far as I recall in the note placed before the Board it was clearly stated that the proposal was for export on D/A basis and not on the basis of L/C. It was also stated that MSTC would take export credit insurance policy to cover its risk. The Board after deliberations, as far as I recall advised us to examine if this was compatible with RBI regulations and to recast the note accordingly. Obviously the Directors did not feel the need for further deliberations in a regular Board meeting, in which case they would not have approved it. I may mention that approval by circulation requires the approval of every Director, **(including the Ministry’s nominee)** while in a Board meeting approval of a majority of the Directors present suffices.”

10. As regard the factors taken into consideration for granting approval for the new business of export of gems and gold jewellery, the Company in its written note stated that the then Board of Directors of MSTC Ltd. had taken the following factors into consideration:

- a) The procedure of export i.e. to associate with the manufacturers/traders who export gems, jewellery etc.
- b) Exporter would be MSTC
- c) Associates would make shipment while MSTC would be the Exporter.
- d) Associate would make shipment against the export order at their own cost.
- e) On receipt of export document duly accepted, MSTC would pay upto 85% of export value towards supply of material. (Though ultimately up to 80% of the export value was paid.)
- f) There was inherent risk in exporting on DA basis. After the presentation made by the Insurance Co and Consultant, it was decided to obtain approval of the Board and formulate a policy of Export of Gems and Gold Jewellery. The New Business in the Export Front was placed before the Board in its meeting held on 19.06.2007. Board while agreeing the proposal in Principle, wanted a separate note on risk management

and payment procedure with reference to RBI guidelines which was circulated to all directors.

- g) After analysis of the risk and payment procedure as per RBI guidelines, the item was again placed before the Board of Directors in the form of Resolution by circulation. Perceptible risks involved in the transaction were annexed to the note.
- h) In the event of non-payment by the overseas buyer, the claim would be lodged to Insurance Co/ Underwriter as per standard procedure.
- i) The two risks were involved in the business of export of gems and jewellery.
  - a) Risk of Performance i.e. actual export of material to buyers as per the Purchase Order satisfying quality and quantity requirements and
  - b) Risk of realization of export proceeds.

11. The first risk was covered by paying for the cost of material exported only after the unconditional acceptance by the buyer without demur and routing the document through the banking channel. The payment of cost of jewellery was also partial i.e. up to 80% of the value.

12. The second risk was covered by taking insurance from Insurance Company namely Export Credit Guarantee Corporation and ICICI Lombard General Insurance Company against three eventualities- Protracted Default by the overseas buyer, Insolvency of the overseas buyers and thirdly Political and Commercial Risks. ECGC in their web site as well as in their advertisement urge exporters to export and they claim to undertake the responsibility for the credit payment. Accordingly, MSTC's model took care of all perceivable risk factors before going for this new business."

13. Asked whether the approval of the Ministry was also obtained for the new business, the Company in its written reply stated that the decision to enter into the new business was taken at the level of the Board of Directors of MSTC Ltd., in which, the representatives of the Ministry of Steel, were members.

14. On the prudence of the decision to venture in to a new business of export of gold, the then CMD (Shri Malay Sengupta) during his deposition before the Committee on 11 January, 2013 stated as under:-

"This Company was a canalising company of the Government of India till 1991 February. Once that business was de-canalised, as far as I know, the Government never gave us any mandate to do anything. They never defined any role for us. The things came to such a pass that in 1998 the company got referred to the Disinvestment Commission and the Disinvestment Commission recommended that this company would soon enter into loss and, therefore, either you sell it off hundred per cent or you close it down. At that point, I had taken over as CMD in November 1997. We started two ventures both of which were totally new. We said that we had been importing scrap as a canalising agency as scrap market was terrible at that time. So, we re-defined our role as a bulk importer. We said: How can we help the company to survive and how can we prosper? So, we re-defined our role as a bulk importer. In between 1991-98 when the company was trying to exist as a merchant importer of scrap, there was a deal in which scrap was imported and had to be sold at loss some time in 1995 because the international prices had come down. On that, the CBI inquiry continued for ten years. We found that if the international market falls and there is a loss, we have to answer. So, how do we insulate ourselves from this market fluctuation? So, we



adopted an import policy. We adopted this e-auction business because we were physical auctioneers. We developed this so that we could earn a reasonable profit. I may point out that both these ventures were immensely successful. The Company was founded in 1964. It continued till 1998. In 34 years, it had made a total profit of about Rs.50 crore. From 1998-2009, in 11 years it made a profit of more than Rs.350 crore. The average profit earned during my tenure was around Rs.30 crore. As I mentioned, in all these years the Government never said that this is the mandate for your company, this is what you are required to do. We were a business venture. We were very much left on our own to do whatever we could. The only role that we could envisage for ourselves was that of a merchant trader, that of an international trader. Imports were our mainstay. Now the international trading house which does not have an export portfolio is a kind of an oxymoron. So we had all along wanted to export. We had all along wanted to develop an export portfolio but simply did not know how. In 2005, a professional market research agency was appointed to suggest what type of diversification in our trading basket we should make. They recommended that gold jewellery would be one item which we could try to export. They had a logic for that. The three topmost items of export from India are petroleum products, engineering products and gold and jewellery. As far as petroleum product is concerned, it is the preserve of four or five refineries. As far as engineering products are concerned, mostly after the auto ancillaries have come, the export has boomed. And it is very much dependent on process inspection and the designs. That left us with gold jewellery. We also found at that time that the State Trading Corporation was already into this business from 2005 and we followed exactly the model followed by the State Trading Corporation”.

15. Elaborating further, he stated as follows:-

“..... We followed the model followed by the STC as far as possible with certain, in my opinion, improvements only. Besides, this market is strong. The National Productivity Council drew up a corporate plan for MSTC and they put a time frame in which this gold jewellery export was to take place. They put as an item of 2007-08. We are consistently being asked that to develop an export portfolio. When all these things coincided, there is the market research firm recommending export of gold jewellery. There is the National Productivity Council telling us to export gold jewellery. The STC, a corporation more experienced than us and bigger than us is already in this business. People are approaching us to start this business. So, all the things are there, the opportunities are there and 100 per cent insurance coverage is available. That was the biggest point. If we had not obtained insurance coverage, we would not have exported. I reiterate that it was only post-shipment the procedure adopted was the jewellery will be exported, shipped physically, and invoice on Indian Rupees will come to us based on which we will raise an invoice in US dollars, a Bill of Exchange in US dollars, send it across to the buyers through the banking channel, it will be received by the buyer through the banking channel, he will sign, his signature will be attested by his banker, the documents will come back via banking channel, and only after we receive the documents did we pay 80 per cent of the money”.

16. While referring to the firms engaged for study before venturing into the new business of export of gold jewellery, ex-CMD of MSTC (Shri Malay Sengupta) stated in a written submission as under:

“Both ORG-India and NPC had spent a long time in making the study, had held detailed discussions at various levels within MSTC, had submitted draft reports which were also discussed with officers and thereafter finalized the reports. If my memory serves me rightly, NPC had taken a long time to print and submit their final report after finalizing it. The recommendations were therefore known to MSTC much before April. ORG-India had probably made their study in 2005.”

## **B. Role of MSTC and associates in the export of gold jewellery**

17. The Audit paragraph brought out that as per the agreement entered into by the Company with the associates for export of gold jewellery, the latter was required to identify the foreign buyers, obtain export orders from them in the name of the Company, export gold jewellery and prepare relevant documents showing the Company as an exporter. The foreign buyers were required to pay the export proceeds after 170 days (due date) from the date of dispatch. The associates were required to monitor and ensure realization of export proceeds from foreign buyers on due date. MSTC was required to release advance up to 80 per cent of the invoice value to the associates immediately after export and the balance amount was required to be paid only after realization of full value of export proceeds. The associates ultimately had to bear all the expenses to be incurred by the Company for such export business. It was also stipulated that the associates would bear all the risks and costs in the event of non-payment of export proceeds by the foreign buyers. Thus, instead of playing the role of an exporter, the Company was to provide only post shipment finance to its associates, who were the actual exporters.

18. While deposing before the Committee, the Secretary, Ministry of Steel on 19<sup>th</sup> April 2012 stated as under:

“They are calling it export transactions but actually in my understanding – because I have spent five years in the Banking Division in Government of India - the way this entire transaction has been structured, my impression is that actually the MSTC acted like a bank and not like an exporter although the transaction is structured as if they are the exporter of gold jewellery.”

19. When asked how MSTC would justify that it acted as an exporter and the Associates as shippers, as the export orders were actually executed by the Associates, the Company in its written reply stated that para 39, Chapter 9 of Exim Policy defined a merchant exporter as a person engaged in trading activity and exporting or intending to export goods. MSTC wanted to be safer and hence made the associates responsible for the shipping also. But it did not dilute the function of MSTC as a Merchant Exporter. A merchant exporter may always obtain supplies and avail services from its associate supplier. In the instant case, the Associate Suppliers sold the gold jewellery to MSTC by raising sale invoices on MSTC for the gold jewellery shipped/delivered by them to the overseas buyers on behalf of MSTC. Associate suppliers shipped gold jewellery on –“ A/C – MSTC LTD”. In the export order also, the status of MSTC and its Associates, was disclosed in clear terms as exporter and shipper respectively. The associate suppliers raised the sale Invoice on MSTC upon shipment of gold jewellery( A/C – MSTC LTD) to the overseas buyers for the gold jewellery delivered by them. Consequently, they are to be paid as per contract. Thus, MSTC purchased the gold jewellery from the Associate Suppliers and paid up-to 80% of the invoice value to them, as part payment of the purchase consideration of gold jewellery, shipped/delivered by the Associates to the overseas buyers on behalf of MSTC for which the Associate Suppliers raised sale

invoices on MSTC. It is a matter of record that it is MSTC and not the Associate Supplier which drew "invoices" and "Bills of Exchange" in foreign exchange on the overseas buyers. It is a matter of fact that in this business of export of gold jewellery, the export proceeds of gold jewellery were received in foreign currency in MSTC's accounts, maintained with a public sector bank and Standard Chartered Bank.

20. Regarding the role of the Company and associates in the export of gold jewellery, ex-CMD of MSTC (Shri Malay Sengupta) in a post evidence reply stated as under:-

"I beg to submit that the crux of the matter is whether MSTC was a purchaser from the associates or a mere financier; it could not have been both. If MSTC were not the purchaser the ownership of goods would never be with MSTC, in which case MSTC could not have passed on the ownership to the foreign Buyers, and the invoice and Bill of Exchange drawn by MSTC would be invalid. Had that been the case MSTC would have no *locus standi* in the Courts of Dubai and its claim for export proceeds from the Buyers would have been thrown out and it would not have got the awards in 26 cases. The documents being exactly similar in all cases it is reasonable to hope that MSTC will get favourable judgments in the remaining cases which remain pending also. The books of accounts of the company showed these transactions as Sales-Purchase, and internal audit, statutory audit or CAG audit never objected to the same. Only if MSTC had acquired the ownership, it could have passed on the ownership to the foreign buyers and thus only MSTC could have been the exporter. Indeed if MSTC was not the exporter, I wonder, how the foreign buyers acquired the ownership of the goods since there is no document, as far as I know, evidencing transfer of ownership from the associates to foreign buyers.

### **C. Selection of Associates**

21. According to the Audit, the Company decided in July 2007 to venture into the business of financing the export of gold jewellery on the basis of proposals received in April 2007 from three associates viz. Space Mercantile Co. Pvt. Ltd. (Space), Ushma Jewellery & Packaging Export Pvt. Ltd. (Ushma) and Bonito Impex Pvt. Ltd. (Bonito) and the business was carried out during 2007-08 with them only. Subsequently, the Company received in July/August 2008 proposals from three more associates viz. K.A. Malle Pharmaceuticals Ltd. (KA Malle), Joshi Bullion Gems & Jewellery Pvt. Ltd. (Joshi) and Bond Gems Pvt. Ltd. (Bond) and the business was carried out with the above six associates during 2008-09. The acceptance of the proposals from these associates was done without properly verifying their credentials. No physical inspection of the offices/manufacturing premises of the associates were carried out by the Company before entering into agreements with them. Two of the above associates (Bonito and KA Malle) were engaged, respectively, in the business of building materials and pharmaceutical intermediaries for animals and had never been in the business of gold jewellery. Four associates were having related party relationship (Space with KA Malle and Bond with Joshi). Therefore, the above export business was in fact carried out through four parties only.

22. When asked why MSTC selected the associates without verifying their credentials, the Company in its written reply stated that MSTC did carry out full scrutiny and credentials of the business associates. For verification of credentials of the Associates, the following documents were obtained:

- (i). Last 3 years Balance Sheet and Profit & Loss Account.
- (ii). Brief report on the organization.
- (iii). Documentary evidence of prior export / dealing in gold jewellery etc.
- (iv). Company's Income Tax / Sales Tax registration.
- (v). Memorandum and Article of Association.
- (vi). Name and address of the bankers.
- (vii). Copy of PAN under Income Tax.
- (viii). EXIM Code number.
- (ix). RCMC from Gems and Jewellery Export Promotion Council.
- (x). Name and address of the Board of Directors. The past experience of similar business with other PSUs such as STC.

23. Prior experience of the Associates with STC was examined from the following documents:

1. Export Invoices
2. Packing List
3. Hall marking certificate
4. Air Way Bill
5. Shipping bill
6. GR Form
7. Valuation Certificate
8. Transit Insurance Certificate
9. Copy of Export Order
10. Forex Realization Certificate.

24. In all the cases, credential certificates were obtained from the banks of the Associates. All the banks had given satisfactory report. With the confirmation of receipt of goods by the foreign buyer along-with unqualified acceptance of liability (through banking channel) to pay to MSTC on due date by foreign buyers, the performance of Associate supplier was completed. After that MSTC released part payment towards purchase consideration of gold jewellery to the Associates. MSTC did not release payment to the Associate supplier before the gold jewellery were received by the overseas buyers and before the overseas buyers accepted the liability to pay MSTC.

25. Responding to the Audit observations that one of the two related associates (Space with KA Malle) enjoyed a high credit exposure during 2008-09 by carrying out 53 per cent of the total export of gold jewellery, MSTC in its written reply stated that regarding business exposure on the associate suppliers, it has been explained in detail that no exposure / risk was taken on the Associate Suppliers. MSTC did not release any payment to the Associate Suppliers in advance. MSTC did not release payment to the Associate supplier before the gold jewellery were received by the overseas buyers and before the overseas buyers accepted the liability to pay MSTC through banking channel. Thus, in the instant model of export of gold jewellery, the element of risk came into existence after the Associate Suppliers delivered the gold jewellery. So, the question of enjoying high credit exposure by the Associate Suppliers does not hold good as there was no exposure at all on the Associates. Regarding carrying out export transaction with each other, it may be noted that it came to the knowledge of MSTC that M/s. Space Mercantile Pvt. Ltd and KA Malle Pharmaceuticals Pvt. Ltd were companies which had a common director. However, no transaction was allowed to be carried out between these two companies in which MSTC was a party. When M/s. Joshi

Bullion Gems and Jewellery Private Ltd was being considered as associates by MSTC, it came to notice that one director of M/s. Joshi Bullion was also a director of some overseas buyers to whom shipment had already been made by other associate suppliers of MSTC. Hence, it was decided that M/s. Joshi Bullion Gems and Jewellery Private Ltd would not be allowed to make shipment to those overseas buyers where there was common director. It is a matter of fact that no shipment was made by M/s. Joshi Bullion Gems and Jewellery Pvt. Ltd to those overseas buyers who had common directors with it.

26. Audit has also observed that three associates viz. M/s Ushma, M/s Space and M/s Bonito were already doing the business with State Trading Corporation Limited (STC) on similar lines but were in default during the period 2007-08. As MSTC was aware of the dealings of the three associates with STC, it should have checked their performance vis-à-vis STC when it renewed their memorandum of Agreements with three associates in August 2008. MSTC, thus, did not take due care in selecting the associates. Rather, it extended undue favour to them by allowing to carry out the export transactions with each other and thus they enjoyed higher credit exposure.

27. When asked why MSTC did not check the performance of three associates' in its business with STC while renewing their Memorandum of Agreements with these associates, the Company in its written reply stated that it may please be noted that, MSTC had taken 4 (four) Associate Suppliers in 2007-08 and all four were doing business with STC as per the documents submitted by them.

28. Prior experience of the Associates with STC was examined from the following documents:

- 1) Export Invoices
- 2) Packing List
- 3) Hall marking certificate
- 4) Air Way Bill
- 5) Shipping bill
- 6) GR Form
- 7) Valuation Certificate
- 8) Transit Insurance Certificate
- 9) Copy of Export Order
- 10) Forex Realisation Certificate.

29. In the financial year 2007-08, MSTC exported gold jewellery worth Rs. 260 Crore through the Associate Suppliers. The export proceeds were realized in full, in foreign currency through banking channel. Thus, for obvious reason, as the business was going smooth and export proceeds were paid, no need was felt for cross verification with other organization. Since the associate suppliers and the overseas buyers performed the contracts flawlessly during financial year 2007-08, MSTC thus did not think of any other cross verification. However, all due diligence was made at the time of selection of associate suppliers as per the standard practice of MSTC. It may be appreciated and noted that 29 out of 36 overseas buyers, which failed to pay the proceeds of export made in the financial year 2008-09, had imported gold jewellery from MSTC in the financial year 2007-08 and had paid the export proceeds in full. Unfortunately the same overseas buyers miserably failed to pay the export proceeds to MSTC in the very next year. Moreover, MSTC was taking insured exposure on foreign buyers and not on associates.

30. When asked whether MSTC had framed any policy and guidelines for selection of associates, the Company in its written reply stated that MSTC did not have separate guidelines for selection of associates for export business. But we had an elaborate marketing manual which contains guidelines for scrutiny of associates for import business. MSTC did follow those guidelines. Moreover, there was no risk of non-performance by associate in our model. It was post shipment payment. So no exposure were taken on associates. It may please be noted that MSTC has explored the export of gold items for the first time, based on the report of existence of potential future growth opportunity, as envisaged by National Productivity Council (NPC). Due to not having a regular export item, no general standard operating procedure could be formulated but separate formalities / procedure for export of gold jewellery was formulated and approved by the Board of Directors of MSTC.

#### **D. Identification of foreign buyers**

31. Audit has brought out that the foreign buyers were identified by the associates and the Company did not verify their credentials. The associates also arranged to obtain export order in the name of MSTC. There was no agreement between MSTC and the foreign buyers for the export and even MSTC did not make any official communication with them before such export. It was observed that out of 47 foreign buyers related to export of gold jewellery during 2008-09, 18 were dealing either in wholesale business of stainless steel, food stuff, building materials or garments but 39 per cent of the total export of gold jewellery during 2008-09 was made to them. It was observed that in respect of 20 foreign buyers, ownership was concentrated in the hands of a few persons. Further, Director of one associate (Joshi) was also owner/director of 4 foreign buyers\* and three of them received gold jewellery from Space and another from Ushma during 2008-09. The existing related party relationship of Bond and KA Malle (other two associates) with Joshi and Space, respectively, indicated that the above five associates were having transactions between themselves. It was also observed that eight foreign buyers to whom gold jewellery worth of Rs. 99.78 crore was exported were found not traceable. It was, further, observed that the principals of 13 foreign buyers refused to accept any liability of export dues of Rs. 187.13 crore on the ground that gold jewellery was actually not received by them. Thus, MSTC did not carry out due diligence in identifying the foreign buyers and left it completely on the associates who were the ultimate beneficiaries in the export business by receiving 80 per cent of the export proceeds as advance from MSTC.

