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YOUR PEEK INTO THE INDIAN LEGAL SCENE

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Attn: KENNETH PINTO

Thought for the month

Experience is not what happens to man. It is what a man does with what happens to him.

- Aldous Huxley

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Note from the Editor

India, with a new government in power, is poised to approach the millennium with a host of reforms. These second-generation reforms bode well for India. The government promises to implement both old and new policies, which is the need of the hour today.

As always, in our endeavour to educate as well as keep our readers informed about the current legal position, our focus in this issue is on venture funds. We also bring the concluding part of Dr. Abhishek Singhvi's article on arbitration, which examines the features of the Arbitration & Conciliation Act of 1996.

Recovery of debts due to banks and financial institutions and the high rate of non-performing assets are gigantic problems in India. In this connection we have an article on debt recovery tribunals. Though the Recovery of Debts due to Banks and Financial Institutions Act was enacted way back in 1993, only a single bench has recently been constituted in Mumbai, to look into the long pending demands of the financial institutions and banks.

For the benefits of our busy readers, we have the legal snapshots covering an array of topics, which are quite informative.

I take this opportunity to wish all our readers a joyous Christmas season and a happy and healthy New Year.

- Rajesh N. Begur, Editor, Legal Eye

Venture Capital Funds - perspectives and problems

- RAJESH N. BEGUR, PARTNER, A.R.A. LAW
- ANOOSHREE CHAKRAVORTY, ASSOCIATE, A.R.A. LAW

In India, the role of venture capital fund has traditionally been an extension of developmental financial institutions like IDBI, ICICI, SIDBI and SFCS. The origins of modern venture capital may be found in the establishment of Technology Development Fund (TDF) in 1987-88 to provide financial assistance to innovative and high-risk technological programs through the IDBI. Another form of venture capital, that was present in India, was the funding, through subscription to initial public offering (IPO) of companies, of greenfield ventures by small investors.

Venture funding, though successful abroad, has been facing a lot of hurdles in India. We briefly discuss some of these hurdles below:

General

One of the major problems faced by VCF's may be attributed to the general mindset against change from traditional "collateral funding" to high-risk funding. Venture capital as an activity was till recently virtually non-existent in India. Most VCF companies want to provide capital on a secured debt basis, to established businesses with profitable operating histories. Further, most VCF companies were offshoots of financial institutions and banks and the lending mindset continued. True venture funding is capital that is used to launch new products and ideas of the future.

Abroad, the problem is solved by the presence of "angel" investors. They are typically industry-bred high net worth individuals who not only provide venture finance, but also help individuals to shape their business and make their venture successful. Angels are an important link in the process of venture capital funding. This is because they support a fledgling enterprise at a very early stage - some times even before commercialization of the product or service offered.

Regulatory framework

Probably one of the biggest impediments to setting up VCF's in India is the multiplicity of regulators like the Central Board of Direct Taxes (CBDT), Securities & Exchange Board of India (SEBI) and Reserve Bank of India (RBI). A VCF is subject to the norms laid down by the Foreign Investment Promotion Board (FIPB) for each investment made by it in the event of the fund being an off-shore fund and at the same time the CBDT, too has its own guidelines on investment made by these funds. These funds have to secure the permission of the FIPB while setting up in India and need clearance from the RBI for any repatriation of income. CBDT governs the issues pertaining to income tax on the proceeds from venture funding activities. SEBI has its own set of regulations setting out the procedure for setting up and carrying on venture funding activities.

In addition to these, there are a number of arms of the Government of India - Ministry of Finance that may have to be approached in certain situations depending on the nature of the industry.

This multiplicity of regulators and regulations has resulted in foreign venture capital funds preferring to function as private equity funds and being reluctant to register in India.

The next hurdle that needs to be crossed is that of a gamut of loosely framed laws at odds with each other which have led to a whole lot of grey areas and left the field open to abuse.

Though a VCF may be set up as either a trust or a company, most domestic venture funds are set up as trusts under the Indian Trusts Act, 1882 (Trusts Act) in order to take advantage of taxation laws (please see the article on *Taxation of Venture Capital Funds*). However, there are a number of tax-related issues which are still grey and require careful consideration before any VCF structure is formalised. In India, though the

SEBI guidelines talk of VCF's being set up as trusts, these VCF trust funds hardly fit into the scope of "trust" as traditionally understood by the Trusts Act.