32. When asked why the credentials of the foreign buyers were not verified by the Company itself, MSTC in its written reply stated that MSTC was new in the field of gold jewellery having no past experience. It neither had any client base in overseas market nor had any supplier base for gold jewellery in India. So, for obvious reason, it entered into MOA with experienced Associate Suppliers who were business associates of another PSU viz. STC, and had knowledge in export business. Accordingly, as per the terms of MOA, the Associate suppliers introduced the foreign buyers and arranged export orders from them in favour of MSTC. However, MSTC did not take such overseas buyers on its face value. MSTC obtained several documents on the overseas buyer including the D&B/TCM report, Chartered Accountants certificate of past experience before sending the proposal for due diligence and further scrutiny on the overseas buyers to ECGC for their approval and sanction of credit limit against each such potential overseas buyer for export of gold jewellery as they had adequate experience in credit insurance business. In its application for insurance cover from ECGC for export of gold jewellery, MSTC clearly mentioned / declared that it was new in gold jewellery business having previous export turnover of gold jewellery as "NIL". ECGC made the due

diligence on each such potential overseas buyer and sanctioned the credit limit against each such potential overseas buyer for export of gold jewellery. ECGC had taken the fees for carrying out due diligence on each such approved buyer. ....

.....ICICI Lombard specified the names of the buyers and their limit in the factoring mode. Hence both the insurance companies carried out the due diligence on individual buyers and also specified individual limits of exposure on the foreign buyers. It is a matter of record that export orders were entered by MSTC with such overseas buyers only after the insurers approved the overseas buyer and assigned a credit limit against such overseas buyer. MSTC exported the gold jewellery valued within the sanctioned limit.

33. When asked why MSTC allowed the export of gold jewellery to foreign buyers owned by the Associates, the Company in its written reply stated MSTC did not allow export of jewellery to any overseas buyer by an associate who had common directors with the same overseas buyer. It revealed that out of total thirty six foreign buyers in ECGC mode only three foreign buyers viz. M/s. Himalaya Diamond FZE, M/s. Leo Diamond and M/s. Superior General Trading had a director who was also a director of the associate viz. Joshi Bullion Gems & Jewellery Pvt. Ltd. MSTC did not permit any export from M/s Joshi Bullion to those 3 foreign buyers. Exports to those foreign buyers had been made earlier by other associate suppliers. In fact, Joshi Bullion Gems & Jewellery Pvt. Ltd was not an associate supplier of MSTC at all when these shipments took place. It came to light only at the time of processing the proposal of M/s. Joshi Bullion Gems & Jewellery Pvt. Ltd for considering them as an associate supplier of MSTC. It is a matter of record that gold jewellery was shipped to Himalaya Diamond FZE by M/s. Ushma Jewelry and Packaging Export Pvt. Ltd. and gold jewellery to other two buyers viz. M/s. Leo Diamond and M/s. Superior General Trading were supplied by M/s. Space Mercantile Co.Pvt. Ltd.

34. Regarding due diligence of associates and foreign buyers, Shri Malay Sengupta, Ex-CMD of MSTC in a written reply stated that since the associates were not paid anything before they performed, i.e.no credit was ever extended to them, too rigorous a scrutiny was not considered necessary. However, the usual diligence drill for buyers in case of the procurement portfolio was followed for associates too. As regards the buyers, whatever documentary information was considered necessary by ECGC, including DNB reports were obtained and given to ECGC. We provided whatever information was desired by them. From amongst the list of Buyers submitted by MSTC, ECGC rejected a few, fixed individual credit limits for those accepted by them, and also changed these limits (enhanced) from time to time. In other words Insurers decided the pre-sanction credit limit for buyers individually within which MSTC always operated. They also charged processing fee from MSTC to carry out the exercise. In this connection I may be allowed to make a reference to a recent interview given by the present chairman ECGC, published in The Telegraph dated 24.12.12. In this interview he mentioned that ECGC is restructuring the rating system to improve its assessment of overseas buyer risk. ECGC has a score card system where the risk assessment of an overseas buyer is made based on the nature of its business, its financials, experience with the buyer in the past, and industry outlook. ECGC had thus assessed the risk associated with the foreign buyers individually in this case also and had issued the insurance coverage for each individual buyer. It may be mentioned that ECGC had taken exposure on the buyers and not on MSTC or associates. The performance risk was thus covered by making payment to the associates only after export, and the credit risk through the insurance policies.

35. When asked whether MSTC has framed any policy for selection of foreign buyers, the Company in its written reply stated that MSTC made a methodology for doing business being new business including selection of foreign buyers. The methodology of business was approved by the Board at that time before the export of gold jewellery took place. In this case MSTC carried out due diligence by obtaining following documents about the foreign buyer:

1. Name and address of the foreign buyers
2. Banking details of the foreign buyers
3. Report from D&B,/TCM report, past business experience with the foreign buyer by the associate supplier of MSTC.

36. With this the proposal were forwarded to ECGC for further scrutiny and sanction of credit limit within which MSTC should take individual exposure. The ECGC applied its mind and in some cases they have rejected and in some cases enhanced or reduced the exposure limit after due diligence. The chart below will explain the position:

1	Applications made for credit Limit	76
2	Applications approved as per applied limit	22
3	Applications approved with modified limit	43
4	Applications rejected	2
5	Applications rejected initially, then approved after some time	2
6	Application status not communicated, hence considered rejected	7

37. ICICI Lombard specified the names of the buyers and their limit in the factoring mode. Hence both the insurance companies carried out the due diligence on individual buyers and also specified individual limits of exposure on the foreign buyers MSTC did business with the foreign buyers only after approval and sanction of credit limit by ECGC as per guidelines approved by the Board of Directors of MSTC and the tenets of the insurance policy document.

#### **E. Safeguarding of the financial interest**

38. The Audit has observed that as per agreement, the associates were required to bear all the risks and costs in case of non-payment of export proceeds by the foreign buyers. Since advance up to 80 per cent of the export proceeds was payable to the associates immediately after export, the Company should have taken adequate measures to safeguard its financial interests before releasing such advance. Contrary to this, MSTC modified (August 2007/September 2008) original clause of the agreement enabling the Company to encash Post-Dated Cheques (PDC), covering equivalent amount of advance payable to associates in the event of non-receipt of export proceeds from the foreign buyers. As per modified clause, the PDCs could have been encashed only in the event of non-payment by the foreign buyers due to disputes with the associates relating to quantity, quality and price.

39. It was also observed that there was no provision in the agreement to obtain collateral security from the associates to cover the amount of advance payable to them. The financial position of the associates was also not considered while fixing their credit exposure as the advances given by MSTC during 2008-09 ranged between 7 and 111 times of their net worth.



40. When asked about the advance steps taken by MSTC to safeguard its financial interest from the associated risks involved in the business, the Company in its written reply stated that the following advance steps were taken by the company to safeguard the financial interest:

1. Supply Risk mitigation: MSTC did not have any experience in the export of Gold Jewellery business. Hence it has entered into MOA with the manufacturers/traders (associates) of Gold Jewellery who export gems, jewellery or other materials to foreign buyers. The Associate of MSTC would make the shipment as per export order at their own cost.
2. Performance Risk Mitigation: Here again, to be on the safer side, the purchase consideration was not released immediately after export. MSTC released part payment only after ensuring the followings:
  - i) Receipt of the gold jewellery by the overseas buyers,
  - ii) Declaration by the overseas buyer that there was no dispute regarding quality / quantity /specification etc.
  - iii) The invoice value was accepted by the overseas buyer
  - iv) Acceptance of Bill of Exchange by the overseas buyer undertaking the liability to pay to MSTC on due date.
3. Buyers Risk Mitigation:- Due diligence by the insurer and pre-approved, pre-sanctioned limit of exposure for each and every foreign buyer.
4. Payment Risk Mitigation: MSTC took the insurance policies to cover all the probable risk of non-realization. Insurance Policies were taken to cover the following risks:
  - i) Protracted Default by overseas buyers
  - ii) Insolvency of overseas buyers
  - iii) Political and Commercial Risks.

41. It was also stated that the insurance policy undertaken by MSTC, did not cover the risk of repudiation by the overseas buyers. MSTC did not release payment before receipt of gold jewellery by the overseas buyers and acceptance of the liability to pay to MSTC by the overseas buyers. It means, in the extant model of export of gold jewellery the element of "risk" comes into existence only after receipt of gold jewellery by the overseas buyers. All the above acceptances by the overseas buyer were verified / authenticated and confirmed by the overseas buyer's bank. Overseas banks communicated such acceptance directly to MSTC's bank in India. Thus, MSTC did not release payment to the associate suppliers before delivery/ shipment and receipt of gold jewellery and acceptance of Bill of Exchange by the overseas buyer. Standard commercial practice demands that, once gold jewellery had been received by the overseas buyers, the purchase consideration was to be paid for the full invoice value of the gold jewellery, delivered by the associate suppliers. Here again, to be safer side, MSTC released only up-to 80% of the invoice value to the associate suppliers. Thus, 20% of the export value remained invested by the Associate Suppliers with MSTC; because after shipment, it would be MSTC, in whose account 100% of the export invoice value would be received. In this process a security deposit equivalent to 20% of the invoice value was inbuilt in the business model itself.

42. When asked why MSTC modified the clause of the contract that enabled the Company to encash Post-Dated Cheques furnished by the Associates in the event of non-receipt of export proceeds from the foreign buyers, MSTC in its written reply stated that in the insurance policies issued by ECGC, the risk of repudiation was deleted because MSTC did not release payment to the Associate supplier before the gold jewellery were received by the overseas buyers and the overseas buyers accepted the liability to pay MSTC. It may be noted that MSTC did not take the risk of repudiation by the overseas buyers. PDCs were accepted to cover the performance risks of associate suppliers. However, till the acceptance of jewellery without dispute on quality, quantity, price etc and acceptance of liability of payment by the foreign buyers a risk of non-acceptance existed which was not covered by the insurance policy. To cover this risk, PDCs were accepted from the associate supplier. Upon acceptance of jewellery and the liability for payment by the overseas buyer, there existed only the risk of default by the overseas buyer which was covered by the insurance policy. Thus, to cover this contingency of repudiation for non-acceptance quality, quantity and specification of gold jewellery or any other disputes, the PDCs were taken. Since, there was no dispute or non-acceptance by the buyer, the PDCs were not encashed, as the PDCs were submitted for this specific purpose and the Associates did not agree to the PDCs being encashed for payment failure of the foreign buyers, which was covered by the insurance. That is why the Agreement had to be amended. Also, the retention of PDCs for payment failure by the overseas buyers, might have made the insurance policies infructuous. Payment risk of the foreign buyers was hedged through insurance policy and PDCs of associate suppliers were to hedge the performance risk of associates. ....

43. It was further stated that MSTC did not release payment to the associate suppliers before delivery / shipment, receipt of gold jewellery and acceptance of Bill of Exchange by the overseas buyer, undertaking the liability to pay to MSTC on due date. . Therefore, it was not an advance paid to the Associate Suppliers. ....

.....In the instant case, it was a part payment towards purchase consideration of the gold jewellery, already supplied by the associate suppliers and which was received by the overseas buyer, whose acceptance was confirmed through banking channel. It may be appreciated that, in the commercial world no body would deliver full material and simultaneously provide PDCs as well. Thus, Post Dated Cheques were provided by the Associate Suppliers as a security only to cover the risk of non-performance by the associate suppliers, who were the shippers of such gold jewellery. Non-Performance was defined as dispute regarding quality, quantity, specification, price, documentation and/or any sort of dispute which may arise between overseas buyers and associate suppliers, who were the shippers of such gold jewellery. It may be evident from the MOA that this very objective / purpose, for which the associate suppliers agreed to give PDC to MSTC, was not reflected from the wordings of the relevant clause. As per the clause of the MOA (before amendment), it would appear that the Associates Suppliers provided PDCs to cover the loss arising out of non-payment of export proceeds by the overseas buyer; where as, the Associate Suppliers had already supplied / shipped the gold jewellery and the receipt of the same was confirmed by the overseas buyers. Thus, the performance of the Associate Suppliers was over in full satisfaction. Still, if the Associate Suppliers had to provide PDC for recovery of loss, which might be suffered by MSTC due to non payment by the overseas suppliers, then there was no need of taking any insurance cover to mitigate the loss arising out of non-payment of export proceeds by the overseas buyers and the Associate Suppliers also would not have agreed to bear the expenses in the form of Insurance premium. ....

.....So, for obvious reason, the relevant clause of the MOA needed suitable amendment, to reflect the true spirit / purpose for providing PDCs by the Associate Suppliers. It may be observed from the correspondences with the insurers in regard to settlement of claims that, the insurers did raise the issue of having PDC with MSTC to take care of loss. It is amply clear that ECGC would not have paid in case of non-existence of the addendum, modifying the clause of PDC, in the MOA. In this regard, Para 5 (i) of the letter of ECGC dated 14/05/2011 in which ECGC repudiated the claim of MSTC may be referred. This would also be vouched from the letter dated 29.04.2010 and letter date 03.03.2011, from another insurer viz. ICICI Lombard General Insurance Ltd, on this issue of having PDC with MSTC.

44. When asked why the contracts entered with the Associates did not include the provision of collateral security from the Associates to safeguard against the risk attached with the amount of advance paid to them, the Company in its written reply stated MSTC did not pay advance to associate suppliers. MSTC had paid part of the purchase value to associate suppliers after shipment and on acceptance of foreign buyers.....

45. With regard to the question of security deposit, it was also stated that in the commercial world, the question of "security deposit" comes into existence with an object to secure/ guarantee of delivery of an indented service / delivery of an indented material in a future date from the date of such advance. As enumerated in the above paragraph, in the instant business model, no advance was paid at all to any body. The associate suppliers delivered the gold jewellery and the same was received by the overseas buyers also. Such receipt of gold jewellery and acceptance of liability to pay to MSTC by the overseas buyer, was verified / authenticated and confirmed by the overseas buyer's bank. Then only payment for purchase consideration was made to the associate suppliers. Standard commercial practice demands that, once gold jewellery had been received by the overseas buyers, the purchase consideration was to be paid for the full invoice value of the gold jewellery, delivered by the associate suppliers. Rather, to be on the safer side, MSTC released only up-to 80% of the invoice value. Thus, 20% of the export value remained invested by the Associate Suppliers in the process. This was because of the fact that after shipment, it would be MSTC, in whose account 100% of the export invoice value would come in. In this process, a security deposit, equivalent to 20% of the invoice value, was built in the business model itself. In this context, it may be kept in mind that the quantum of indemnification assured under the insurance policies was 90% of the export invoice value against each overseas buyer, where as, MSTC released a part payment to its Associates Suppliers up-to 80% of the invoice value, as purchase consideration for the gold jewellery, shipped by the Associate suppliers on behalf of MSTC. Thus, there was also an inbuilt mechanism to realize security deposit, to the extent of 10% out of 20% security deposit as stated earlier, through insurance policy which was in place. Thus, it may be noted that MSTC did not pay any advance to the associate suppliers. Part payment towards purchase of Gold jewellery was made after completion of performance by the associates. So no collateral was proposed. Moreover in case of taking collateral security against the release of purchase consideration to them there would not have any insurable interest and that might have been jeopardized which existed to take care of failure of foreign buyers and the insurance policy would have been infructuous. However after default by the overseas buyer took place MSTC insisted and obtained wherever provided, the collateral securities to mitigate the losses as per the tenets of the insurance policy."

46. On the question of adequate financial safeguards to cover the risks involved in the business, ex-CMD of MSTC stated that risks involved were adequately studied, understood, and safeguarded.

- a) The first risk involved in such a contract is that of non-performance by the associates. To safeguard it, it was decided that no pre-shipment / mobilization advance will be given. MSTC was acting as a merchant Exporter, and in such cases pre-shipment advance is often asked for and agreed to. It was further decided that the documents related to the export will be sent by MSTC through its Bank to the Buyer's Bank abroad, where the Buyer will take the document, sign it as a proof of his having received the document and hence ownership of the material without complaint, the signature will be attested by his Banker and the same will be returned by his Bank to MSTC's Bank in India. Only thereafter the Associate will be paid 80% of the amount (purchase consideration) due to him. It may be mentioned that customarily the documents reach the Buyer's Bank much after the Goods have reached the destination and hence based on the advance copy the Buyer would have received the material well before the documents were accepted and signed by him. Hence only 80% of the purchase consideration was paid to the suppliers after getting accepted document from the Buyer through banking channels against Insurance coverage of 90% of the sale proceeds. Non-performance by the associates was therefore not an issue.
- b) Nomenclature used by MSTC to describe such payment, "Advance" was certainly unfortunate. However even before MSTC sent the documents to its Bank, it would receive the sales invoice from the Associate in INR, based on which MSTC's Invoice and Bill of Exchange would be prepared in US \$ which would be part of the documents received by the the Buyer through his Bank. It is therefore clear that the 80% payment was made well after the associate had sold the material and the ownership had been transferred from the associate first to MSTC and then to the foreign buyer. Any payment made by a buyer to a seller against an Invoice, after the goods and the title in ownership have been transferred can only be regarded as part Payment, and by no means as an "advance" as understood in accountancy.
- c) The biggest and obvious risk was of course non-payment by the buyers. MSTC entered into this venture only because Insurance could be taken against such risks. In the first year of the operation the intention was to limit the exports to Rs. 300 Crore. This could be done by taking a policy of Rs. 300 Crore. However, since the Insurance Company put a maximum loss limit of 30%, it was seen that in the event of non-payment by buyers exceeding Rs.90 Crore MSTC would be left with no recourse. It was therefore decided to take a policy for Rs. 1000 Crore so that MSTC's exposure in no case would exceed the maximum loss limit of the policy. The associates, who were required to bear the premium, were naturally aggrieved but they were persuaded to agree. It may be mentioned that in the second year of operation, ECGC increased the maximum loss limit to 50% from 30%, and a policy for Rs. 1200 Crore was taken. The original decision of taking Post dated cheques from associates covering full value of consignment to be encashed in the event of non-payment by Buyers, in addition to the insurance, by way of abundant caution had to be given up as we were advised by Insurance Consultant that this would render the insurance policy infructuous and the relevant clause of the agreement was modified.

- d) That left MSTC with two minor and rather improbable risks. A buyer could raise a dispute about quality, damage of goods, or delay in supply. Obviously such a dispute would have to be raised before he made the payment (170 days). To cover this performance related risk post dated cheques were taken from the associates, encashable only in the event of a dispute, mainly because the Buyers were identified by those associates. Another risk was faulty documentation jeopardizing MSTC's possible claim with ECGC. Hence recourse was kept to make a claim on the associates in the event of any loss suffered by MSTC including non-payment by Buyers. This, I believe, is in conformity with the underlying obligation of an insured to make all the endeavour to minimize loss through recovery from all available avenues. Needless to mention that as per the Insurance policy, all the recoveries and legal decrees are to be subrogated in favour of Insurer after settlement of claim. Thus this approach cannot be said to have prejudiced Insurers in any way. I, therefore, submit that the risks were understood and safeguards taken.

47. When asked whether MSTC has framed any policy and guidelines for taking adequate measures for safeguarding its financial interests in such a high-risk business, the Company in its written reply stated that this was the first time that the company ventured into the export of gold jewellery and after protracted discussion a procedure was formulated with the approval of the Board which was the policy / guidelines. However, no further guidelines / policies has been made and no export business has been undertaken since the export of Gold jewellery. Exim policy of Govt. of India permits export of jewellery on DA basis (Document against Acceptance) which is as follows: (Handbook of Procedure 2004-09, Vol. 1, Chapter 4, Para 4A.11 Terms of payment) "Export of Gold/silver/platinum jewellery and articles thereof shall be against irrevocable letter of credit, payment of cash on delivery basis, Documents Against Acceptance (DA) basis for advance payment in foreign exchange." It may be noted that as per Sec. 13C .18 of Chapter -13 (Export of Goods, Software, etc.) PART – C (Authorized Dealer's Obligation) of Foreign Exchange Management Manual (FEMA), an authorized dealer (nominated banks) may write off the outstanding bill, in case of settlement of claim of unrealized export proceeds by ECGC. It may be noted that the whole export turnover of MSTC was backed by ECGC and other insurance co. MSTC took the insurance policy to cover all the probable risk of non-realization. Insurance Policies were taken to cover the following risks:

- i) Protracted Default by overseas buyers
- ii) Insolvency of overseas buyers
- iii) Political and Commercial Risks.

.....Further, to minimize the overall exposure on D/A basis export business as a whole, MSTC entered into a "Receivable Purchase Agreement" with Standard Chartered Bank, through which, the said bank purchased the future receivables of MSTC from the overseas buyers, on account of export of gold jewellery on D/A basis. It had helped MSTC to go one step farther, in its mission, to hedge its exposure on overseas buyers. It should also be appreciated that, had the extant export business on D/A basis with insurance back-up, not been a conceivable safe business model, a renowned first class scheduled foreign bank like Standard Chartered Bank, having age old experience in disbursement of advances and commercial credit, would not have agreed to purchase the future receivable of MSTC on account of such export of gold jewellery .In view of the above laid down rules and regulations, this particular business model had been developed. The similar model already existed with another public sector company viz. State Trading Corporation (STC). MSTC's model has

certain improvements over that of STC. The entire risk was hedged with the insurance companies through the policies issued by them. Based on its present experience, MSTC has decided to discontinue export of gold jewellery and also any exports on DA basis with insurance coverage.

## **F. High risk exposure and return not commensurate with the risk**

### **High risk exposure**

48. The Audit has brought out that although MSTC decided to finance the associates for the export of gold jewellery, it did not ascertain the volume of its risk exposure before entering into such business. It was observed that during 2007-08 and 2008-09, the credit exposure of the Company, by way of advancing finance to the associates, was high and the same was 80 per cent and 185 per cent respectively of its net worth of the respective previous years. MSTC also did not obtain any security from the associates before releasing such advances to mitigate the risk of non-recovery of advances.

### **Return not commensurate with the risk**

49. According to Audit, the financial risk involved in the above business was 80 per cent of the export proceeds along with the cost of financing in the event of non-payment of dues by the foreign buyers and consequential non-realisation of the same from the associates. The return of MSTC was, however, only 1.25 to 1.5 per cent of the entire export proceeds. Thus, the quantum of return was not commensurate with the size of the risk involved. It was observed that the Company earned a service charge of Rs. 3.91 crore only from financing the export of gold jewellery worth of Rs. 260.63 crore in 2007-08 which was only three per cent of the profit for that year. Further, due to non-realisation of export proceeds, the Company did not earn any service charge during 2008-09. Thus, the decision of the Company to venture into the above business with a meagre return was not economically justified.

50. Asked why MSTC entered into a high risk business of export of gold jewellery with meagre returns as the same was not economically justified, the Company in its written reply stated MSTC made a model to mitigate the risks involved. MSTC as a trading Company worked on a fixed margin without exposing itself to the price volatility in the market thereby protecting itself from high risk. In this segment all PSU Trading Companies have very thin margins. A Comparative study of all three major PSU trading co. proved that MSTC is the most profitable of all three. The model of any business house is based on credit exposure. This is true to any banking business as well as trading houses business like STC, MMTC and so on. MSTC's net worth on 1.4.2008 was 271 Crore. While debtors were Rs. 2935 Crore which gives a Capital Adequacy Ratio (CAR) of about 9% which is same as CAR followed by most of the banks and financial institution. For Banking Industry, CAR is an important factor i.e. no. of times of capital to be advanced to the customer in order to protect the interest of depositors/customers. Moreover every trading house takes exposure based on their financial limits available from Banks. In this connection Comparative figures of some trading houses are given below for 2008-09:

Name of Co.	Net Worth 31.03.2009	Total Volume of trading Business	Volume of Business to net worth
STC	570.28	20137.01	3531.07%
MMTC	1123.38	36820.76	3277.61%

PEC	160.69	10274.78	6394.16%
MSTC	342.37	8507.44	2484.56%

51. Comparative figure of percentage of profit which is highest in MSTC as evident from the chart below:

### Financial Results for the Year 2010 – 11

Rs In Crore

	MMTC	STC	MSTC
Turnover / Volume of Business	69056.00	20475.65	14100.77
Gross Margin	204.25	82.70	150.70
Profit before Tax	191.78	79.63	149.40
Profit after Tax	121.64	56.44	99.16
Capital Employed	1096.64	673.05	489.39
Net Worth	1379.74	679.46	505.20
Gross Block	207.95	93.16	31.52
	In % age	In % age	In % age
Gross Margin Ratio ( Gross Margin / Net Sales)	<b>0.30</b>	<b>0.40</b>	<b>1.07</b>
Profit before Tax / Sales	0.28	0.39	1.06
Profit after Tax / Sales	0.18	0.28	0.70
Profit before Tax to Capital Employed	17.49	11.83	30.53
Profit after Tax to Capital Employed	11.09	8.39	20.26
Net Profit to Net Worth (PAT / Net Worth)	8.82	8.31	19.63
Sales / Gross Fixed Assets	332.07	219.79	447.36
Profit before Tax per Employees	<b>0.11</b>	<b>0.09</b>	<b>0.47</b>

Source: (Published Balance Sheet in respective wave sites)

52. Moreover, MSTC has not taken any risk exposure on the associate supplier. They have been paid 80% of material value only after supply of material and acceptance of the same by the foreign buyer. The export transaction was fully covered by Insurance and in the second year the bills were purchased by SCB who also had insured the transactions. Thus in the event of failure by the foreign buyer to make payment, the insurance Companies would have to pay up to 90% which covered the advance paid to the associates. As regards exposure on foreign buyers, the Concerned Insurance Co has done the due diligence and they have given the limit of exposure against each buyer. MSTC did not cross the exposure limit at any point of time and fully complied with the policy conditions.

53. On the aforesaid audit observation, Shri Malay Sengupta in his written submission stated that M/S Oriental Insurance and M/S ECGC had both agreed to cover the risk of the Exporter in the event of Insolvency or protracted default by the Buyers by charging a premium of 0.3% with maximum Loss limited to 30% of the face value of the Policy. This meant an exporter could take a policy of Rs.100 Crore, export to the tune of Rs. 100 Crore but in the event of his loss due to Insolvency or protracted default of the Buyer(s) exceeding Rs. 30 Crore, the Insurer will limit the claim for payment to Rs. 30 Crore. This effectively works out to

a premium of 1%. (MSTC finally took the policy from ECGC and not Oriental). In the 2<sup>nd</sup> year of operation of the scheme M/S Standard Chartered Bank purchased the receivables covered by ICICI Lombard under a factoring scheme at 1%. M/S STC who operated a scheme similar to that of MSTC also charged a margin which was comparable to that charged by MSTC.

54. The then CMD of MSTC further stated that this clearly establishes that Banks and Insurance Companies whose job is to assess and price commercial risks did not consider the risk of non-payment very high and considered a 1% margin as adequate. Post-insurance MSTC's risk due to non-payment by buyers was certainly lesser and therefore a higher than 1% margin net of the insurance premium cannot be considered inadequate.

### **G. Assessment of demand of gold jewellery in foreign markets**

55. The Audit has observed that MSTC did not analyse the demand of gold jewellery in foreign markets before venturing into the export business. The global market for gold jewellery was favourable in 2007-08. However, the demand for the same started declining globally (including UAE# & Middle East) from the first quarter of 2008-09. The export of gold jewellery to the above countries was, however, increased by 143 per cent during 2008-09 compared to 2007-08.

56. When asked why MSTC did not assess the market demand before venturing into new business, the Company in its written reply stated that before the start of new line of business, MSTC engaged NPC for assessment of demand, volatility etc. MSTC did find that demand for export of Gold Jewellery did exist in 2007 when decision to start this new segment was taken. There was good demand of Gold jewellery as evident from the export orders received by MSTC and increase in export of Gold jewelley from India. The healthy market situation in 2007 is also proved from the fact that 100% payment of exports made by MSTC in the financial year 207-08 was realized. The sudden downfall of the world economy in 2008-09 could not be predicted by IMF, World Bank and other economist. The prices of gold and gold jewellery in the market have gone up continuously since exports were made. Hence the observation that the company did not analyze the demand is not true. A graph showing price trend of 24K gold jewellery in UAE market shows that while in 2007 it was AED 71.25, in 2008 it was AED 82.00 and in 2009 it was AED 102.75. The Occasional Paper no. 138 published in Feb'2010 by Exim Bank , entitled " Indian Gems & Jewellery : A Sector Study" inter-alia states -- " During the year 2008-09, the export of gold ( or jewellery) has witnessed a growth rate of 51.1% over the previous year, from USD 4.3 billions to USD 6.5 billions...." . Further it states that -- " Main export destination of gold jewellery include UAE, Singapore, Hongkong". From This it can be concluded that export of gold jewellery from India to UAE showed an increasing trend in 2007-08 and 2008-09.Hence, this also confirms that the demand for gold jewellery was increasing in 2007-08 and 2008-09.In this context, it may be noted that for any trader, the need for assessment of market demand, primarily comes into play in case of purchase of material, because the materials need to be sold in the market in a future date and the then market demand for the material would play the most vital role in such cases. MSTC already had confirmed demand in the form of Purchase orders by the foreign buyers. MSTC paid for the jewellery to the associate suppliers after selling the same in advance to the foreign buyers. Therefore, there was no question of not having the demand and purchase of jewellery paid for by MSTC. In case of export of gold jewellery, MSTC did not pay for any gold jewellery, which was intended to be sold in the market in a future date. In other words, MSTC took the exposure on the overseas buyers only after the export was completed. MSTC exported on confirmed order. Thus, it would be the responsibility of the overseas buyer to get



buyers for such gold jewellery imported by them from MSTC. Moreover, As explained in earlier paragraphs, MSTC did not release payment to the Associate supplier before the gold jewellery were received by the overseas buyers and before the overseas buyers accepted the liability to pay MSTC through banking channel. It may be noted that the insurance policies of MSTC did not undertake the “risk of repudiation by the overseas buyers”. Should MSTC release payment before receipt of gold jewellery by the overseas buyers and should MSTC take the risk of repudiation by the overseas buyers, then only MSTC would have taken risk and exposure on the future market condition for gold jewellery and the question of assessing the future demand of gold jewellery would have been relevant. Because, in such case, MSTC would have paid for the purchase of gold jewellery which might not be accepted by the overseas buyers at a price at which MSTC had purchased. Needless to say, in such eventualities, MSTC would have to sell the gold jewellery at a price lesser than its purchase price culminating to loss.

57. To take care of such eventualities, MSTC released part payment only after ensuring the followings:

- i) Receipt of the gold jewellery by the overseas buyers,
- ii) Declaration by the overseas buyer that there was no dispute regarding quality / quantity /specification etc.
- iii) The invoice value was accepted by the overseas buyer
- iv) Acceptance of Bill of Exchange by the overseas buyer undertaking the liability to pay to MSTC on due date.

58. All the above acceptances by the overseas buyer were verified / authenticated and confirmed by the overseas buyer’s bank. Overseas banks communicated such acceptance directly to MSTC’s bank in India. Thus, in the extant model of export of gold jewellery business, risk was not on the purchase of gold jewellery from the Associates but on the probability of default by the foreign buyers, after receipt of the goods by them to their satisfaction and after accepting the liability to pay to MSTC by the overseas buyers, which was confirmed by the overseas buyer’s bank through banking channel. It is a matter of fact that no overseas buyer even after such above-said acceptance of liability to pay to MSTC through banking channel, approached MSTC for taking back the gold jewellery for any ground / reason what so ever. Rather, the overseas buyers not only accepted the liability to pay to MSTC on due date but reiterated their obligation to pay to MSTC and sought / requested for some more time to pay off. Although, the market condition vis-à-vis demand of gold in UAE during the subject period has been stated in earlier paragraph, now, even for argument sake, if the overseas buyers were not able to sell the gold jewellery in UAE due to fall of demand for gold jewellery ( as commented in audit report), then the overseas buyers should have returned the gold jewellery to MSTC and MSTC might have brought back those gold jewellery to India or would have sold the gold jewellery in UAE itself. In this context, it may be kept in mind that MSTC had released part payment (upto 80% of invoice value) to the Associate suppliers, towards purchase consideration of gold jewellery shipped to the overseas buyers on behalf of MSTC. It may be noted that gold price could not have gone down by more than 20% at that period, so that, MSTC would not have incurred loss, even if the gold jewellery would have been returned back unsold by the overseas buyers to MSTC.

59. To a question whether any demand survey was undertaken, Shri Malay Sengupta, Ex-CMD of MSTC stated that a direct survey is almost never undertaken but inferences are drawn from secondary sources. The Report itself mentions that in 2007-08 the global market

was favourable but the demand started slackening from the 1<sup>st</sup> quarter of 2008-09. This data could not have been available in real time and was certainly too late for deciding business plans for 2008-09.

## **H. Insurance coverage of export of gold jewellery**

60. The Audit has brought out that as per agreement, MSTC would arrange to insure the risk of non-realization of the export proceeds from the foreign buyers. The insurance premium was to be recovered from the associates. The Company accordingly insured the risk of non-payment of export proceeds of 2007-08 with ECGC. This insurance policy was renewed (September 2008) for the exports of 2008-09 to cover the risk of non-payment of dues by the foreign buyers whose bills (Rs. 453.54 crore) were to be discounted through four banks. In addition, the Company took (August 2008) another insurance policy from ICICI Lombard General Insurance Co. Ltd. (ICICIL) to cover the risk of non-payment of export dues (Rs. 184.66 crore) for which loan from Standard Chartered Bank (SCB) was obtained.

61. When asked to furnish a detailed note on the Insurance policy taken by MSTC with ECGC stating inter-alia its terms and conditions, the extent of payment of insurance premium, liability on the parties concerned in the event of default by the potential overseas buyers, etc., ECGC in a written reply stated that on 29<sup>th</sup> August, 2007, MSTC submitted a proposal to ECGC, for issuing insurance cover against non-payment by the foreign buyers and/or the country of import. In the Proposal form, MSTC has given an undertaking that they were not aware of any circumstances which may adversely influence acceptance of risks by ECGC and also declared and certified that they had not misrepresented or omitted any material fact which might have a bearing on the policy to be issued to them and agreed that such representations and facts informed formed the basis of policy to be issued to them and that the truth of such representations as facts and due performance of each and every undertaking given by them and stated in the Policy to be issued shall be condition precedent to any liability of the Corporation under the policy issued to them. Pursuant to the receipt of proposal made by MSTC, a customized Export Turnover Policy (ETP) numbered ETP. No. 0050007043 with a Maximum Liability of Rs. 300 Crore for the period 29/08/2007 to 31/08/2008 was issued by ECGC on 5.9.2007. The customization in the ETP was done with reference to Exclusion of Repudiation Risk Cover, Approval of Low Fixed Rate of Premium on Actual Export Turnover and Fixed amount of Minimum Premium of Rs. 1.50 Crore. At the request of the exporter, the Maximum Liability under the Policy was increased to Rs. 600 Crore w.e.f. 15.7.2008, with an additional Minimum Premium of Rs.0.60 Crore. This insurance Policy was further renewed for the period 01/09/2008 to 31/08/2009 with higher Minimum Premium of Rs. 2.40 Crore. The major terms and conditions of the customized ETP Policy issued to MSTC were as under:

- (a) Percentage of Cover: 90
- (b) Risk Covered: Protracted Default and Insolvency of Buyer (*Cl. a (i) and (ii)*) and Political Risks (*Clause a (iv) to (viii)*)
- (c) Premium Rate: 0.30% on export turnover
- (d) Declaration of Shipments: The exporter to declare all shipments made to all buyers without any exception to ECGC (Whole turnover principle) – Clause 11 of the Policy.
- (e) Exporter (MSTC) to apply for and obtain Credit Limits on each Overseas Buyer approved by ECGC. (*Clause 19*)
- (f) The exporter to declare all material facts and circumstances having a bearing on the risks insured to ECGC.

(g) Other Terms as applicable to Normal ETP.

62. The actual premium paid by MSTC under the policy was Rs.1.81 Crore during 29.8.2007 to 31.8.2008 and Rs.0.38 Crore during 1.9.2008 to 31.8.2009. ECGC's liability under the Policy was to indemnify up to the insured percentage of the insured loss specified or up to the amount of relevant credit limit available on the insured buyer whichever is lower, if any insured buyer fails to pay the insured debt by reason of insured perils, viz., Protracted Default or Insolvency (Commercial Risks) and Inconvertibility, Contract Frustration, Contract Cancellation, Import Restriction and Shipment Diversion (Political Risks). The indemnity given is subject to the exporter complying with all terms of the Policy which, inter alia, included disclosure of material facts having a bearing on the risks insured, existence of insurable interest of the exporter, buyer not disputing his liability and availability of right of recourse against the overseas buyer for recovery.

63. Responding to the question what exercise was undertaken in ECGC to assess the "insurable interest" of MSTC, the ECGC in post evidence information furnished to the Committee stated that MSTC had covered certain exports with ECGC till 30<sup>th</sup> April 2007 under an Export Turnover Policy. Additionally in the policy proposal MSTC's status was given as 'one star trading house'. Thus, ECGC was aware that MSTC is a PSU "Merchant Exporter". ECGC issues policies to Merchant exporters and Trading houses in normal course of business. Generally, Merchant Exporters and Trading houses negotiate and conclude orders from the overseas buyers with a clause in the order enabling them to outsource procurement / production / supply / execution to a third party. While the third party may get paid by the merchant exporter / trading house as per their bilateral arrangement, the merchant exporter / trading house will have 'insurable interest' as the merchant exporter will take the risk on the foreign buyer, take a part of the risk on his books, negotiate and facilitate export trade, have full responsibility for export performance and monitor and ensure realization of dues from buyer, will have only procurement relations with the supplier and not any financing arrangements and he will also bear the cost of insurance. When any exporter seeks policy cover, it is presumed that he has an insurable interest in the transaction and accordingly cover is issued. It is for the exporter to disclose to the insurer the details of arrangement / agreement, if any, with the suppliers in case certain clause of the agreement has a bearing on the insurance cover. In the subject case, since MSTC declared them as the exporter, we had no reason to not believe that MSTC had insurable interest for the goods sourced from the supplier as MSTC is a one star trading house with experience in international trade and credit insurance cover. It was only later, when the Memorandum of Agreement was submitted on November 17, 2008 (i.e. much after the Issue and Renewal of policy), ECGC came to know through the preamble (in page 2) of the agreement and the terms (clause no. 1.1, 1.3, 1.6, 5.b (4), 11 b, 11 c and 11 d) of the Agreement that MSTC was merely acting as a " Financing Company" (clause 5.1 to 5.4) at the post shipment stage in the subject transaction and that MSTC had recourse to suppliers in the event of non-payment of bills by overseas buyers. It may be mentioned that as per the credit insurance requirement indicated by MSTC and in the proposal submitted by MSTC, gold jewellery is one of the items of export along with other items of exports, such as Building materials, Ceramic related products, Iron, steel & other allied products/articles.

64. The Committee noted that ECGC granted a concession of reduced premium to MSTC in this case.

65. When further asked what specific factors weighed with ECGC for granting a concession of reduced premium to MSTC, ECGC in a post evidence information furnished to the Committee stated that the following factors were taken into account while quoting the premium to MSTC:

1. MSTC was a Government of India Company with 'mini-ratna' status and a one star trading house.
2. ECGC's experience with MSTC until 30<sup>th</sup> April, 2007 was satisfactory, with no incidence of claim.
3. In the proposal for new policy, the exporter had indicated an anticipated export turnover of Rs.1000 Crore and the destination countries as UAE, Singapore, Hong Kong, Turkey, UK, Spain, Germany and Romania and it offered reasonable spread in terms of volume and country risk.
4. Break-up of anticipated turnover for Countries classified in A1 group is Rs.255 Crore and A2 group is Rs.710 Crore and B1 group is 35 Crore
5. Exclusion of Repudiation Risk
6. Fixed Minimum Premium of Rs.1.50 Crore.
7. All Buyers were subject to ECGC assessment and no discretionary limits were to be issued to MSTC.