For instance, a traditional trust as per the Trusts Act envisages three parties: the settlor, the trustee and the beneficiary of the trust. In a VCF though the parties include a settlor, contributors (who may be financial institutions or high net worth individuals), the trustees, the beneficiaries and the asset management company (AMC). The problems arise in so far as the contributors to the trust are also the beneficiaries, which goes against the grain of a traditional trust where the beneficiaries are merely the recipients and make no contributions to the fund.

The next discrepancy is the addition of a new party to the traditional set up - the (AMC). Though the traditional role of a trustee is to execute the trust, in most cases of VCF the execution and management of the trust is delegated to the AMC. The trustee's business in this case is to "police" the activities of the AMC and take care of the interests of the contributors/beneficiaries of the trust. The liability chain goes as such - the AMC is liable to the trustees who are in turn liable to the contributors/beneficiaries. Under the current legal regime, we do not have a direct liability link between the AMC and the contributors. There are no regulations mandating that an arms-length relationship has to be maintained between the AMC and the trustee. As such there is scope for the AMC, the trustee and the settlor to be one single entity, which might lead to a sticky situation. Keeping in mind the liability chain, there is much scope for abuse and it is advisable that some standards are set up to regulate the relationship between these three entities.

Should the very nature of these VCF as "trusts" be challenged, it will be interesting to see how the Courts reconcile the differences. Abroad such funds are made under the Limited Partnership Act, which brings advantages in terms of taxation. The concept of limited liability partnerships has recently been accepted quite enthusiastically in India, however formal proposals are yet to be drafted.

Valuation

Thanks to the software boom, most promoters have sky high expectations. Given this, it is difficult for deals to reach financial closure, as promoters do not agree to a valuation. This, coupled with the fancy for software bourses, means that most companies are preponing their IPO's. Consequently, the number and quality of deals available to venture funds gets reduced. Furthermore, an offshore investor would also have to conform with certain RBI regulations relating to the mode of valuation at the time of disinvestment, which could be quite onerous.

Exit option

The exit options available to venture capitalists are restricted to the IPO route. Before deregulation, the pricing was dependent on the CCI regulations and issues were largely under-priced. Even now the SEBI guidelines make an easy exit difficult for pricing issues. .

Conclusion

We may draw a lesson from the successful functioning of VCF's abroad. Among the various suggestions we would make are:

Attitudinal changes: The funds should understand that the essence of a VCF is to invest in start-up high-risk companies. The current practice of caution by most VCF's in investing in companies with reliable track records to a certain extent defeats the very purpose of having a VCF. No doubt the investor's interest needs to be protected but if we do not know where to draw the line, we actually tend to revert to traditional loan regimes. The regulatory agencies ought to also keep in mind the basic nature and function of VCF's. For instance, under the SEBI guidelines, there is a cap on VCF's for investing at least 80% of their funds in certain types of companies, which include sick and/or financially weak companies. Sick companies are hardly the territory for VCF's. Discretion, if any, should be that of each VCF.

Barriers to investments: The government should allow pension funds and insurance companies to invest in VCF's, as in USA where corporate contributions to VCF are large.

Investors: It is necessary to look into a case study of any of the countries where the VC is successful. The success of the start-up company has been due to adequate funds along with the fact that the fledgling companies have been backed up with technical expertise.

Multiplicity of regulators: Like foreign institutional investors (FII's), VCF's should also have a one-stop-shop kind of facility where they can register with a particular agency and then go ahead and make their investments. It may also be advisable to allow offshore VCF's to invest upto certain percentages through an automatic approval route. The caps on the percentages may be decided on industry-specific criterion. This has the effect of reducing bottlenecks caused by the VCF's having to take permission of the FIPB for each and every investment made by them.

Regulations: One of the top priority concerns is to change and streamline the current laws governing setting up offshore as well as domestic VCF's in India.

Tax: VCF's should be accorded the same tax benefits as those enjoyed by mutual funds.

Disclosure norms: Investors, especially those who had invested in relatively small-scale and little known info-tech companies, are facing increasing problems while transferring their shares. The Bombay Stock Exchange (BSE) has been getting a number of complaints from investors for non-transfer of shares sent to companies. Some norms should be developed regulating disclosure and transparency in the functioning of such companies.