66. In a post evidence reply, ECGC further elaborated that ECGC assesses the credentials on Buyers based on external agency reports received on the buyers. The non-financial factors taken into account include buyer's year of establishment of business, number of employees, legal structure, line of business, office setup, status (wholesaler/retailer), etc. The financial factors such as Capital, Sales, Operating profit, Margin, Net profit, Liquidity ratio, Tangible net worth, Agency rating, etc are taken into account, to the extent available. ECGC's experience with buyers available on ECGC's record, details available in the credit Limit Application received from the exporter(s), etc. are also taken into account. ECGC lists the positive and negative factors from the above and based on the request for limit from the exporter(s) and assessment of credit limit requirement, the exposure limit on the buyer is fixed".

67. Audit observed that export business with four foreign buyers (during 2008-09) was covered under these two insurance policies. This was, however, not disclosed to the insurers. It was also stipulated in the above policies that the Company should exercise reasonable care and prudence in granting credit to the foreign buyers. It was, however, observed that the Company did not carry out due diligence in identifying the foreign buyers. It was, further, observed that the Company also did not disclose the insurers about the contractual obligations of the associates to bear the entire risks and costs in the event of non-realisation of export proceeds from the foreign buyers. Audit has also pointed out that as per terms and conditions of the policy with ECGC, the whole export proceeds of the Company were to be insured. It was also specified in the policy of ICICL that the company should not enter into any other export trade insurance policy without the consent of the insurer.

68. In this regard, when asked whether MSTC was also required to apprise ECGC about the contractual obligation enshrined in the insurance policy of ICICL, ECGC response in a written reply was as under:-

"In the Preamble of the Policy issued to MSTC, it has been specifically stated that MSTC has submitted a proposal in writing and applied to us for indemnity in respect of the whole of its export trade with overseas buyers and it was also specifically

mentioned in Clause 11 of the Policy that MSTC will declare to ECGC all shipments made during the relevant declaration period under the policy, thereby cumulatively for the entire period of the policy. The Schedule attached to the Policy Bond specifically mentions Shipments made against Letters of Credit, Shipments to associates and Shipments made on Consignment basis are not covered under the policy. Considering that MSTC has agreed to offer their entire export turnover for cover, ECGC had agreed for a special lower rate of premium than the rate usually charged for similar policies for other exporters. Further, if MSTC intended to cover a part of its export turnover with any other insurer, it should have taken specific written consent from ECGC. MSTC not seeking ECGC's consent was in violation of the undertaking given by them in the proposal form viz.

*“We hereby declare and certify that all statements made in the application are true and that we have not misrepresented or omitted any material fact which might have a bearing on the policy, and we agree that such representations and facts shall form the basis of and be incorporated in the policy and that the truth of such representations as facts and due performance of each and every undertaking contained herein or in the policy shall be condition precedent to any liability of the Corporation hereunder and to the enforcement thereof by us”*

and non-fulfillment of obligations of the exporter expressed in *Clause 1* under “Terms and Conditions” of the Policy which warrant notification of any change in material facts and circumstances to ECGC and to act with the utmost good faith at all times.

Thus the terms of policy issued by ECGC also makes it obligatory for MSTC not to enter into any other export trade insurance policy, without its consent”.

69. When asked why MSTC did not disclose the fact to both the insurers (ECGC & ICICI Lombard) that the associates would bear all the risk and cost in case of non-realisation of export proceeds, the Company in its written reply stated that before taking up the Insurance there was detailed discussion with ECGC. ECGC offered MSTC a Multi Buyer Exposure policy which MSTC accepted. The first offer received from Insurance Company is as back as 16.07.2007. On the basis of offer there was further discussion and again on 17.07.2007, ECGC confirmed the documents required at the time of claim processing while the actual policy was issued on 29.08.2007. The copy of draft MOA was produced to them before issuing the policy. Again on 17.11.2008, the copy of executed MOA was sent to ECGC. The responsibility of a company/exporter to realize payment from the overseas buyers is to be judged solely as per the guidelines of the RBI and not what contract has been entered into between merchant exporter and supporting supplier. The RBI had been following up with the company for realization of export proceeds and has issued letter/notices and seeking reasons for non-realization of payment. The Insurance with ICICI Lombard was taken by the Standard Chartered Bank as lead insured where MSTC was co-insured. Standard Chartered Bank has purchased the export receivable of MSTC which were insured by ICICI Lombard.

70. When asked to elaborate on the aspects on which correspondence was exchanged between officials of ECGC and MSTC before entering the new export business, ECGC in a post evidence reply stated that aspects on which correspondences (including discussions) were exchanged with MSTC, its Consultant and insurance broker are as follows:

- Estimated / Projected turnover: Rs.1000 Crore for one year period (policy year) i.e. 29.08.2007 to 31.08.2008
- Minimum Premium (INR 1.5 Crore) / Committed Turnover: INR 500 Crore or 50% of estimate Turnover
- Commodities / Items to be exported: Hallmarked Gold jewellery, Tiles, Agricultural Commodities, Processed food materials, Fruits pulp etc. (Additional products can be added which will be informed to ECGC and consent obtained).
- Mode of Payment: DA 180 days
- No. of Buyers: 40 to start with which is expected to grow around 60-70 by the policy year end
- Destination Country: UAE, Singapore, Hong Kong, Turkey, UK, Germany, Gulf, Romania, Africa (Other countries will be added subject to insurer's prior consent)
- Broad Guidelines : Salient features of Policy (Export Turnover Policy (ETP), Multi Buyer Export Policy) (MBEP)
- Percentage of Cover: 90 %
- Risks to be covered: mainly Protracted default, Insolvency of Buyer, and Political risk
- Risks to be excluded: Repudiation by buyers
- Details of procedure of Policy as well as procedure of settling Claims
- Premium rate
- Maximum Liability/Aggregate Loss: INR Rs.300 Crore.
- Transaction modalities: Buyer limit, export documents, acceptance by buyers, identifying buyers' signature by overseas banks etc.
- Prospective buyers in 8 countries with estimated/ projected turnover: UAE Rs.700 Crore, Singapore Rs.25 Crore, Hong Kong Rs.10 Crore, Turkey Rs.30 Crore, UK Rs.100 Crore, Spain Rs.50 Crore, Germany Rs.80 Crore and Romania Rs.5 Crore and current status of Buyers: limits to be fixed by ECGC, default list etc.

Appointment of Advance Risk Solutions India Private limited (ARSIPL) as credit insurance Consultants by MSTC and authorizing ARSIPL and its associates to

structure, discuss and plan insurance programme (including buyer limit and premium) with the underwriter. Decision on final placement of business to be taken by MSTC.

71. To a specific question whether MSTC sought the opinion of ECGC on its insurable interest in the proposed new business of export of gold jewellery through associates on post shipment and document of acceptance (DA) basis, ECGC in a written reply stated that as per available records, MSTC has not specifically sought any opinion of ECGC on its insurable interest. As per the Industry practice, details given in the proposal submitted by the applicant (MSTC) and the correspondences exchanged as mentioned in response to item 1 (a) above were accepted in good faith and policy was issued accordingly.

72. When asked about the reasons for taking insurance coverage of four foreign buyers under two insurers (ECGC & ICICI Lombard) without informing both the insurers thereby violating the conditions in insurance policies, the Company in its written reply stated that the insurance policy of ECGC and ICICI Lombard are mutually exclusive. In the ECGC the Insurer is MSTC while in the case of ICICI Lombard, lead insurer is Standard Chartered Bank who has purchased the export Receivable from MSTC. In this case, MSTC is only the coinsurer. The fact was referred to Mr. Gopal Subramaniam, Solicitor General of India for opinion. It was opined that unless and until the policy has any express terms or clauses which prohibits any such arrangement of apportionment, the buyer, the Bank as well as the insured would have the option to adopt such arrangement. In other words it is an arrangement which is internal to the buyer, the bank and the insured. However, an insurer can provide by an express stipulation that if a factoring mode arrangement is being adopted prior consent of the insurer should be obtained. In the Insurance policies with ECGC, there is no such clause. In view of the fact that there is no such clause, it appears that the Company is justified. It was opined that ECGC has taken buyer specific insurance and liability of ECGC would arise with reference to the default committed by individual buyers and that ought to be one of the contingencies on the basis of which the insurer will have to proceed to settle claims. He also opined that Clause 5 of the Insurance policy of ICICI Lombard does not in any way suggest the factoring mode arrangements entered into are precluded. In fact factoring mode arrangements are to be permissible both on the face of the ECGC policy as well as ICICI Lombard policy. The fact is that there are 4 foreign buyers under two insurers. Attention of Solicitor General India was drawn on this issue. He opined that "even in respect of these 4 buyers where policies have been taken out both from ECGC as well as ICICI Lombard, it is clear that it is not the same claim which has been insured, but in fact, different extents of pay-ability have been ensured. Since the priority of the insurer in point of time is that of ECGC the first claim will lie in favor of ECGC and in respect of any additional credit limit or pay-ability risk which was covered by ICICI Lombard, ICICI Lombard will have to settle the claim. Thus even in respect of this 4 buyers even though they have been subjected to two policies- one from ECGC and the other from ICICI Lombard – it is clear that since the policies are buyer specific, it is not exactly a case of double insurance. It is further opined that an additional factor in favour of such an interpretation is that there is no common bill. In view of the fact that both ECGC and ICICI Lombard had conducted due diligence before offering the policy and also having regard to the fact that such claims are based upon trade volumes, that creditworthiness is not the sole factor for limiting the insurance cover. Hence it is possible for the company to contain that both the policies were intended to be complementary to each other and one was not intended to be replaced or subsumed by the other. Thus the question

of double insurance should not be attracted in this case. The opinion of the Solicitor General of India is enclosed as annexure.

73. To a pointed question what has been the impact of Additional Insurance availed by MSTC with ICICI Lombard, ECGC in its post evidence reply stated that it was observed that the arrangement entered into by MSTC with ICICI Lombard which was prohibited as per ECGC Policy conditions also included common buyers. Beyond the credit limit assessed by ECGC, if the transactions under ICICI arrangement are also taken into effect, the overall exposure on the buyers got enhanced. MSTC had covered six buyers with ECGC and these buyers were also again included in the factoring facility availed by MSTC for fourteen buyers. It was found that the aggregate exposure on these buyers were exceeding by 25%, 35% and even over 100% compared to the credit limits approved by ECGC. The total outstanding on account of some buyers were more than twice the credit limits fixed by ECGC. This led to overtrading and over exposure beyond the credit worthiness or the payment capacity of those buyers, resulting in stress and ultimate default.

74. When asked about the normal practice followed in this regard in its other business dealings, the Company in its written reply stated that the Company did not take Multi buyer policy from any insurance Company. This is first time MSTC has taken ECGC policy covering insurance perils arising out of

1. Protected Default by the overseas Buyer
2. Insolvency of the Overseas Buyer
3. Other political risk.

75. In other business dealings like Import, MSTC takes Marine Insurance policy for the full shipload of material and insurance of properties and stock. In case of import/procurement of material and sell to domestic customers, as per the model, materials are kept under the control of MSTC through custodian and materials are released on piecemeal basis on receipt of payment from customers. Hence no credit insurance is taken to cover payment risk of customers.

#### **I. Non-payment of dues by the foreign buyers**

76. The Audit has observed that during 2008-09, gold jewellery worth Rs. 638.20 crore was exported by six associates to 47 foreign buyers and the last batch of export was made in November 2008. MSTC discounted export bills worth Rs. 453.54 crore from four banks and also obtained loan from one of the above banks i.e. Standard Chartered Bank, against the balance bills worth Rs. 184.66 crore. Six associates were paid Rs. 501.55 crore as advance. 46 foreign buyers did not pay their dues of Rs. 598.63 crore to the banks on the due dates. The Company paid Rs. 68.78 crore as interest, bank charges and discounting charges to the banks. Further, Fixed Deposit Receipt (FDR) of the Company amounting to Rs. 25 crore as security against the bank loan was encashed (April 2009) by the Standard Chartered Bank. In addition, the Company had to incur crystallisation loss of Rs. 53.06 crore as deducted by banks. The Company could realize only an amount of Rs. 10.48 crore from the associates thus, an advance amounting to Rs. 528.49 crore (including crystallisation loss) remained unrealized. Even the post dated cheques deposited by them could not be encashed as the non-payment by the foreign buyers was not due to disputes relating to quantity, quality and price.



77. MSTC subsequently received (November 2008) two Bank Guarantees (BGs) amounting to Rs. 62 crore from two associates (Ushma - Rs. 32 crore and Space Rs. 30 crore) as security towards the exports to be made in future i.e. after December 2008. Since there was no export after November 2008, the above BGs could not be encashed. Further, 14 FDRs amounting to Rs. 100 crore issued by Pen Co-operative Bank (PCB), a non-scheduled urban co-operative bank, were received (April 2009) from Ushma (Rs. 52 crore) and Space (Rs. 48 crore) with the condition to encash the same on maturity (between October 2010 and June 2011) only. The Company placed (03 September, 2010) six FDRs maturing on 28 October 2010 amounting to Rs. 30 crore (Rs. 15 crore pertaining to Space and Ushma each), to PCB for encashment. In the meantime, the Reserve Bank of India precluded the PCB, with effect from 22 September 2010, from incurring any liability or granting/renewing any loans/advances or making any payments or discharging any liability or obligation, vide its directives dated 21 September 2010. The Company, as such, could not encash these FDRs. It was worth mentioning that the above bank was having a meagre deposit of Rs. 400 crore only and one of its Directors was an ex-Director of an associate (Space).

#### **J. Rejection of claims by insurers**

78. According to Audit, insurance claims were lodged (November 2009/January 2010) with ECGC and ICICIL for non-realisation of export proceeds from the foreign buyers. Both the insurers, however, rejected such claims on the ground that as per the agreement with the associates, all the risks and costs in this business was to be borne by them in the event of non-payment by the foreign buyers and as such MSTC did not have any insurable interest. Further, the insurance policies would cover only the risk of non-payment by the foreign buyers and in this case the risk of the Company arose due to non-realisation of advances from the associates who were the actual exporters.

79. On being asked to furnish a note giving detailed reasons for rejection of insurance claim lodged with ECGC along with the provisions of the policy under which such rejections have been made, ECGC in a written reply stated that MSTC lodged 37 claims aggregating Rs.452.81 Crore under customized ETP No. 0050007043. Out of these 36 claims amounting to Rs. 446.64 Crore pertained to 35 buyers in UAE and one buyer in Singapore. On one buyer viz., Mine Gold and Jewellery LLC, UAE, two claims of Rs. 6.71 Crore and Rs. 1.95 Crore were lodged. The claims have been lodged against shipments made during the period from 15.04.2008 to 18.12.2008.

80. The shipments to the buyers were made by three Associates with whom MSTC Ltd. had signed Memoranda of Agreements. The details of the Associates are as under:

1. M/s Ushma Jewellery & Packaging Exports Pvt. Ltd.
2. M/s Space Mercantile Company Pvt. Limited.
3. M/s Bonito Impex Pvt. Limited.

81. The claims were lodged with ECGC during the period from 31.03.2009 to 17.11.2009. The claims were regretted by the Corporation vide letter no. HO/ Pol. Claims/ER/2010 dated 14/05/2010. The reasons for rejection of claims are as under:

- (i) Non-existence of "Insurable Interest" under the Policy:

ECGC was not aware of the clauses in Memorandum of Agreement between MSTC Limited and its Associates (MOA) which makes its Associates responsible for the losses in non-realisation of export proceeds in exchange for the amount advanced to them by MSTC. If ECGC were to know of the details of the arrangement, ab-initio, it would not have issued such a policy as there was no “insurable interest of MSTC Limited”. Insurable interest over a property is “such interest as shall make loss of the property to cause pecuniary damage to the assured”. In the instant case, insurable interest of MSTC Limited, if any, lied in the failure of Associates to repay the advance given by MSTC to them and not in the failure of the overseas buyers to pay the export proceeds.

MSTC was required to pay an advance of 80% of invoice value to the Associate on acceptance of the bill of exchange by the overseas buyer and balance was to be paid to the Associate after receipt of export proceeds from the buyer. In the event of non-realization of payments from the buyer, the Associate was responsible for all costs, risks and consequences.

Clause 5(b) 4 of MOA states:

*“a post-dated cheque covering the issuance period for the equivalent amount of advance shall be encashed by MSTC in the event of non-receipt of export proceeds on the due date”.*

Clause 11 (c) of MOA states:

*“It is clearly understood by the parties that the export contract is an integral part of this MOA. In the event foreign buyer fails to honour its contractual obligations, the Associate alone shall bear all the risks, costs and consequence for the same”.*

Quite contrary to the requirements under ECGC’s Insurance Policy, MSTC had no control whatsoever over any of the aspects of the exports. MSTC had no proximate insurable interest on the ‘buyer failure’. MSTC’s proximate cause of loss was actually the risk of failure of those exporters on whom MSTC was advancing money on the security of their export bills and their post-dated cheques.

(ii) Losses arising due to the risks not covered

The proximate cause of loss is default on the part of the “Associates” as per the MOA between MSTC Limited and the Associates which is not covered by ECGC under the policy. MSTC had paid advance to the Associate against the invoices raised on the overseas buyer and the Associate failed to recover the export proceeds from the Buyer. Hence the failure of the Associate to recover the payment which resulted in loss to MSTC is a risk not covered under the policy. MSTC extended the advance to the suppliers with recourse to them as per Clause 5 (b) (4) of MOA and Bank Guarantee executed by Associates in favour of MSTC. The default, if any, will arise if the suppliers in India fail to repay the advance granted by MSTC. The policy issued does not cover risk of the failure of the suppliers (Associates) in India.

(iii) Violation of “ Whole turnover” Principle:

Under the policy issued to MSTC, MSTC is required to declare, in the format prescribed, the Gross Invoice Value (GIV) of total export turnover for each of the declaration periods specified in the schedule. The ECGC was informed after a delay of 10 months by MSTC that they had availed finance under a factoring arrangement with Standard Chartered Bank for shipments worth Rs.187 Crore made during September to November, 2008 which were insured by ICICI Lombard for credit risks. This is violation of the conditions stated under the preamble, Clause 11 (a) and 11 (b) of ECGC Policy. MSTC had to insure all his shipments to all buyers without any exceptions (Whole-turnover Principle).

The Preamble of the policy states:

*“You have completed a Proposal in writing and applied to us for indemnity in respect of **whole of your export trade with buyers** in the countries specified in the Schedule (Schedule of Countries) save and except those that are specified as excluded in this POLICY and we have agreed to give you such indemnity subject to all the terms and conditions contained in the POLICY including the payment of premium and other charges specified in the Schedule (“Premium Schedule”).”*

Clause 11 (a) of the policy states:

*“You must declare to us in writing in the format prescribed by us the GROSS INVOICE VALUE of your export turnover **for each of the Declaration Periods** specified in the Schedule giving full details of all the shipments made/ Invoices raised by you during the relevant Declaration Period.”*

Clause 11 (b) of the policy states:

*“It is a condition precedent to our liability that completed declarations giving full details of **all the shipments DESPATCHED by you** during each of the Declaration Periods specified in the Schedule must be submitted to us in our prescribed form after the last day of the relevant Declaration Period within such number of days specified in the Schedule.”*

(iv) Non-Disclosure of material information at the time of proposal

The policy holder did not submit a copy of the Memorandum of Agreements (MOA) and Addendum to the MOA dated 16.08.2007 at the time of submission of the policy proposal. MOA was submitted by MSTC vide letter dated 17.11.2008 and Addendum was submitted vide letter dated 14.01.2009. MSTC availed Factoring facility during September to November 2008 with Standard Chartered Bank. This was informed vide letter 22.07.2009. The non-disclosure of any material fact at time of submitting proposal cover is a violation of the clause 1 under “Terms and Conditions” of the policy. The clause states that:

*“You also warrant that you will immediately notify us of any material change to the information supplied in the Proposal form or any other material facts affecting the POLICY.*

*These warranties do not limit any legal obligation or duty (at common law or otherwise) on you to disclose to us all material facts and circumstances and to act with the utmost good faith at all times.*

*At the time of any amendment, change, variation and/ or addition to the Policy you must disclose to us all material facts and circumstances and your failure to do so will render the amendment, change, variation and/or addition void ab initio."*

Thus, procurement of insurance policy by MSTC through active suppression / non-disclosure of material information had rendered the Policy issued void *ab initio*.

(v) Disputed Liability:

As per "Exclusions" defined in the policy document, ECGC is not liable to any losses arising out of disputes with buyer.

In the instant case, buyers have disputed the quality of the shipments made and also disputed the order itself. They informed that their name was used by some other person, who in turn promised to pay a fixed commission for the purpose.

Clause 2(d) under "Exclusions of the policy states:

*"We shall not be liable for any losses arising Buyer Risks where there is an unresolved dispute between you and the INSURED BUYER unless we have agreed otherwise in writing"*

(vi) Possibility of fraud:

MSTC vide their letter No. MWR/EGJ/2009 -10/5275 dated 22.03.2010 provided the details of discussions held between officials of MSTC Limited and Dubai Chamber of Commerce and Industry, Dubai which indicates that buyers were induced to only lend their names purportedly by the representatives of suppliers in India (Associates) / MSTC's Agent /Consultant. On this ground, the Buyers had disowned the liability, although they had signed the documents against acceptance at the point of time when documents were submitted.

The Clause 12 (a) of the policy states:

*"If you make any claim knowing it to be false or fraudulent in any way the Policy will be void and all claims under it will be forfeited. .... In such circumstances, we shall be entitled to retain all the premiums paid by you under the Policy".*

The Corporation submits that there is in existence preponderance of circumstances and information that suggest that whole or a substantial part of the export transactions in respect of which the claim had been made by MSTC were fraudulent and that several of the so called export bills were mere accommodation bills. The Corporation is in the business of export credit insurance for more than fifty years now and never ever in its history had it come across a case where 35 out of 36 buyers in one place had at a stroke uniformly failed and defaulted."

82. On being asked if ECGC raised a red flag at that time, MSTC would not have exported it or would not have gone into this, CMD, ECGC during his deposition before the Committee stated as under:-

“Sir, whatever information was available at that time to me, I had no reason to raise any red flag because since I was not aware of the clauses in the MoU between the MSTC and its associates, everything was okay at that particular point of time when we issued the policy. Had we known the clauses in the MoU, yes, I would not have issued the policy at that time itself. I would have told the exporter to come. We were not aware of the MoU clauses.”

83. When asked whether ECGC conducted due diligence before covering risks on overseas buyers, CMD, ECGC during his deposition before the Committee stated as under:-

“Yes, Sir. Here I am saying that whatever we do for any other exporter, we have done totally for MSTC also in terms of conducting the due diligence on the overseas buyers. What has not come to our notice is that here in effect I was not really covering the overseas buyer’s risk. After reading the MoU, I came to know, what I am covering is the Indian exporters associate’s risk. Whatever amount the exporter has given to associate, if he does not pay then he is coming to us. It is not the overseas buyer’s risk because he has covered himself totally with the buyer. He has asked for PDC from the exporter. If a trading house is trading, how can he take PDC? Normally, the PDC is taken when a buyer has to give to the seller. But here the reverse has taken place. MSTC is supposed to be the buyer, who has to export, has taken PDC from the exporter. It is very important point.”

84. Adding further, representative of ECGC during her deposition before the Committee stated as under:-

“We have been with the organisation for 30 years. I am just taking the liberty to say that never ever in the history of ECGC or never ever in the history of any other export credit institution have defaulted. At the same time, 40 odd buyers have defaulted. Secondly, as regards our policyholders, we have to do some basic due diligence, which are the KYC norms. If an exporter comes to me, he has in IE code. We tell him to get his banker’s reference. We verify it with the bank. We check with the GDFT. We know he is a genuine exporter. That is what I would do. The trading houses, normally who do not manufacture, have to procure through various suppliers. I cannot be going behind each supplier asking as to what kind of agreement he has, how does he get the goods, does he mark up the price and what is his commission. No. That is not my role. The role of the ECGC is to ensure the receivables from abroad. So, my job is to do due diligence on the buyers. We have a laid down system for the buyers as to what kind of information to call for, which are the source, what if financial information is not complete, etc. etc”.

85. With regard to Audit observation of non-disclosure of material information to ECGC, ex-CMD of MSTC (Shri Malay Sengupta) in his written submission stated that all information sought by ECGC were supplied. They were informed that we would buy from the disclosed associates and export to the buyers selected by the associates provided such buyers were approved by ECGC. All relevant information about the Buyers as demanded by ECGC were provided. If they thought any other information was required, it was for them to ask for it.

MSTC never denied them any information asked for. Regarding the contention that two Insurance policies were taken from two different companies, without informing each of the other, and that it violated the conditions of insurance, I submit that this appears to be a mis-construction of the clause. The purport of this clause, as far as I have been able to understand, is that for the same failure of the same Buyer claims cannot be lodged under more than one policy. Since Standard Chartered Bank purchased the receivables pertaining to the Buyers covered by the ICICI Lombard policy obviously no claim would lie on ECGC.

86. On rejection of insurance claims of MSTC, ex-CMD of MSTC in his written submission stated as under:-

“As regards the applicability of Insurance policies or validity of MSTC’s claims, the matter I believe is sub-judice. However, MSTC not being the exporter, once again this contention is not right. MSTC purchased the Jewellery from the associates as evidenced by their sales invoice in INR. MSTC raised its own invoice on the Buyers in US \$, which is also a matter of record. An exporter is the party who, in case of a cross-border sales-purchase transaction, is entitled to receive the sales proceeds. It is a matter of record that MSTC and MSTC alone received the sales proceeds (barring the cases of default). Such proceeds being in Foreign Currency the necessary formalities were carried out by MSTC. For non-receipt of sales proceeds in cases of default MSTC was asked to explain by RBI. I also understand that Dubai court has unambiguously upheld MSTC’s right to receive the sales proceeds. These cases in Dubai were filed by MSTC on its own right and not as an agent of, or with any no objection certificate from the associates. MSTC is therefore clearly the Exporter. ....

87. In addition to above, ex-CMD of MSTC in his written submission stated that the defaults took place, the meltdown of the global Financial system, has not been mentioned even, let alone being examined. No comment has been made on the recovery process either.

## **K. Legal Proceedings**

88. When asked about the exact quantum of losses suffered by the Company in the extant export business, the Company in its written reply stated that the volume of export made during financial year 2007-08 – Rs. 260 Crore.

The volume of export made during financial year 2008-09:

Under Discounting Mode (ECGC)	=	Rs. 453.54 Crore.
Under Factoring Mode (Standard Chartered Bank-ICICI Lombard):	=	Rs. 184.66 Crore

89. Full export proceeds for the financial year 2007-08 were realized. Against export in Financial Year 2008-09, an amount of Export Invoice of Rs. 22.77 Crore was realized from the overseas buyer under the Discounting/ ECGC Mode. An amount of export Invoice of Rs.16.80 Crore was realized from the overseas buyer under the Factoring/ Standard Chartered Bank-ICICI Lombard. Thus outstanding export Invoice value under Discounting mode insured by ECGC remained at Rs 430.77 Crore and outstanding export Invoice value under factoring mode factored by Standard Chartered Bank and insured by ICICI Lombard remained at Rs. 167.86 crore. However, in financial year 2008-09, a total amount of Rs. 475.45 crore was paid to the Associate suppliers towards part payment for the purchase consideration of the above outstanding export of gold jewellery. Out of the above said total part payment of

Rs. 475.45 crore, an amount of Rs. 342.25 crore has been paid against export under discounting mode insured by ECGC and an amount of Rs. 133.20 crore has been paid against export under factoring mode which was factored (paid) by Standard Chartered Bank who purchased, the receivables of export of gold jewellery from MSTC.

90. When asked what legal action has been initiated against the defaulters, MSTC in a written reply stated that arbitration against all the 6 (six) associates suppliers have been started since December 2009 and are still continuing. Legal cases against the associates viz. M/S Ushma Jewellery have been initiated in the Bombay High Court for enforcing sale of the mortgaged collateral Securities. Legal cases against all the 46 foreign buyers have been initiated/being initiated in the Courts of UAE, Singapore and Kuwait. Legal actions against foreign buyers are being taken as per advice of the Ministry of Law, Government of India. Legal cases against ECGC have been initiated for transaction of all the 36 buyers insured by ECGC for payment of claim amount in National Consumer Disputes Redressal Commission, Delhi. Legal case against The Pen Cooperative Urban Bank Limited is being initiated for encashment of FDRs and BGs issued by them, subject to such advice by MSTC Counsel. Hence the entire gamut of transaction and securities are all presently sub-judice.

91. Former CMD of MSTC stated in this connection in written submission that MSTC, I understand, has initiated legal proceedings against Buyers, associates as well as ECGC. Against the Buyers, I understand, MSTC has got several decrees and has not had its claim rejected in any case. Some are pending. Against the associates also it has won a few awards and has not been denied any. Again a few proceedings are pending. Against ECGC proceedings are continuing. But, I understand, before commencement of the proceedings MSTC had obtained a legal opinion from the then Additional Solicitor General which supported MSTC's claim. I, therefore, submit that MSTC has done no legal wrong and has to depend on the legal process to recover its dues.

92. When desired to know the extent of legal expenses having been incurred in recovery action for gold jewellery matter, the Company in a written reply stated that the Company have spent the followings:

DETAILS OF LEGAL EXPENSES IN RECOVERY ACTION FOR GOLD JEWELRY MATTER UPTO  
NOVEMBER 2011 (Rs. INR)

	CONSULTATION FEES	COST DISBURSEMNET	TOTAL
<b>CASE AGAINST ECGC</b>	<u>PAID</u>	<u>PAID</u>	
PAYMENT OF AMARCHAND MANGALDAS, KOLKATA	49,14,553	4,63,222	53,77,775
Additional Solicitor General (SR. COUNSEL), DELHI	5,60,500		5,60,500
<b><u>CASES AGAINST FOREIGN BUYERS</u></b>			
AL SHAMSI & PARTNERS, DUBAI	46,37,882	17,12,268	63,50,150
AMARCHAND MANGALDAS, KOLKATA	10,36,716		10,36,716
COURT FEE, DUBAI		65,01,734	65,01,734
LEGALISATIONTION - UAE EMBASSY, DELHI		62,04,750	62,04,750

LEGALISATION OTHERS, KOLKATA & DELHI		96,000	96,000
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**CASE AGAINST ASSOCIATES**

**ARBITRATION**

ARBITRATOR'S FEES(Shri Shiadas Banerjee),KOL.	9,09,880	29,400	9,39,280
COUNSEL FEES (Sanderson & Sutanu),KOLKATA	17,70,120		17,70,120
PAYMENT TO SOLICITORS (SANDERSONS), KOL.	3,69,944	71,257	4,41,201
<b><u>MUMBAI HIGH COURT</u></b>			
LITTLE & CO. (SOLICITOR), MUMBAI	13,27,906	1,46,553	14,74,459
POLICE AND EOW COUNSEL AT MUMBAI	70,000		70,000
COURT FEES AT BOMBAY HIGH COURT		3,00,000	3,00,000
PUBLIC NOTICE	98,329		98,329
<b><u>PAYMENT REGARDING OPINIONS AT MUMBAI</u></b>	4,96,900		4,96,900
<b>TOTAL</b>	<b>1,61,92,730</b>	<b>1,55,25,184</b>	<b>3,17,17,914</b>

93. When asked to specify the number of cases of legal action initiated against ECGC for rejection of its claims, ECGC in a written reply stated that MSTC has filed 36 consumer complaints at National Consumer Disputes Redressal Commission at New Delhi against rejection of its claim by ECGC. All these 36 complaints are clubbed together and scheduled for hearing on 25/04/2013. Pleadings are complete and ECGC has to file its affidavit of evidence on the next date.

94. To a query as to what initiatives were taken by MSTC to recover the unrealized money before initiating legal action against the defaulters. In the evidence held on 31<sup>st</sup> July 2012, the CMD, MSTC stated as under:

“I along with my MSTC team went to Dubai, saw and met these people. Out of 46 buyers, I could meet about 25 of them because of Ramadan. I went to their offices and each one of them promised me. In 2008-09 there was a world economy slow down so they said that they were not in a position to pay, but they made a commitment that they will pay. Some of them said that they will after Ramadan and some said that they would pay later on. I obtained a commitment from them in writing and submitted a report of this to the Government. Later on it was decided that we should also approach the Consular in Dubai because most of them were stationed at Dubai. So, I met the Commercial Consular and Ambassador in Dubai. He suggests that there is a Dubai Chambers of Commerce and they have the reconciliation procedure so the MSTC should make a complaint there. Actually, we made 46 different applications to Dubai Chambers of Commerce to call these people because they owe this much of money to



MSTC and they must pay. This procedure took a long time because they were called by Dubai Chambers of Commerce. But the reconciliation procedure ultimately failed and the Dubai Chambers of Commerce gave in writing to the MSTC that the procedure has failed and that it can approach the court for realisation of its dues. They gave a clear indication that it will go in our favour. Accordingly, we started lodging cases parallelly.....

....we will have to go for the legal process of execution. So, further legal cases will have to be taken.”

95. On the steps being taken to recover the unrealized money, MSTC in a written reply stated that for realization of the outstanding, the Company has taken the following steps:

- 1) Initiated Arbitration against the Associate Suppliers in terms of Memorandum of Agreements entered with them on 14.12.2009.
- 2) Initiated legal action to recover the insurance claim from ECGC, which insured the risk of failure of the overseas buyer to pay the export proceeds in November, 2010.
- 3) Took possession of title deeds of the immovable properties, mortgaged by on of the Associate suppliers to securitize the part payment released by MSTC to them valuing to Rs. 39.29 Crore as on June, 2010.
- 4) Initiated criminal action in May, 2011 against one of the Associate Suppliers which tried to sell out some of the immovable properties mortgaged in favour of MSTC.
- 5) Initiated legal action against the defaulted overseas buyers in the competent Courts of Law in United Arab Emirates. On 13.12.2011, the competent Court of Law in United Arab Emirates pronounced its judgement in favour of MSTC in the legal suit against one such defaulted overseas buyer. In the judgment, the Competent Court of Law in United Arab Emirates has directed the defaulted overseas buyer, to pay the export invoice value to MSTC.

96. The power point presentation made by the MSTC during the evidence held on 31<sup>st</sup> July 2012 revealed the following information about the status of progress made for recovery of dues from buyers, associates and insurance agents that arbitration was invoked against each of the six associates as per Memorandum of Understanding to claim Rs. 655.51 crore including interest up to 8<sup>th</sup> February 2010 and arbitration invoked with effect from 5<sup>th</sup> December 2009 regular hearings are taking place. In respect of ECGC claim, MSTC had initiated 36 cases against ECGC for the buyers insured by them in National Consumer Dispute Redressal Commission (NCDRC) at various point of time during the last two years. NCDRC in its hearing on 25<sup>th</sup> July 2012 passed an order overruling the objection of ECGC that MSTC is not a consumer within the meaning of Consumer Protection Act.

97. As regards the legal cases against foreign buyer, it was explained that out of 46 cases filed against foreign buyers (44 in UAE, 1 in Singapore and 1 in Kuwait), judgement in 13 cases have been received in favour of MSTC so far. 13 decrees awarded by foreign courts in favour of MSTC amounts to Rs. 216.11 crore.

98. The Committee have also been informed that for execution of decrees in Dubai, MSTC's lawyer in Dubai are taking action and in some cases already filed. In the evidence before the Committee, the representatives from MSTC added that UAE courts have referred seven cases so far to experts to find out the genuineness of MSTC claim. Out of seven, expert report in respect of two has been obtained and the opinion favoured MSTC claim.

99. About the status of the case against Pen Urban Cooperative Bank/RBI, it stated that a total sum of Rs. 162 crore (FDR Rs. 100 crore + BG of Rs. 62 crore) has been claimed from the Pen Urban Cooperative Bank/RBI imposed restrictions on 22<sup>nd</sup> September 2010 after MSTC complained them for non-issuance of balance FDR on 2<sup>nd</sup> January 2010. MSTC pursued the matter with RBI and Maharashtra Government. It has been decided that a suit against Pen Bank and others for encashment of BG and FDR will be initiated to register MSTC' claim. Draft plan is being finalized and case will be filed shortly.

100. As for Standard Chartered Bank, the Committee have been informed that out of total outstanding of about Rs. 600 crore, SCB had financed export of jewellery for about Rs. 185 crore under a Receivable Purchase Agreement (RPA) with MSTC. SCB agreed to share 50 percent of MSTC legal expenses against the foreign buyers under RPA. SCB being principled insured has filed cases against ICICI Lombard against repudiation of their claim on flimsy ground. SCB converted the loan against RPA to a debt and initiated a case on 13.3.2012 against MSTC in Debt Recover Tribunal, Mumbai without giving MSTC a chance to explain and clarify their point of view. MSTC has already submitted its Reply to the Tribunal denying the claim of SCB. MSTC has filed a Declaratory Title Suit in Kolkata court challenging the action taken by SCB at DRT, Mumbai, without exhausting their legal remedy/recourse against ICICI Lombard. In the said Title Suit MSTC had also filed an application for injunction for restraining SCB from giving effect to their letter dated 10.3.2012 to MSTC. The Ld. Court has passed interim order valid till 24.8.2012.

101. To sum up the recoveries made against the outstanding of export of gold jewellery amounts to Rs. 52 crore (39 crore received through remittance from foreign buyers already considered in dues of Rs. 598.63 crore) and 13 crore from interest on FD while the recoverable dues totals Rs. 486.62 crore with Rs. 162 crore from FDR and BG, Rs. 39 crore for original title deeds of properties in Raigarh District with MSTC-properties mortgaged in favour of MSTC as collateral security by M/s. Ushma Gem and Jewellery Limited, Rs. 216.11 crore from 13 decrees in favour of MSTC awarded by foreign courts and Rs. 69.51 crore from arbitration award in favour of MSTC.

102. Elaborating in this regard, the CMD, MSTC during evidence on 19<sup>th</sup> April 2012 stated as under:

“MSTC had entered into a Memorandum of Agreement with Associates, and under that there was an arbitration clause.

The Associates had undertaken it upon themselves to indemnify the MSTC. But after the default occurred, we had started arbitration against them.....

..... this is the current status of our arbitration. We have already got the full award against the Bond Gems Private Limited and Joshi Bullion Gems and Jewelry Private Limited. For other Associates they are contesting; and they are at various stages in arbitration proceeding.”

Adding further, he stated as under:

“.....Sir, the cases against the foreign buyers had been filed in batches well within their respective limitation period. All the 46 cases have been filed – 44 in courts of UAE and one each in Singapore and Kuwait. The judgements have been received in five cases, four in UAE and one in Singapore and all are in favour of MSTC.”

103. On being asked about the date on which first decree was awarded by the Dubai court, the CMD, MSTC in the evidence held on 31<sup>st</sup> July 2012 informed through a power point presentation as under:

“In 13 cases we got the decree and the first decree we have received on 13<sup>th</sup> December, 2011.”

104. With regard to ECGC, the Chairman, MSTC while deposing before the Committee on 19<sup>th</sup> April, 2012 stated as under:

“After the ECGC repudiated the claim of the MSTC, the MSTC had taken the legal opinion from the Solicitor-General of India and also from Mr. Anando Mitro, another senior advocate in Kolkata. We have started the legal cases against ECGC for wrongful repudiation of our claim. And, these cases have been admitted after prolonged discussion and hearing in the National Consumer Forum in New Delhi.”

#### **L. Referral of the case to Enforcement Agencies**

105. When asked whether any accountability has been fixed on any one for not following sound business principles and prudent commercial practices during the entire process, MSTC in their written reply stated that the matter is being investigated by CBI & ED and accountability will be fixed by them, if any.

##### **(i) Central Bureau of investigation**

106. Explaining how the case came up with them, Director, CBI during evidence before the Committee on 26<sup>th</sup> April, 2012 deposed as under:

“This case was registered on the source information report dated 23.9.2010 received by CBI, ACB, Mumbai. Based on the registered source information report, verification was conducted and the case was registered.”