It is heartening to note that the Union Finance Ministry has taken the decision to begin the process of identification and rectification of the existing norms governing the VCF industry. Hopefully, the high-level meetings scheduled to discuss, among other things, the need to harmonise the various norms in place for VCF's in the country will result in some positive action. ❖

Taxation of Venture Capital Funds

- ALIFF FAZELBHOY, PARTNER, A.R.A. LAW

- MRINAL CHANDRAN, NLSIU

The onset of the second phase of reforms is likely to witness resurgence in investments in new industrial and infrastructural activities. Venture Capital is likely to be used as a vehicle to invest in such projects. Under regulations issued by the Securities and Exchange Board of India (SEBI), a **venture capital fund** means a fund established in the form of a company or trust which raises monies through loans, donations, issue of securities or units as the case may be, and makes or proposes to make investments in accordance with these regulations.

In order to encourage the use of venture capital funds as vehicles of investment, the Income Tax Act, 1961 (IT Act) has provided certain exemptions. In respect of investments made prior to 31st March 1999 the provisions as contained in 10(23F) of the IT Act would be applicable. In respect of investments made thereafter, section 10(23FA) included by the Finance Act, 1999 and having effect from assessment year 2000-2001, would be applicable. Significantly, the sub-sections distinguish between a venture capital fund and a venture capital company though the exemption is available as regards investments made by both.

Under both the sub-sections, an exemption is allowed in the computation of total income with respect to income by way of dividends or long-term capital gains from investments in the equity shares of a venture capital undertaking. The term 'venture capital undertaking' has also been defined differently under the new sub-section. Exemption under the earlier sub-section was available with respect to undertakings engaged in electricity generation and distribution, telecommunication services, infrastructure facilities, software, etc. Under section 10(23FA), exemption is available with respect to undertakings in software, information technology, pharmaceuticals, biotechnology, agriculture and sectors notified by the Government. However, this exemption is available only if the prescribed authority has approved the venture capital fund or company.

The Central Board of Direct Taxes (CBDT) has prescribed certain guidelines for the approval and exemption of the income of a venture capital fund or company. Applications are to be made to the Director of Income Tax (Exemptions). Briefly the guidelines for the application state as follows:

- The application for approval must be made in the prescribed forms;
- The application must be made in any previous year in which any income by way of dividends or long-term capital gains is received;
- Every application must be accompanied by the following documents:

  (a) a copy of the trust deed or the certificate of incorporation; and

  (b) a copy of the registration with SEBI.

The approval granted by the Director of Income Tax (Exemptions) shall be subject to the following conditions:

- The fund or the company is registered with SEBI;
- Every such fund or company invests an amount of not less than 80% of the total money raised in the equity shares of a venture capital undertaking;
- A minimum of 20% of such money must be invested, during or before the end of the previous year in which the application is made, in equity shares of the venture capital undertaking;
- 50% or more of such money shall be invested in equity shares of the venture capital undertaking during or before the end of the succeeding previous year;
- 80% or more of such money shall be invested in equity shares of the venture capital undertaking during or before the end of the succeeding previous year;
- A fund or company shall not invest more than 20% of the total money raised or total paid up capital in one venture capital undertaking;
- Every fund and company shall maintain books of account and shall submit the same for verification in the manner prescribed to the Director of Income Tax (Exemptions) before the due date of filing returns under section 139(1).

The Director of Income Tax (Exemptions) shall withdraw the approval granted if the venture capital fund or company violates any of the aforesaid guidelines, any of the provisions of the IT Act, the rules made thereunder, or if the certificate of registration granted by SEBI is suspended or cancelled by SEBI.

The provisions of the IT Act relating to representative assessment, would be applicable to a venture capital, which is in the form of a trust. While the trust itself is exempt from taxation, the distributions to the contributors of the fund could be taxed in the hands of the trustee in his capacity as a representative assessee of the beneficiaries. Under section 161(1A) of the IT Act, if the income for which a person is liable as representative assessee includes profits and gains from a business or profession then tax shall be levied on the aggregate income at the maximum marginal rate of tax. In a recent advance ruling by the authority has indicated that the provisions of section 161 would be applicable in the context of trusts [*Advance Ruling P. No. 10 of 1996, In Re*, (1997) 224 ITR 473]. Though not of binding value, the decision may be adopted by the income tax authorities for the purposes of assessment. It may be noted, however, that the section 161 is only an enabling provision and the assessing authority has the discretion to use the same. The suitability of using trusts as vehicles of venture capital would therefore have to be examined. ❖