107. To a specific question what action has been taken by CBI against MSTC associates who were apparently involved in the export of jewellery acted with the intent of defrauding the Corporation, CBI Office in its subsequent written reply submitted that during the course of investigation accused persons (total 14) namely were arrested.

- (1) Shri Shishir Dharkar, Chairman of Pen Urban Co. Op. Bank (He was in custody from. 25.11.2010 to 28.01.2011 and he was released on bail on 28.01.2011)
- (2) Mrs. Gulraihna Omer, Wife of Shri Shishir Dharkar and Share holder of M/s. Space Mercantile Co. Pvt. Ltd. (She was in custody from. 25.11.2010 to 14.12.2010 and she was released on bail on 14.12.2010)

- (3) Shri Premkumar Sharma, Advisor of Pen Bank, (He was in custody from. 25.11.2010 to 14.12.2010 and he was released on bail on 14.12.2010)
- (4) Shri Rahis Ahmed, Consultant (He was in custody from. 25.11.2010 to 14.12.2010 and he was released on bail on 14.12.2010)
- (5) Shri Jayesh Desai, Director of M/s. Joshi Bullions and owner of M/s. RKM General Trading LLC, (Consignee) and 4 buyers company at UAE (He was in custody from. 25.11.2010 to 14.12.2010 and he was released on bail on 14.12.2010)
- (6) Shri R. Mani, Consultant (He was in custody from. 25.11.2010 to 14.12.2010 and he was released on bail on 14.12.2010)
- (7) Shri Malay Sengupta, Ex-CMD of MSTC, (He was in custody from. 29.04.2012 to 11.06.2012 and he was released on bail on 11.06.2012)
- (8) Shri Tapas Basu, GM, MSTC, (He was in custody from. 29.04.2012 to 11.06.2012 and he was released on bail on 11.06.2012)
- (9) Shri S.K.Sinha, Insurance Consultant of MSTC, (He was in custody from. 29.04.2012 to 11.06.2012 and he was released on bail on 11.06.2012)
- (10) Shri Utpal Sarkar, DGM, MSTC (He was in custody from. 02.05.2012 to 11.06.2012 and he was released on bail on 11.06.2012)
- (11) Shri Rahul Bhomavat, Ex Director of M/s. Space Mercantile Co. Pvt. Ltd. (He was in custody from. 20.07.2012 to 08.08.2012 and he was released on bail on 08.08.2012)
- (12) Shri Vivek Vaidya, Director of M/s. Ushma Jewellery and Packaging Export Pvt. Ltd. (He was in custody from. 20.07.2012 to 08.08.2012 and he was released on bail on 08.08.2012)
- (13) Shri Vinod Motwani, President of M/s. Bonito Impex Pvt. Ltd. were arrested on 20.07.2012 (He was in custody from. 20.07.2012 to 08.08.2012 and he was released on bail on 08.08.2012)
- (14) Shri D.K. Jain, Manager of M/s. Apollo Trading, Dubai, UAE and also working as Manager with M/s. Space Mercantile Co. Pvt. Ltd. (He was in custody for one day i.e. on 30.08.2012 and released on bail on same day).

108. When desired to know whether CBI has come across any evidence of former CMD, GM and AGM of MSTC having assets disproportionate to their known sources of income, CBI Office in their subsequent written reply stated that during the searches at the residential and office premises of former CMD, GM and DGM, MSTC, documents have been collected. Documents pertaining to investment, bank accounts and salary statements are under scrutiny. After completion of the scrutiny, competent authority of CBI would take appropriate decision for registration of DA case against these officials if deemed fit.

109. With respect to recovery efforts made by CBI, it was informed to the Committee that CBI has recovered movable and immovable properties worth Rs. 155 crore in cash and kind. After additional seizures, CBI is scrutinizing assets worth Rs. 172.62 crore.

110. On the status of probe and action taken to file charge sheet, Director, Central Bureau of Investigation during his further evidence, stated as under:

“Broadly, we have registered this case on our own information in September, 2010 and after that substantial progress has been made.....The six of the accused were arrested by the CBI and they were in police custody for 15 days and subsequently

judicial custody for three months. Then they came out on bail. The court has granted them bail.....

.....Normally, unless the charge sheet has been filed, within 90 days, they get the bail. In this case, because of the foreign investigation involved, we were not able to file a charge sheet at that stage. So, that is how they got the bail.”

111. On the pending foreign investigation, CBI stated that Letter Rogatory was issued by the special court, Mumbai on 24<sup>th</sup> April 2012 and LR is sent to Centre for Arabic and African Studies School of Language, JNU for translation from English to Arabic Language. The matter is being pursued with the University to expedite besides seeking police to police cooperation from Dubai through Inter. As soon as the LR is executed in Dubai, the CBI has proposed to send the team to Dubai.

112. When further asked if charge sheet had been filed since then and the reasons for delay if any, CBI in its subsequent written reply stated that after completion of investigation in this case, it was legally scrutinized in detail at various level of CBI and on the basis of the legal opinion it was decided by the competent authority that the charge sheet would be filed only after execution of Letter Rogatory at UAE. The Translation of the documents in Arabic from the English is not yet completed by the Jawaharlal Nehru University, New Delhi and the same would be received in due course. After receipt of the translated documents, the Letter Rogatory will be sent to the Competent Authority at UAE for its execution through Ministry of External Affairs, New Delhi.

## **(ii) Enforcement Directorate**

113. The Committee were also informed by CBI that they had informed ED and IT on 23<sup>rd</sup> December 2010 about ongoing investigation of the suspected fraud in the export business of gold jewellery of MSTC.

114. Explaining the steps being taken for expeditious investigation in the matter, Director, ED in the evidence held on 31<sup>st</sup> July 2012 stated as under:

“Pursuant to the directions of this hon. Committee, a Special Team was constituted for expeditious investigation of the subject case. As this hon. Committee is aware, the Enforcement Directorate is investigating the subject case under two laws, the Foreign Exchange Management Act, that is, FEMA, and the Prevention of Money Laundering Act, that is, PMLA. Under FEMA, we have recorded statements of a number of persons and investigation has been completed in one case, namely M/s Ushma Jewellers and Packing Exports Private Limited, and as per procedure a complaint under FEMA has been filed before the adjudicating authority, that is, the Special Director of Enforcement, Mumbai. The Special Director of Enforcement, Mumbai has issued a show-cause notice dated 26<sup>th</sup> July, 2012 amounting to Rs.132. 96 crore for contravention of provisions of Sections 7 and 8 of FEMA read with Regulations 9 and 13 of Foreign Exchange Management, Exports of Goods and Services Regulation, 2000 and Regulation 3 of Foreign Exchange Management Realisation, Repatriation and Surrender of Foreign Exchange Regulation, 2000 as amended from time to time. After this, the process of adjudication will be initiated along with penalties as prescribed under the Act. Further under PMLA a number of people have been interrogated and more than 17 statements have been recorded and during the course of investigation,

we got to know that certain proceeds of crime were secreted, which were placed by one of the associates, M/s Space Mercantile. So, we seized Rs.13 crore in a bank account which amounts to proceeds of crime under the PMLA Act. We have also identified several properties and investigation is under progress. As soon as the CBI files the charge-sheet, we will initiate attachment proceedings against these properties.”

#### **M. Role of Ministry**

115. When asked what has been the role of Government/Government nominated Directors on the board of MSTC Limited in the entire business venture of the Company in dealing with the export of gold jewellery, the Company in its written reply stated that the decision to enter into the new business of export of gold jewellery was taken at the level of the Board of Directors of MSTC Ltd. The Government / Government nominated directors were the members of the Board of Directors which approved this export business along with the detailed procedure to be followed in the export of gold jewellery.

116. When asked to highlight the salient features of the CVO Report, if any sought by the Secretary to fix the responsibility, the Secretary, Ministry of Steel in the evidence held on 31<sup>st</sup> July 2012 stated as under:

“I will just read out a few of the more important points. In June, 2008, the Board of Directors of MSTC authorized foreign currency loan of Rs. 800 crore for export business despite risks stated in the Board note. So what he is saying is that despite the fact that the Board note stated that there were risks in this business, still the Board approved it. That is the one point he is making. Foreign buyer evaluations were left to the discretion of, or conducted by the insurers that are ECGC and ICICI Lombard. So what he is saying is that because the payment is to be received by MSTC from the foreign party, thereby MSTC should normally have done the due diligence itself but they have given it to third party. That is the point he is making. Then another point is this. He has said already that the risk was high. Now he says that the trade margins were very low, only 1.25 per cent for issuance period of 120 days and 1.5 per cent for 170 days. So what he is saying is that while on one hand the risk was high, the reward was very low. Normally when the risk is high the reward should be high. That was not the case here. Then the CVO has said more importantly that on account of the foreign purchasers having failed to make payments two of the associates, Ushma Jewellery & Packaging Exports Pvt. Ltd. and some Space Mercantile responded by trying to provide assurance to MSTC in the shape of collateral securities, in the shape of fixed deposits also. But unfortunately these were provided but they were provided by Pen Urban Cooperative Bank which was taken over by the Reserve Bank of India because the bank had collapsed. As far as the CVO report is concerned, the CVC directions with regard to taking action against the officers, of course, the officers have been suspended, but I have to admit that they were not suspended at that time, which is extremely wrong. They should have been suspended immediately at the time when this happened, but they were suspended only in 2012. I would say to the Committee that this was a big lapse on the part of the Ministry as well as MSTC, mainly MSTC... Now they have been suspended. In 2009, they were not suspended. So, as far as suspension is concerned, that was late by at least three years according to me and that is not acceptable. The other point is with regard to taking action against people involved, there is a CVC guideline which says that no dual inquiry should happen when

CBI is looking into the matter, and we have to wait for CBI report to take action. So, we are really waiting for the charge-sheet to happen. Once that happens, we will take action against all the people concerned. There is a CVC manual which actually says this. I have got a copy of that.”

117. When desired to know the procedure of reporting of the board proceedings to the Government, the Secretary, Ministry of Steel in further evidence held on 31<sup>st</sup> July 2012 stated as under:

“There is a system in which there has to be a detailed reporting of the board proceedings to the Government. In this Ministry at that time there was no such habit, so, nobody was reporting. Since COPU has taken up this issue we have reiterated the earlier instructions of the Government that all the Directors on the Board of companies have to report any major decision taken by a company to the Government. In the period when this happened, unfortunately, that did not happen and there was no reporting to the Government.”

#### **N. Lessons learnt by MSTC**

118. When asked what lessons have been learnt by MSTC in carrying out such kind of business activities in the future In view of the Audit findings, the Company in its written reply stated that MSTC has learnt that no business should be undertaken on the basis of any credit insurance cover, even if the insurance cover is issued by a Govt. of India undertaking. At the time of undertaking a risk coverage, insurance companies neither raise any objection nor precisely point out the eventualities in which they would not settle claim; but after receipt of claim of the insured, they come out with all sorts of allegation / alibi/ pretext with an eye to disown the liability to pay. The insurance companies forget the basic need of the insured, for which, the insured paid the premium as demanded by the insurance companies. The insurance companies take the advantage of prolonged and time consuming judiciary system in India to delay and defer settlement of claims under insurance policies. Thus, the basic purpose of taking insurance cover is frustrated. In a word, the insurance companies do not practice what do they preach / advertise. Rather, the advertisements of insurance companies have been misleading / misguiding the business men, without putting any onus on such insurance companies.

119. When asked what reforms/safeguards/remedial measures have been taken by MSTC for avoiding recurrence of such kind of lapses in the future, the Company in its written reply stated that it has been decided that no business should be undertaken merely relying on credit insurance cover in future. Moreover, MSTC has taken a decision not to carry out any more business of export on DA Basis.

## PART-II

### OBSERVATIONS / RECOMMENDATIONS OF THE COMMITTEE

1. The audit para 17.2 of the C & AG's 2011-12, Report No. 3 (Commercial) relating to MSTC's export of Gold Jewellery brought out that an amount of Rs. 611.79 crore (including financial charges) remained unrecovered after effecting exports during 2008-09. The Committee's examination of the audit para reveals that the entire gamut of the transactions and securities are all presently sub-judice. In the 46 legal cases filed against defaulted foreign buyers in UAE, Singapore and Kuwait, 13 decrees amounting to Rs. 216.11 crore awarded so far by foreign courts in favour of MSTC. Arbitration against all the six associates suppliers started in December, 2009 is still continuing. Legal action to recover insurance claims from Export Credit Guarantee Corporation (ECGC) is in progress. A suit against Pen Urban Corporative Bank for Rs. 162 crore for enforcing sale of mortgaged collateral securities is being initiated. It is observed that recoveries already made include Rs. 52 crore through remittance from foreign buyers, Rs. 13 crore from interest in Fixed Deposit (FD), Rs. 39 crore from mortgaged properties and Rs. 69.51 crore from arbitration award in favour of MSTC. In normal course, the Committee would not have selected a sub-judice matter for examination. The Committee, therefore, in conformity with parliamentary practice and in order not to prejudice the course of justice, refrain from making any observation on the substantial issues and bring out in most of the subsequent paragraphs mere facts of the case in the light of audit observations.

2. During the course of the Committee's examination of the subject, an impression was sought to be created that undue haste was shown by MSTC in approving the business of export of jewellery in July, 2007 soon after submission of corporate planning study by the National Productivity Council (NPC) in April, 2007. According to the then CMD of MSTC (Shri Malay Sengupta), export of jewellery had been recommended by a Professional Market Research Agency (ORG-India) as early as in the year 2005. Looking at the MSTC's foray into new businesses in totality, the Committee find that on the basis of NPC study of April, 2007, export of jewellery was not the only new business started during 2007-08 but there were four other new businesses of coal, steel, iron ore and oil & natural gas all of which commenced in the same year based on NPC report. It is a moot point as to how the allegation of undue haste can be singled out to only one item - 'export of jewellery'. The Committee note



that the sale figure during 2007-08 for the four commodities ranged from Rs. 1053 crore to 2626 crore whereas in the case of jewellery, the export figure stood much less at Rs. 261 crore. It is observed that while business in respect of the four commodities continued in the successive years, export of jewellery was discontinued after 2008-09 due to the problem of non-recovery of dues.

3. During the examination of the subject, it was brought to the notice of the Committee that MSTC Ltd. did not carry out due diligence in verifying the credentials of the associates and foreign buyers before accepting the proposals for the export business of gold jewellery as a result of which huge some of public money has been locked up in legal battle. MSTC has pleaded in this connection that credentials of the associates were verified through a numerous set of documents such as documentary evidence of prior export/dealing in gold jewellery, etc., Income tax/Sales tax registration, RCMC from Gems and Jewellery Export Promotion Council, documentary evidences regarding prior experience with STC, etc. MSTC reportedly obtained several documents on the overseas buyers including the D & B / TCM report, Chartered Accountants certificate of past experience. According to Audit, three out of six associates were defaulters in paying their dues to State Trading Corporation in the business of export of gold jewellery in the year 2007-08. MSTC has contended that the associate suppliers and overseas buyers performed the contracts flawlessly during 2007-08 and did not think of any other cross verification and the Company relied on the due diligence made by the insurers regarding the foreign buyers.

4. Audit has pointed out that there was meagre networth of the associates selected by the Company as compared to advances paid to them. MSTC has pointed out that it did not pay any advance to the associate suppliers. Part payment towards purchase of gold jewellery was made after completion of performance by the associates – after shipment and on acceptance of foreign buyers. It is observed from the statement of comparison between total volume of trading business of PSUs and their networth, furnished to the Committee that exposure of MSTC is one of the least and is much lower than the financial institution/banks. All PSU trading companies have very thin margins – MMTC 0.11%, STC 0.09% and MSTC 0.47% in 2010-11. The MSTC's Capital Adequacy Ratio (CAR) as on 01-04-2008 was about 9% which is stated to be the same as CAR followed by most of the banks and financial institutions.

5. The Audit has observed that as per agreement, the associates were required to bear all the risks and costs in case of non-payment of export proceeds by the foreign buyers. MSTC in September, 2008 reportedly modified original clause of the agreement enabling it to encash Post-Dated Cheques (PDCs) furnished by the associates in the event of non receipt of export proceeds from the foreign buyers. As per modified clause, the PDCs could be encashed only in the event of non-payment by the foreign buyers due to disputes with the associates relating to quantity, quality and price only. This is stated to have facilitated the associates to become risk free in the event of non-payment by the foreign buyers on any ground and the entire such risk was passed on to the Company / Insurers. MSTC has argued in this regard that the relevant clause of the MOA needed suitable amendment to reflect the true spirit / purpose for providing PDCs by the associate. The retention of PDCs for payment failure by the overseas buyers might have made the insurance policies infructuous. Payment risk of foreign buyers was hedged through insurance policy and PDCs of associate suppliers were to hedge the performance risk of associates.

6. The Committee note that in addition to a Multi buyer insurance policy taken out with ECGC to cover the risk of non-payment of export proceeds from overseas buyers, the Company entered in to a factoring mode arrangement with ICICI Lombard General Insurance Company Ltd. in respect of four foreign buyers. The policy with the ICICI Lombard stipulated that the Company should not enter into any export trade insurance policy without the written consent of insurer. Regarding coverage of four foreign buyers under two insurance policies, the Company stated that the insurance policies of ECGC and ICICI Lombard are mutually exclusive and in the opinion of the Solicitor General it is not exactly a case of double insurance. According to Solicitor General, factoring mode arrangements are to be permissible both on the face of the ECGC policy as well as ICICI Lombard Policy.

7. Out of 47 foreign buyers to whom gold jewellery worth Rs. 638.20 crore was exported during 2008-09, 46 foreign buyers did not pay their dues of Rs.598.63 crore on their due dates. The Company which paid Rs. 68.78 crore as interest, bank charges and discounting charges to the banks besides incurring crystallization loss of Rs. 53.06 crore could realize only an amount of Rs. 10.48 crore from the associates after encashment of FDR amounting to Rs. 25 crore which the Company received in April 2009. The Committee have been informed that the Company had also received, in

November 2008, two Bank Guarantees (BGs) amounting to Rs. 62 crore from two associates as security towards exports to be made in future i.e. after December, 2008. However, since no export took place after November 2008, the aforesaid BGs could not be encashed. Further, the Company received 14 FDRs amounting to Rs. 100 crore from two associates issued by Pen Co-operative Bank in April 2009 with the condition to encash the same on maturity between October 2010 and June 2011. These also could not be encashed because of RBI directive dated 22 September 2010 precluding the bank from making any payment or discharging any liability or obligation. During audit scrutiny, it was revealed that the bank was having a meagre deposit of Rs. 400 crore only and one of its Directors was an ex-Director of an associate (Space).

8. The Committee have been informed that the Company has initiated legal action against all defaulters including associates, insurers and foreign buyers, invoking judicial provisions in force in the country and abroad and till November, 2011, have incurred legal expenses of over Rs. 3.17 crore in recovery action for gold jewellery matter. Detailing about the steps taken for recovery of unrealized money through courts and otherwise, the Chairman and Managing Director of the Company during his deposition before the Committee stated that the Company has succeeded in securing 13 decrees in their favour in the foreign courts during last six months at various points of time. Beside, the Company has also put up their case strongly in the hearing of National Consumer Grievance Forum which agreed to treat MSTC as 'consumer' overruling the objection of ECGC in the consumer complaint against ECGC. The Committee however, note with dismay that the Company which received its first decree way back in 13<sup>th</sup> December, 2011 have not ensured its execution so far. The Committee express their strong displeasure over undue delay in this regard and desire that besides taking efforts for speeding up the legal process, the Company should also take necessary action to ensure execution of decrees in a time bound manner.

9. The Committee note that besides initiating legal action, MSTC referred the case of defaulters to the CBI for a probe after repeated extensions sought by overseas buyers on flimsy grounds raising a suspicion of criminal conspiracy. Based on the information gathered during investigation, CBI has stated that the extant case is indicative of foul play involving associates, insurers and foreign buyers. The agency further pointed out that as new links are also being unearthed, its domain of probe continues to widen procrastinating completion of the investigation process and task of

sending the perpetrators of fraud to jail. The Enforcement Directorate also is investigating the case under the Foreign Exchange Management Act (FEMA) and Prevention of Money Laundering Act (PMLA). The Committee desire that CBI and ED must complete their investigations expeditiously and take the cases to their logical conclusion at the earliest, without compromising the interests of MSTC. The Committee also desire the Ministry of Steel to make a periodical review of the probe being conducted by the investigating agencies in the matter and ensure its completion with promptitude.

10. Emphasizing the need for Government representatives in the Board of PSUs to report to the Ministry about important developments in Board Meetings, the Steel Secretary deposed before the Committee that “all the Directors (Government nominees) on the Board of Company have to report any major decision taken by the Company to the Government. In the period when this happened, unfortunately, that did not happen and there was no reporting to the Government.” Further, the Committee were informed that Central Vigilance Commission in addition to CBI and ED are currently looking in to the suspected criminal conspiracy involving the officials of Ministry and MSTC and a CVO report has also been sought to fix the responsibility against the wrong doers. According to the report, collusion of some officials of the MSTC / Ministry with the suspected persons has been discovered and suspension order was issued. However, the culprit remained scot-free for unknown reason for a longer duration. Taking a strong exception to the non-implementation of the decision to issue a suspension order to a staffer in the Ministry, the Secretary, Steel, candidly admitted that this was a ‘serious lapse’ and assured the Committee that immediate action would be taken against the guilty in the matter. He added that since CVO report suggests that CBI inquiry is still underway, the responsibility against the erring officials will be fixed as soon as the inquiry report is made public.

New Delhi  
29 April, 2013  
9 Vaisakha 1935 (S)

JAGDAMBIKA PAL  
Chairman  
Committee on Public Undertakings

AUDIT FINDINGS AS CONTAINED  
IN PARA No. 17.2 OF  
C&AG's REPORT  
NO.3  
(COMMERCIAL)  
OF 2011-12 ON  
EXPORT OF GOLD JEWELLERY  
BY  
MSTC Ltd.

## **MSTC Limited**

### **17.2 Export of Gold Jewellery**

#### ***Introduction***

MSTC Limited (Company) is a Mini Ratna Category-I under the administrative control of the Ministry of Steel, Government of India. The Company was set up in 9 September 1964 to act as a regulating authority for export of ferrous scrap. MSTC became a subsidiary of SAIL in 1974. In 1982, it got delinked from SAIL and became an independent Company under Ministry of Steel. It was a canalizing agency for import of ferrous scrap till 1992.

As on date, MSTC has two major portfolios of business i.e. procurement of industrial raw materials in bulk, mainly consumed by the steel industry in the country, for its Principals and second which provides a virtual marketplace for domestic seller and buyers to do business in metal scrap (ferrous/non-ferrous), surplus stores, machineries, obsolete spares, vehicles, Plants etc.

The Company on being approached (April 2007) by three merchant exporters/traders (associates) decided in July 2007 to enter into a new business of export of gems and gold jewellery on post-shipment basis<sup>1</sup> without opening letter of credit (L/C). As per arrangement agreed for the new business, the associates were required to export the articles and the Company was required to pay up to 80 per cent of the export bill value to the associates as advance by discounting the bills<sup>2</sup> from the bank and the balance 20 per cent was to be released to the associates on collecting full value of the bill from the foreign buyer on due date. During 2007-08, gold jewellery worth Rs. 260.63 crore was exported to 29 foreign buyers in Dubai under the above arrangement with the three associates and the entire export proceeds were fully recovered. The Company received Rs. 3.91 crore as service charges in the above business. In 2008-09, six associates (including three of 2007-08) exported gold jewellery worth Rs. 638.20 crore to 47 foreign buyers<sup>3</sup> with the insurance coverage from ECGC<sup>4</sup> and ICICI Lombard (ICICIL). 46 foreign buyers did not pay their dues amounting to Rs. 598.63 crore (August 2012). An amount of Rs. 611.79 crore remained unrecovered

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<sup>1</sup> Material to be delivered to foreign buyers on acceptance of liability.

<sup>2</sup> Bill discounting is a type of lending where bank takes the bill drawn by customer and pays immediately deducting some amount as discount/commission.

<sup>3</sup> 45 in Dubai, one each in Kuwait and Singapore.

<sup>4</sup> Export Credit Guarantee Corporation of India Limited, a Central PSU, was set up to provide export credit insurance support to Indian exporters.

(August 2010) from the associates towards the advances paid to them and related financial charges incurred by the Company. The Company lodged claims with the insurers for non-payment of dues by the foreign buyers. However, the claims were rejected by both the insurers.

### **Scope of Audit**

The theme audit was conducted to review the activities of the Company for export of gold jewellery during 2007-08 and 2008-09.

### **Audit Objective**

Theme Audit of export of gold jewellery was taken up to ascertain whether:

- The decision of the Company to enter into the business of export financing of gold jewellery was prudent and economically justified;
- The Company carried out due diligence in selecting and indentifying the associates and foreign buyers; and
- The Company took all prudent measures to safeguard its financial interest from the associated risks involved in the above business.

### **Audit Methodology**

After a preliminary study and collection of background information, field audit was conducted during June 2010 to August 2010. Audit covered examination of the records of the Company relating to export of gold jewellery during the year 2007-08 and 2008-09 and the records maintained at the Head Office (Mumbai) of ECGC relating to the insurance policy of the Company.

### **Audit findings**

#### **17.2.1 Role of the Company and associates in the export of gold jewellery**

As per the agreement entered into by the Company with the associates for export of gold jewellery, the latter was required to identify the foreign buyers, obtain export orders from them in the name of the Company, export gold jewellery and prepare relevant documents showing the Company as an exporter. The foreign buyers were required to pay the export proceeds after 170 days (due date) from the date of dispatch. The associates were required to monitor

and ensure realization of export proceeds from foreign buyers on due date. The Company was required release advance up to 80 per cent of the invoice value to the associates immediately after export and the balance amount was required to be paid only after realization of full value of export proceeds. The associates ultimately had to bear all the expenses to be incurred by the Company for such export business. It was also stipulated that the associates would bear all the risks and costs in the event of non-payment of export proceeds by the foreign buyers.

Thus, instead of playing the role of an exporter, the Company was to provide only post shipment finance<sup>5</sup> to its associates, who were the actual exporters. In view of the above, Management's contention (October 2010) that the Company acted as an exporter and the associates acted as shippers is not acceptable as the export orders were actually executed by the associates.

## **17.2.2 Economic justification and risk involved**

### **17.2.2.1 High risk exposure**

Although the Company decided to finance the associates for the export of gold jewellery, it did not ascertain the volume of its risk exposure before entering into such business. It was observed that during 2007-08 and 2008-09, the credit exposure of the Company, by way of advancing finance to the associates, was high and the same was 80 per cent and 185 per cent respectively of its net worth of the respective previous years. The Company also did not obtain any security from the associates before releasing such advances to mitigate the risk of non-recovery of advances.

Management contended (October 2010) that the Company's risk exposure was hedged through credit insurance policy. This is not acceptable as the risk involved was payment of advances to the associates without any financial security and non-recovery of the same in the event of non-realisation of export proceeds.

### **17.2.2.2 Return not commensurate with the risk**

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<sup>5</sup> Post shipment finance is a kind of loan provided to an exporter against a shipment that has already been made.



The financial risk involved in the above business was 80 per cent of the export proceeds along with the cost of financing in the event of non-payment of dues by the foreign buyers and consequential non-realisation of the same from the associates. The return of the Company was, however, only 1.25 to 1.5 per cent of the entire export proceeds. Thus, the quantum of return was not commensurate with the size of the risk involved. It was observed that the Company earned a service charge of Rs. 3.91 crore only from financing the export of gold jewellery worth of Rs. 260.63 crore in 2007-08 which was only three per cent of the profit for that year. Further, due to non-realisation of export proceeds, the Company did not earn any service charge during 2008-09. Thus, the decision of the Company to venture into the above business with a meagre return was not economically justified.

Management in their reply (October 2010) could not bring out any economic justification for the above. However, it was stated that the Company earned an average trading margin of one per cent approximately, even in its import trade with huge credit exposure. The contention was, however, not acceptable as in the import business, the risk of non-payment by the vendor was substantially reduced since the imported materials remain under the control of the Company till the receipt of final payment.

***Recommendation***

***The Company should venture into such business where the return is commensurate with the risk involved.***

### **17.2.3 Assessment of demand of gold jewellery in foreign markets**

The Company did not analyse the demand of gold jewellery in foreign markets before venturing into the export business. The global market for gold jewellery was favourable in 2007-08. However, the demand for the same started declining globally (including UAE<sup>6</sup> & Middle East) from the first quarter of 2008-09. The export of gold jewellery to the above countries was, however, increased by 143 per cent during 2008-09 compared to 2007-08.

Management stated (October 2010) that gold jewellery was exported against purchase orders placed by the foreign buyers and no material was returned back. This contention was not acceptable as the Company was providing advances on post shipment basis to the associates and the realisation of such advances primarily dependent on the overseas market

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<sup>6</sup> United Arab Emirates

conditions. Thus, the Company should have assessed the demand of gold jewellery in the overseas market.

***Recommendation***

***Assessment of demand of a particular commodity in the foreign markets may be made before entering into export business of that commodity.***

**17.2.4 Selection of the associates**

The Company decided (July 2007) to venture into the business of financing the export of gold jewellery on the basis of proposals received (April 2007) from three associates viz. Space Mercantile Co. Pvt. Ltd. (Space), Ushma Jewellery & Packaging Export Pvt. Ltd. (Ushma) and Bonito Impex Pvt. Ltd. (Bonito) and the business was carried out during 2007-08 with them only. Subsequently, the Company received (July/August 2008) proposals from three more associates viz. K.A. Malle Pharmaceuticals Ltd. (KA Malle), Joshi Bullion Gems & Jewellery Pvt. Ltd. (Joshi) and Bond Gems Pvt. Ltd. (Bond) and the business was carried out with the above six associates during 2008-09. The acceptance of the proposals from these associates was done without properly verifying their credentials. No physical inspection of the offices/manufacturing premises of the associates were carried out by the Company before entering into agreements with them. Two of the above associates (Bonito and KA Malle) were engaged, respectively, in the business of building materials and pharmaceutical intermediaries for animals and had never been in the business of gold jewellery. Four associates were having related party relationship (Space with KA Malle and Bond with Joshi). Therefore, the above export business was in fact carried out through four parties only. Audit scrutiny also revealed that one of the two related associates (Space with KA Malle) enjoyed a high credit exposure during 2008-09 by carrying out 53 per cent of the total export of gold jewellery. Audit observed that three associates viz. M/s Ushma, M/s Space and M/s Bonito were already doing the business with State Trading Corporation Limited (STC) on similar lines but were in default during the period 2007-08. As the Company was aware of the dealings of the three associates with STC, it should have checked their performance vis-à-vis STC when it renewed their Memorandum of Agreements with three associates in August 2008. The Company, thus, did not take due care in selecting the associates. Rather, it extended undue favour to them by allowing to carry out the export transactions with each other (refer to para 17.2.5) and thus they enjoyed higher credit exposure (refer to para 17.2.6).

Management's contention (October 2010), that the Company did not extend undue favour to any of the associates, was not acceptable in view of the manner in which the Company selected its associates.

### **17.2.5 Identification of foreign buyers**

The foreign buyers were identified by the associates and the Company did not verify their credentials. The associates also arranged to obtain export order in the name of the Company. There was no agreement between the Company and the foreign buyers for the export and even the Company did not make any official communication with them before such export. It was observed that out of 47 foreign buyers related to export of gold jewellery during 2008-09, 18 were dealing either in wholesale business of stainless steel, food stuff, building materials or garments but 39 per cent of the total export of gold jewellery during 2008-09 was made to them. It was observed that in respect of 20 foreign buyers, ownership was concentrated in the hands of a few persons. Further, Director of one associate (Joshi) was also owner/director of 4 foreign buyers<sup>7</sup> and three of them received gold jewellery from Space and another from Ushma during 2008-09. The existing related party relationship of Bond and KA Malle (other two associates) with Joshi and Space, respectively, indicated that the above five associates were having transactions between themselves. It was also observed that eight foreign buyers to whom gold jewellery worth of Rs. 99.78 crore was exported were found not traceable. It was, further, observed that the principals of 13 foreign buyers refused to accept any liability of export dues of Rs. 187.13 crore on the ground that gold jewellery was actually not received by them.

Thus, the Company did not carry out due diligence in identifying the foreign buyers and left it completely on the associates who were the ultimate beneficiaries in the export business by receiving 80 per cent of the export proceeds as advance from the Company.

Management stated (October 2010) that it had relied on the due diligence made by the insurers regarding the foreign buyers. This contention was, however, not acceptable since as per the insurance policies, the Company was required to carry out due diligence in granting credit to the foreign buyers and the insurers did not make any independent investigation in this respect.

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<sup>7</sup> (i) Himalaya Diamonds (Rs. 17.54 crore by Ushma), (ii) Superior General Trading (Rs. 9.69 crore by Space), (iii) Golden Stock Electronics (Rs. 19.89 crore by Space), (iv) Leo Diamonds (Rs. 13.80 crore by Space)

***Recommendation***

***The Company should exercise due diligence in selecting the associates/foreign buyers before entering into business transaction with them.***

**17.2.6 Safeguarding of financial interest**

As per agreement, the associates were required to bear all the risks and costs in case of non-payment of export proceeds by the foreign buyers. Since advance up to 80 per cent of the export proceeds was payable to the associates immediately after export, the Company should have taken adequate measures to safeguard its financial interests before releasing such advance. Contrary to this, the Company modified (August 2007/September 2008) original clause of the agreement enabling the Company to encash Post-Dated Cheques (PDC), covering equivalent amount of advance payable to associates in the event of non-receipt of export proceeds from the foreign buyers. As per modified clause, the PDCs could have been encashed only in the event of non-payment by the foreign buyers due to disputes with the associates relating to quantity, quality and price.

Thus, the financial interest of the Company was not safeguarded against protracted default by the foreign buyers. It was also observed that there was no provision in the agreement to obtain collateral security from the associates to cover the amount of advance payable to them. The financial position of the associates was also not considered while fixing their credit exposure as the advances given by the Company during 2008-09 ranged between 7 and 111 times of their networth. The Company, therefore, depended on the insurance coverage only, for safeguarding its financial interests towards recovery of advances from the associates in the event of non-realisation of export proceeds (refer to para 17.2.7).

Management stated (October 2010) that the associates did not agree to give PDCs for non-payment as envisaged in the agreement originally and the relevant clause of the agreement was therefore amended. It was also stated that the insurance coverage would not have been available had the Company accepted the PDCs from the associates for non-payment of export proceeds by the foreign buyer.

The above contention of the Management was not acceptable as the insurance coverage was taken towards non-realisation of dues from foreign buyer only. Further, the advances paid to associates were as per the agreement entered into with them and therefore there was no

relationship between the non-recovery of such advances and the insurance coverage. Management's contention was also contradictory in view of the fact that the Company took insurance coverage irrespective of the clause of the agreement with associates that all the risks and costs of the export business would ultimately be borne by them.

***Recommendation***

***The Company should take adequate measures to safeguard its financial interest before making any advance payment.***

**17.2.7 Insurance coverage of export of gold jewellery**

As per agreement, the Company would arrange to insure the risk of non-realisation of the export proceeds from the foreign buyers. The insurance premium was to be recovered from the associates. The Company accordingly insured the risk of non-payment of export proceeds of 2007-08 with ECGC. This insurance policy was renewed (September 2008) for the exports of 2008-09 to cover the risk of non-payment of dues by the foreign buyers whose bills (Rs. 453.54 crore) were to be discounted through four banks. In addition, the Company took (August 2008) another insurance policy from ICICI Lombard General Insurance Co. Ltd. (ICICIL) to cover the risk of non-payment of export dues (Rs. 184.66 crore) for which loan from Standard Chartered Bank (SCB) was obtained. The Company paid insurance premium of Rs. 4.37 crore during 2008-09 for the above policies. As per the terms and conditions of the policy with ECGC, the whole export proceeds of the Company were to be insured. It was also specified in the policy of ICICIL that the Company should not enter into any other export trade insurance policy without the consent of insurer.

It was observed that export business with five foreign buyers (during 2008-09) was covered under these two insurance policies. This was, however, not disclosed to the insurers. It was also stipulated in the above policies that the Company should exercise reasonable care and prudence in granting credit to the foreign buyers. It was, however, observed that the Company did not carry out due diligence in identifying the foreign buyers. It was, further, observed that the Company also did not disclose the insurers about the contractual obligations of the associates to bear the entire risks and costs in the event of non-realisation of export proceeds from the foreign buyers.

Management stated (October 2012) that there was not condition in the policies, debarring the company to carry out export under any other policy and also not to enter into any other insurance policy without the consent of insurer. Management further, contended that the agreement of the Company with the associates was an internal arrangement between them and the insurers were not party to the same and thus, there was no need to disclose such information to the insurers.

The above contentions of the Management were not based on the facts as it was clearly mentioned in the first para of the insurance policy of ECGC that the policy was meant to cover whole of the export trade of the Company with buyers in the specified countries during the policy period. Condition 5 (b)(i) of the insurance policy of ICICIL also clearly mentioned that the “Insured must not, without written consent of ICICI Lombard enter into any trade credit insurance policy that indemnifies the insured in relation to the insured’s own Account”. The contention of the Management with regard to arrangement between the Company and the associates, specifying that the associate and not the Company would ultimately bear the loss, being an important fact, hence should have been disclosed to the insurers prior to taking up such insurance policies.

***Recommendation***

***The Company should disclose all material facts to the insurer before taking up insurance coverage and also strictly adhere to the terms and conditions of the insurance policy.***

**17.2.8 Non-payment of dues by the foreign buyers**

During 2008-09, gold jewellery worth Rs. 638.20 crore was exported by six associates to 47 foreign buyers and the last batch of export was made in November 2008. The Company discounted export bills worth Rs. 453.54 crore from four banks<sup>8</sup> and also obtained loan from one of the above banks i.e. Standard Chartered Bank, against the balance bills worth Rs. 184.66 crore. Six associates were paid Rs. 501.55 crore as advance. 46 foreign buyers did not pay their dues of Rs. 598.63 crore to the banks on the due dates. The Company paid Rs. 68.78 crore as interest, bank charges and discounting charges to the banks. Further, Fixed

<sup>8</sup> Corporation Bank, United Bank of India, Indian Overseas Bank and Standard Chartered Bank

Deposit Receipt (FDR) of the Company amounting to Rs. 25 crore as security against the bank loan was encashed (April 2009) by the Standard Chartered Bank. In addition, the Company had to incur crystallisation loss<sup>9</sup> of Rs. 53.06 crore as deducted by banks. The Company could realize only an amount of Rs. 10.48 crore from the associates thus, an advance amounting to Rs. 528.49 crore (including crystallisation loss) remained unrealized. Even the post dated cheques deposited by them could not be encashed as the non-payment by the foreign buyers was not due to disputes relating to quantity, quality and price.

The Company subsequently received (November 2008) two Bank Guarantees (BGs) amounting to Rs. 62 crore from two associates (Ushma - Rs. 32 crore and Space Rs. 30 crore) as security towards the exports to be made in future i.e. after December 2008. Since there was no export after November 2008, the above BGs could not be encashed. Further, 14 FDRs amounting to Rs. 100 crore issued by Pen Co-operative Bank (PCB), a non-scheduled urban co-operative bank, were received (April 2009) from Ushma (Rs. 52 crore) and Space (Rs. 48 crore) with the condition to encash the same on maturity (between October 2010 and June 2011) only. The Company placed (03 September, 2010) six FDRs maturing on 28 October 2010 amounting to Rs. 30 crore (Rs. 15 crore pertaining to Space and Ushma each), to PCB for encashment. In the meantime, the Reserve Bank of India precluded the PCB, with effect from 22 September 2010, from incurring any liability or granting/renewing any loans/advances or making any payments or discharging any liability or obligation, vide its directives dated 21 September 2010. The Company, as such, could not encash these FDRs. It was worth mentioning that the above bank was having a meagre deposit of Rs. 400 crore only and one<sup>10</sup> of its Directors was an ex-Director of an associates (Space).