The Recovery of Debts due to Banks and Financial Institutions Act, 1993 (Act No. 51 of 1993) - A Synopsis

- PRIYARANJAN SINGH SEKHON, ASSOCIATE, A.R.A. LAW

Introduction

In India, due to the diversity and multitude of litigation, the civil courts are burdened with a plethora of private litigation. The intricate procedure in practice in the civil courts is also not conducive to a quick adjudication and disposal of cases. As a result, in suits filed by banks and financial institutions for recovery of loans and advances, a lot of valuable time is lost before the suit is finally heard and decreed by the trial court. Consequently banks and financial institutions often end up locking their funds in unproductive ventures, resulting in an uncalled for burden on the economy.

Due to these reasons, the need was felt for establishing a separate Tribunal with special powers of adjudication for the speedy adjudication and disposal of suits filed by banks and financial institutions for the recovery of loans and advances. The establishment of such a tribunal was also strongly recommended by the various Committees appointed by the Government.

As a result, the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (the 'Act') was finally passed by Parliament on 27th August 1993. The Act primarily seeks to provide for the establishment and functioning of tribunals for the purpose of expeditious adjudication and recovery of debts due to banks and financial institutions and lays down the jurisdiction and powers of such tribunals.

Chapter I of the Act deals with the extent and application of the Act and defines certain terms for the purposes of the Act. The application of the Act is limited to cases where the amount of debt due to any bank or financial institution or to a consortium of banks and financial institutions is higher than Rs. 10 lakhs or such other amount (not being less than Rs 1 lakh), as the Central Government may notify. Specific definitions are provided in Section 2 for terms such as "bank", "financial institution", "banking company" and "debt" for the purposes of the Act.

Chapter II of the Act provides for the establishment of tribunals and appellate tribunals. Sections 3 and 8 thereunder provide for the establishment of Debt Recovery Tribunals ("DRT") and Debt Recovery Appellate Tribunals ("DRAT") respectively by the Central Government by notification specifying the jurisdiction of such tribunals.

Sections 4 and 9 provide for the composition of the DRT and DRAT. Both sections limit the composition of such tribunals to one person each know as the Presiding Officer of the DRT and the DRAT respectively. The qualifications for a Presiding Officer of the DRT and DRAT are prescribed under Sections 5 and 10 respectively.

The Central Government, by virtue of Section 7, has also been authorised to appoint and prescribe the terms of service of a recovery officer and such other officers and employees as it deems fit for the DRT. By virtue of Section 12 of the Act, the Central Government has been authorized to make the same appointments in respect of the DRAT as set out in Section 7, except that the Central Government cannot appoint a recovery officer for the DRAT.

It is pertinent to note that, under Section 14, it is provided that the proceedings before the DRT or DRAT shall be carried on from whatever stage they may have been at, from the date when a vacancy arose till the vacancy is filled. This is a positive step towards ensuring that there is no waste of time by re-hearing the case from the initial stage due to a new Presiding Officer taking over the hearings. Section 16 prohibits any objections to be raised on the grounds of the constitution of the tribunal.

Chapter III of the Act deals with the jurisdiction, powers and authority of the DRT and the DRAT. Section 17(2) of the Act bestows the DRT with the jurisdiction, power and authority to entertain and decide applications from banks and financial institutions for the recovery of debts. The DRAT has been bestowed with the jurisdiction, power and authority to entertain all appeals from any orders passed by the DRT under the Act.

Chapter IV of the Act deals with the procedure to be followed by the DRT and DRAT in the exercise of their jurisdiction, powers and authority. The form of the applications to the DRT/DRAT and other details are provided in the Debt Recovery Tribunal (Procedure) Rules, 1993 and the Debts Recovery Appellate Tribunal (Procedure) Rules 1994 respectively. The provisions of the Limitation Act, 1963 apply to applications made before a Tribunal by virtue of Section 24 of the Act.

Section 19 provides the procedure for making an application to the DRT. In order to recover a debt from any person, a bank/financial institution is supposed to make an application to such tribunal within whose area of jurisdiction the defendant(s) resides or carries on business or personally works for gain; or where the cause of action, wholly or in part arises. Upon receiving such an application, the DRT is required to issue summons to the defendant to show cause and thereafter provide the applicant and the defendant an opportunity of being heard. The Tribunal is empowered to pass interim orders of injunctions or stays against Defendants debarring them from transferring, alienating or otherwise dealing with, or disposing of, any property and assets belonging to them or final orders determining the debt due from the Defendant.

Upon passing an order, the Presiding Officer of the DRT is required to issue a signed certificate specifying the debt to the recovery officer for recovery of the amount of debt specified in the said certificate. It may be noted that Section 19(8) provides for the expeditious disposal of an application and recommends a time limit of six months for the tribunal to dispose off an application.

The Act also provides for a procedure of appeal from orders passed by the DRT. Section 20 of the Act deals with the procedure to be followed by the DRAT when dealing with appeals. An appeal can be preferred from all orders passed by a DRT under the Act to the DRAT exercising jurisdiction over such DRT. A limitation period of forty-five days has been provided for filing an appeal from any order passed by a DRT. The DRAT is also expected to deal with and dispose off appeals as expeditiously as possible and Section 20(6) recommends that the appeals be disposed off in six months. The orders of the DRAT are final and only a writ under Articles 226 or 227 of the Constitution can lie to the Supreme Court or the High Court from an order of the DRAT.

As per the provisions of Section 21 the DRAT shall only hear an appeal if the appellant has deposited 75% of the amount of debt determined by the DRT under Section 19 of the Act. However such deposit may be waived or reduced by DRAT for reasons to be recorded in writing.

Section 22 of the Act lays down that the DRT and DRAT shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 and shall be guided primarily by the principals of natural justice. However the DRT and DRAT have been vested with the powers of a civil court under the Code of Civil Procedure, 1908 while trying a suit in certain matters more specifically set out in Section 22(2). Both the DRT and DRAT have been provided with the right to regulate their own procedure. The parties have been provided the right to appear either in person or through their officers or through an advocate by virtue of Section 23 of the Act. By providing the DRT and DRAT with authority to frame their own rules with respect to procedure, the Act aims to simplify the proceedings and reduce the wastage of time.

Chapter V of the Act deals with the manner in which debts determined by a DRT are to be recovered. As per Section 25 of the Act, the Recovery Officer, upon receipt of the certificate forwarded by the Presiding Officer under Section 19(7) of the Act, proceeds to recover the amount of debt so specified in the said certificate from the Defendant in the manner set out therein. A certificate issued by a Presiding Officer cannot be challenged before the Recovery Officer. The Recovery Officer has been vested with certain other modes of recovery of debts from Defendants; these are set out in Section 28 of the Act. The Recovery Officer can utilise these modes without prejudice to the modes specified in Section 25. The Recovery Officer is empowered to recover the debt of a defendant from any person from whom an amount is due to the defendant, and such a person is bound to comply with the requisition by the Recovery Officer and pay the sum to the Recovery Officer under Section 25(2). The procedure for recovery of the amount of debt from debtors of the Defendant is set out in Sections 28(3), (4) and (5). However, as the DRT is empowered to frame its own rules as to procedure, the process of recovery of the debt is not as long drawn as it would be under the Code of Civil Procedure.

Chapter VI of the Act deals with miscellaneous provisions, such as the transfer of all pending cases before other courts covered by the Act, except appeals which are pending hearing (Section 31); and the protection of all legal action taken by the Central Government, Presiding Officers of the DRT and DRAT, Recovery Officers under the Act against legal proceedings or other prosecutions (Section 33).

Conclusion

In civil suits filed by banks and financial institutions for recovery of their dues, there are generally very few grounds of defense available to a defendant. In most cases, defendants are ordered to pay back the dues in installments by conditional interim and/or ad-interim orders directing a Receiver to be appointed in respect of the properties hypothecated by defendants to the banks in the event of default in payment. The process of the Receiver taking possession of the properties and either maintaining the same or the funds from the sale of the same till the final hearing of the suit is a long-drawn and time consuming process. The suits remain pending at the Civil Courts for periods ranging from at least 10 to 15 years and the entire process results in most banks writing off a part of or at times the entire debt.