Thus, an amount of Rs. 611.79 crore remained unrecovered (August 2010) from the associates. The Company, however, referred (December 2009) the matter to arbitration.

### **17.2.9 Rejection of claim by insurers**

Insurance claims were lodged (November 2009/January 2010) with ECGC and ICICIL for non-realisation of export proceeds from the foreign buyers. Both the insurers, however, rejected such claims on the ground that as per the agreement with the associates, all the risks

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<sup>9</sup> Foreign currency loss due to difference in foreign currency rates prevailing on the date of discounting of bills and due dates of payment of such bills.

<sup>10</sup> Shri Shishir P. Dharkar, was Director of Space from August 2000 to June 2007

and costs in this business was to be borne by them in the event of non-payment by the foreign buyers and as such the Company did not have any insurable interest. Further, the insurance policies would cover only the risk of non-payment by the foreign buyers and in this case the risk of the Company arose due to non-realisation of advances from the associates who were the actual exporters.

Management stated (October 2010) that the Company was considering to initiate legal action against the insurers and the foreign buyers.

### **Conclusion**

The business of post shipment finance of export of gold jewellery was conceived by the Company on being approached by the associates only. The Company ventured into this business in spite of the fact that there was high risk involved in the foreign market was meagre return. Moreover, the demand for the gold jewellery in the foreign market was not assessed. The associates in fact controlled the entire export business by selecting the foreign buyers, obtaining the export orders and also exporting the gold jewellery in the name of the Company. The Company financed to the extent of 80 per cent of the export proceeds to the associates immediately after export without any financial safeguard for recovery of the same in the event of non-receipt of export proceeds from the foreign buyers on due dates. The Company did not also verify the credentials of the associates and the foreign buyers. There was related party relationship amongst the associates themselves and also between one associate and four foreign buyers but the Company ignored their related party relationship. The Company ventured into this risky business without safeguarding its own financial interests. Thus, there were serious lapses on the part of the Management.

Finally, the Company had to face a financial burden of Rs. 611.79 crore due to non-recovery of advance and related financial expenses, from the associates for gold jewellery exports during the year 2008-09, as the foreign buyers defaulted to pay their dues. The insurer also refused to make good the loss on the grounds that the Company did not have any insurable interest in the business as all the risks and costs in this business were to be borne by the associates only and also due to violation of terms and conditions of the insurance policies by the Company.

The matter was reported to Ministry in November 2010; reply was awaited (February 2011).



**MINUTES OF THE 13<sup>th</sup> SITTING OF THE COMMITTEE ON  
PUBLIC UNDERTAKINGS (2011-12)**

The Committee sat on Thursday, the 19<sup>th</sup> April 2012 from 1130 hrs to 1300 hrs in Committee Room '74', Ground Floor, Parliament Library Building, New Delhi.

**PRESENT**

**Chairman**

**Shri Jagdambika Pal**

**Members, Lok Sabha**

- 2 Shri Hansraj G. Ahir
- 3 Shri Ambica Banerjee
- 4 Shri Vilas Baburao Muttemwar
- 5 Shri Ponnamp Prabhakar
- 6 Shri Nama Nageswara Rao
- 7 Shri Uday Singh

**Members, Rajya Sabha**

- 8 Shri Pyarimohan Mohapatra
- 9 Dr. Bharatkumar Raut
- 10 Shri N.K. Singh

**Secretariat**

1. Shri S. Bal Shekar Additional Secretary
2. Shri Rajeev Sharma Director
3. Shri Ajay Kumar Garg Additional Director

**Representatives of Office of C&AG**

- 1 Shri A.K. Patnaik Dy. C&AG
- 2 Ms. Revathy Iyer Director General (Commercial)

**Representatives of Ministry of Steel and MSTC Limited**

- 1 Shri D.R.S. Chaudhary Secretary, Steel
- 2 Shri S. Machendranathan Addl. Secretary & FA
- 3 Shri J.P. Shukla Joint Secretary, Steel
- 4 Shri S.K. Tripathi CMD, MSTC Limited
- 5 Shri A.K. Basu Director, Finance
- 6 Shri B.B. Singh Director, Commercial

2. The Committee met to take oral evidence of the representatives of Ministry of Steel and MSTC Limited in connection with examination of Audit Para No. 17.2 of C&AG Report No. 3 of 2011-12 (Commercial) regarding Export of Gold Jewellery by MSTC Limited.

3. At the outset, the representatives of the Office of C&AG briefed the Committee on the subject matter.

4. The witnesses were then called in.

5. The Chairman welcomed the representatives of Ministry of Steel and MSTC Limited and drew their attention to direction 58 of the Directions by the Speaker relating to evidence before the Parliamentary Committees. The Members raised queries on various aspects pertaining to the subject and the explanations/clarifications on the same were given by the representatives of Ministry of Steel and MSTC Limited. The representatives of MSTC Limited also made a brief power point presentation on the subject.

6. The Chairman thanked the representatives of Ministry of Steel and MSTC Limited for providing all the information on the subject matter as desired by the Committee.

*The witnesses then withdrew.*

7. Verbatim record of evidence has been kept.

8. On the basis of the information made available during the evidence, the Committee deliberated upon the need to take evidence of the officers in position in MSTC and Ministry of Steel during the period when the new business venture to export gold jewellery was undertaken. Taking note of the fact that the matter is presently under investigation by the CBI, the Committee decided to take oral evidence of Director, CBI in the first instance at their sitting to be held on 26<sup>th</sup> April 2012.

*The Committee then adjourned.*

**MINUTES OF THE 14<sup>th</sup> SITTING OF THE COMMITTEE ON  
PUBLIC UNDERTAKINGS (2011-12)**

The Committee sat on Thursday, the 26<sup>th</sup> April 2012 from 1500 hrs to 1615 hrs in Committee Room 'D', Parliament House Annexe, New Delhi.

**PRESENT**

**Chairman**

**Shri Jagdambika Pal**

**Members, Lok Sabha**

- 2 Shri Hansraj G. Ahir
- 3 Shri Shailendra Kumar
- 4 Shri Vilas Baburao Muttemwar
- 5 Shri Baijayant Panda 'Jay'
- 6 Shri Nama Nageswara Rao
- 7 Shri Uday Singh
- 8 Dr. Prabha Kishor Taviad

**Members, Rajya Sabha**

- 9 Shri Pyarimohan Mohapatra
- 10 Shri Mukhtar Abbas Naqvi
- 11 Dr. Bharatkumar Raut

**Secretariat**

- 1 Shri S. Bal Shekar Additional Secretary
- 2 Shri Rajeev Sharma Director
- 3 Shri Ajay Kumar Garg Additional Director

**Representatives of Central Bureau of Investigation (CBI)**

- 1 Shri Amar Pratap Singh Director, CBI
- 2 Shri Abhin Dinesh Modak Dy. I.G., CBI, ACB, Mumbai
- 3 Shri Saurabh Tripathi Dy. I.G., (Policy), CBI, Policy Division

**Representatives of Office of C&AG**

- 1 Shri A.K Patnaik Dy. C&AG (Commercial) and Chairman, Audit Board
- 2 Ms. Revathy Iyer Director General (Commercial)
- 3 Ms. Nandana Munshi Principal Director (Commercial)

2. The Committee met to take the oral evidence of the Director, Central Bureau of Investigation (CBI) on the audit findings contained in Para No. 17.2 of C&AG Report No. 3 of 2011-12 (Commercial) regarding Export of Gold Jewellery by MSTC Limited.

3. At the outset, the Chairman welcomed the representatives of the CBI and drew their attention to Direction 58 of the Directions by the Speaker regarding evidence before the Parliamentary Committees. The representatives of CBI then made a brief power point presentation on the subject.

4. During the power point presentation, the Chairman and Members raised queries on various aspects pertaining to the subject and the explanations/clarifications on the same were given by the representatives of CBI. Information on some of the points raised by the Members was not readily available with the representatives of CBI. They were, therefore, asked to furnish the same to the Committee Secretariat at the earliest possible.

5. The Chairman thanked the representatives of CBI for providing all the information on the subject matter as desired by the Committee.

6. *The witnesses then withdrew.*

*(Verbatim record of evidence has been kept)*

*The Committee then adjourned.*

**MINUTES OF THE 2<sup>nd</sup> SITTING OF THE COMMITTEE ON  
PUBLIC UNDERTAKINGS (2012-13)**

The Committee sat on Friday, the 15<sup>th</sup> June, 2012 from 1500 hrs to 1630 hrs in Committee Room 'E', Parliament House Annexe, New Delhi.

**PRESENT**

**Chairman**

**Shri Jagdambika Pal**

**Members, Lok Sabha**

- 2 Shri Hansraj G. Ahir
- 3 Shri Ambica Banerjee
- 4 Shri Bansa Gopal Chowdhury
- 5 Dr. Mahesh Joshi
- 6 Shri Shailendra Kumar
- 7 Dr. (Smt.) Botcha Jhansi Lakshmi
- 8 Shri Vilas Baburaoji Muttemwar
- 9 Shri Nama Nageswara Rao
- 10 Shri Uday Singh
- 11 Dr. Prabha Kishor Taviad

**Members, Rajya Sabha**

- 12 Shri Anil Desai
- 13 Shri Janardan Dwivedi
- 14 Shri Naresh Gujral
- 15 Shri T.M. Selvaganapathi

**Secretariat**

- 1 Shri S. Bal Shekar Additional Secretary
- 2 Shri Rajeev Sharma Director
- 3 Shri Ajay Kumar Garg Additional Director

**Representatives of Enforcement Directorate**

- 1 Dr. Rajan Katoch Director, ED
- 2 Shri Balesh Kumar Special Director
- 3 Shri Samir Bajaj Joint Director

**Representatives of Office of C&AG**

- 1 Shri A.K Patnaik Dy. C&AG (Commercial) and Chairman, Audit Board
- 2 Ms. Revathy Iyer Director General (Commercial)



**MINUTES OF THE 5<sup>th</sup> SITTING OF THE COMMITTEE ON  
PUBLIC UNDERTAKINGS (2012-13)**

The Committee sat on Tuesday, the 31<sup>st</sup> July, 2012 from 1500 hrs to 1645 hrs in Committee Room No. 74, Parliament Library Building, New Delhi.

**PRESENT**

**Chairman**

**Shri Jagdambika Pal**

**Members, Lok Sabha**

- 2 Shri Hansraj G. Ahir
- 3 Shri Ambica Banerjee
- 4 Dr. Mahesh Joshi
- 5 Shri Shailendra Kumar
- 6 Dr. (Smt.) Botcha Jhansi Lakshmi
- 7 Shri Vilas Baburaoji Muttemwar
- 8 Shri Nama Nageswara Rao
- 9 Dr. Prabha Kishor Taviad

**Members, Rajya Sabha**

- 10 Shri Tariq Anwar
- 11 Shri Anil Desai
- 12 Shri Janardan Dwivedi
- 13 Shri Naresh Gujral
- 14 Shri Mukhtar Abbas Naqvi

**Secretariat**

- 1 Shri S. Bal Shekar Additional Secretary
- 2 Shri Rajeev Sharma Director
- 3 Shri Ajay Kumar Garg Additional Director

**Representatives of Office of C&AG**

- 1 Shri A.K Patnaik Dy. C&AG (Commercial) and Chairman, Audit Board
- 2 Ms. Revathy Iyer Director General (Commercial)

**Representatives of Ministry of Steel**

- 1 Shri D.R.S. Chaudhary Secretary, Steel
- 2 Shri E.K. Bharat Bhushan Addl. Secretary & F.A.

**Representatives of MSTC Limited**

- 1 Shri S.K. Tripathi CMD
- 2 Shri A.K. Basu Director (Finance)

### **Representatives of Central Bureau of Investigation**

1	Shri A.P. Singh	Director, CBI
2	Shri Vineet K. Gupta	Special Director, CBI
3	Shri Abhin Modak	D.I.G., ACB, Mumbai

### **Representatives of Enforcement Directorate**

1	Dr. Rajan Katoch	Director, ED
2	Shri Balesh Kumar	Special Director
3	Shri Samir Bajaj	Joint Director

2. The Committee met to take further evidence of the representatives of Ministry of Steel; MSTC Limited; Director, CBI; and Director, ED on the audit findings contained in Para No. 17.2 of C&AG Report No. 3 of 2011-12 (Commercial) regarding Export of Gold Jewellery by MSTC Limited.

3. At the outset, the Chairman welcomed the representatives of Ministry of Steel; MSTC Limited; Director, CBI; and Director, ED and drew their attention to Direction 58 of the Directions by the Speaker regarding evidence before the Parliamentary Committees.

4. The representatives of MSTC Limited then made a brief power point presentation on the steps being taken to recover the money from the accused through courts and other agencies. During the presentation, the Chairman and Members raised queries on various aspects pertaining to the subject and the explanations/clarifications on the same were given by the representatives of MSTC Limited / Ministry. During the course of deliberations, the Committee also expressed their dismay over the delay in execution of decrees received in favour of the Company from the courts at various points of time during the last six months and desired that action in all these cases be expedited and completed within a definite time frame.

5. Thereafter, the representatives of CBI made a brief power point presentation on the status of probe and action being taken to recover the unrealized money. The Chairman and Members raised queries on various issues including the reason for delay in filing of charge sheet by CBI and the replies thereto were given by the representatives of CBI. The Committee directed representatives of CBI that action on filing of charge sheet be completed within the shortest possible time frame. The Committee also asked the representatives of ED to take immediate action on attachment of properties of accused as soon as the CBI files the charge sheet against the culprits.

6. The Chairman then thanked the representatives of Ministry of Steel; MSTC Limited; Director, CBI; and Director, ED for providing all the information on the subject matter as desired by the Committee.

*The witnesses then withdrew.*

*(Verbatim record of evidence has been kept)*

*The Committee then adjourned.*



**MINUTES OF THE 17<sup>th</sup> SITTING OF THE COMMITTEE ON  
PUBLIC UNDERTAKINGS (2012-13)**

The Committee sat on Friday, the 11<sup>th</sup> January 2013 from 1500 hrs to 1745 hrs in Committee Room 'C', Parliament House Annexe, New Delhi.

**PRESENT**

**Chairman**

**Shri Jagdambika Pal**

**Members, Lok Sabha**

- 2 Shri Hansraj G. Ahir
- 3 Dr. Mahesh Joshi
- 4 Shri Shailendra Kumar
- 5 Dr. (Smt.) Botcha Jhansi Lakshmi
- 6 Shri Vilas Baburaoji Muttemwar
- 7 Shri Ponnam Prabhakar

**Members, Rajya Sabha**

- 8 Shri Anil Desai
- 9 Shri Janardan Dwivedi
- 10 Shri Naresh Gujral
- 11 Dr. V. Maitreyan
- 12 Shri Mukhtar Abbas Naqvi

**Secretariat**

- 1 Shri A. Louis Martin                      Joint Secretary
- 2 Shri Rajeev Sharma                      Director
- 3 Shri Ajay Kumar Garg                      Additional Director

**Representatives of Office of C&AG**

- 1 Shri P. Sesh Kumar                      Director General (Commercial)-II
- 2 Ms. Sandhya Shukla                      Principal Director (Commercial)

**(A) Official Witness**

**Representatives of Export Credit Guarantee Corporation of India Ltd.**

- 1 Shri N. Shankar                              Chairman-cum-Manager Director
- 2 Mrs. Geetha Muralidhar                      Executive Director
- 3 Mr. Rohit Pandya                              General Manager
- 4 Mr. Dharmarajan V.                              General Manager

**(B) Non-official Witness**

1 Shri Malay Sengupta Ex-CMD, MSTC Limited

2. The Committee met to take evidence of the representatives of Export Credit Guarantee Corporation of India Limited (ECGC) and Shri Malay Sengupta, Ex-CMD, MSTC Limited on the audit findings contained in Para No. 17.2 of C&AG Report No. 3 of 2011-12 (Commercial) regarding Export of Gold Jewellery by MSTC Limited.

3. At the outset, the Chairman welcomed the representatives of ECGC Limited and drew their attention to Direction 58 of the Directions by the Speaker regarding evidence before the Parliamentary Committees.

4. The representatives of ECGC Limited then made a brief statement on the subject matter. During their deposition, the Chairman and Members raised a number of queries including the criteria followed for fixing the credit limits of the foreign buyers, factors taken in to account while conducting the due diligence, the extent of responsibility on ECGC due to default by the overseas buyers whose credentials were verified by it, etc. and the explanations/clarifications on the same were given by the representatives of ECGC Limited. They also assured the Committee that written replies to the remaining queries, which could not be responded then, will be furnished to the Secretariat at the earliest.

*(The witnesses then withdrew.)*

*(Non-official witness Shri Malay Sengupta was then called in.)*

5. The Chairman welcomed Shri Malay Sengupta, Ex-CMD, MSTC Limited and drew his attention to Direction 58 of the Directions by the Speaker regarding evidence before the Parliamentary Committees.

6. Shri Malay Sengupta while expressing his gratitude to the Committee for providing him the opportunity to put up his case on the subject matter made a detailed presentation on the audit findings as contained in the Audit Para. During his deposition, the Chairman and Members raised several queries which included the rationale followed for undertaking the high risk export business of gold jewellery, reason for undue haste in firming up the contract with associate suppliers and the extent of due diligence conducted, reason for non-payment of export proceeds by the overseas buyers, and non-disclosure of some material information with ECGC leading it to rejection of insurance claims and the explanations/clarifications on the same were given by him.

7. The Chairman then thanked the Ex-CMD, MSTC Limited for providing all the information on the subject matter as desired by the Committee.

*The witness then withdrew.*

*(Verbatim record of evidence has been kept)*

*The Committee then adjourned.*

**COMMITTEE ON PUBLIC UNDERTAKINGS**  
**(2012-13)**

**MINUTES OF THE TWENTY SIXTH SITTING OF THE COMMITTEE**

The Committee sat on Friday, the 26 April, 2013 from 1000 hrs to 1100 hrs in Chairman's Chamber, Room No. 147, Third Floor, Parliament House, New Delhi.

**PRESENT**

Shri Jagdambika Pal - Chairman

**MEMBERS**

***Lok Sabha***

2. Shri Hansraj Gangaram Ahir
3. Shri Shailendra Kumar
4. Shri Adhalrao Shivaji Patil
5. Shri Nama Nageswara Rao
6. Dr. Prabha Kishore Taviad

***Rajya Sabha***

7. Shri Anil Desai
8. Dr. V. Maitreyan
9. Shri T.M. Selvaganapathi
10. Dr. Janardhan Waghmare

**SECRETARIAT**

1. Shri A. Louis Martin                      Joint Secretary
2. Shri M.K. Madhusudhan                Additional Director
3. Shri G.C. Prasad                         Deputy Secretary

**REPRESENTATIVES OF OFFICE OF C&AG**

1. Ms. Sandhya Shukla                      Pr. Director (Commercial)

2. At the outset, the Chairman welcomed the Members and Audit officials to the Sitting of the Committee.

3. The Committee then took up for consideration the draft Report on Export of Gold Jewellery by MSTC Ltd. (based on audit para no. 17.2 of C&AG's report no. 3 of 2011-12) and after some deliberation adopted the same without any changes.

*(The Audit officials then withdrew)*

4. XXXX XXXX XXXX.

5. XXXX XXXX XXXX

6. The Committee then authorized the Chairman to finalise the Reports on the basis of factual verification and present the same to Parliament.

7. As the Committee's term will end on 30.04.2013, the Chairman thanked the members for their co-operation in smooth functioning of the Committee during the term and placed on record his appreciation for the valuable contribution and active participation of the members in the proceedings of the Committee.

***The Committee then adjourned.***

XXXX MATTER NOT RELATED TO THIS REPORT.