As the DRT and DRAT are allowed to formulate their own rules with respect to the conduct of proceedings and recovery of debts, the process of recovery of debts has been simplified enormously. The Act is a step towards reducing the burden on the Civil Courts in India. Moreover, due to the fact that the cumbersome and tedious procedure prescribed under the Code of Civil Procedure has been done away with by the Act, banks and financial institutions have been provided with a forum and mechanism for a time and cost effective for recovery of their dues. ❖

Arbitration in India - features and importance of the new Act of 1996 – Part 2

- Dr. Abhishek M. Singhvi, Senior Advocate, Supreme Court of India, Former Additional Solicitor General, India

Arbitration in India is a long drawn process. With the introduction of the new Arbitration & Conciliation Act, 1996 (the ‘Act’), hopes run high that arbitration will be conducted and completed in a quicker time-frame than what is currently happening. This is the concluding part of Dr. Singhvi’s essay on Arbitration in India, in which he evaluates the features of the Act.

6. The dilemma

The 1996 model, which transposes Indian arbitration from a model of extreme and frequent judicial interference and judicial scrutiny to a model of absolute and extreme non-interference, coupled with the dominant theme of "Party autonomy" and the doctrine of conclusivity of award, clearly presents a major dilemma - is it better to have an infirm or vitiated award coupled with maximum judicial interference and scrutiny (as under the old law) acting as a check and safeguard, or is it better to have an equally infirm or even corrupt or procured award rendered unreviewable and unchangeable by the doctrine of conclusivity? Does the 1996 model therefore put the seal and imprimatur of judicial approval even on corrupt, infirm or bad awards by adumbrating the doctrine of conclusivity. The answer clearly lies in the premise underlying the Act and underlying the UNCITRAL Rules, which form the basis of the Act. That premise is the premise of the existence of a pool of outstanding arbitrators - lay, legal and judicial - without which the 1996 model clearly cannot work.

7. Regarding old Sec. 3 of 1961 Act - Stay of suit - old Sec. 34 of 1940 Act - New Sec. 45 of 1996

The entire old wisdom regarding stay of suit contained in Sec. 34 of the old 1940 Act and in Sec. 3 of old 1961 Act is now, in a sense, rendered superfluous and irrelevant. In *Renusagar vs. GEC* 1987-4

SCC 137, the law in my opinion was inverted to stipulate the test as to whether the party seeking a stay of the domestic suit could be said to have abandoned its intention to arbitrate or not. In other words, the 1987 decision laid down that the test was not whether the party seeking stay of the domestic suit had taken a step in the proceeding or filed a written statement or not, but whether that party had evinced an intent to abandon arbitration.

This test and the old law are now irrelevant for the simple reason that Sec. 45 of the Act only requires it to be established that the arbitration agreements cover the subject matter of the suit and that it is not null, void or inoperative. Once that is established, the court is mandatorily obliged to stay the suit. Details regarding taking steps in the proceeding etc. have been done away with, at least in respect of international arbitration. Section 8 dealing with domestic arbitration is also more restrictive.

However, if and when a stay of the domestic suit is granted, the effect of that stay (namely that the suit becomes dead and no applications can be moved in the dead suit) would continue to apply as per judgement of the Supreme Court in *R.M. Investment JT* (1994) (1) SC 615.

8. Jurisdiction - Old Sec. 5 of 1961 Act - New Sec. 45

In an earlier judgement in *Renusagar vs. G.E.C* before a single judge of Bombay, 1988 and the Division bench, 1989 (both unreported) held that the test of "subject matter of the award" stipulated in Sec.5 of the 1961 Act really amounted to the same test of territorial jurisdiction as found in Sec. 20 of the Civil Procedure Code (CPC), viz. defendant's residence or cause of action arising. In other words, a person seeking to enforce a foreign award in India can choose any court in India to enforce the foreign award so long as that court has jurisdiction in terms of the "cause of action" test. The contrary argument of Renusagar (rejected by the single judge Bombay) was that the phrase "subject matter of the award" must necessarily mean only that court where the assets (against which the award could potentially be enforced or realised) were located.

The new sec. 47 of the Act adds an explanation, which clearly brings in the "cause of action" test of Sec. 20 of the CPC and thus statutorily recognizes the correctness of the judgement of the Single Judge, Bombay.

9. When is an award domestic qua Indian law - when is it foreign under Indian law - Sec. 9 of the 1961 Act

Finally, an interesting conundrum, which existed under the old section 9 of the 1961 Act, has now been done away with by its deletion in the 1961 law.

Section 9 of the 1961 Act provided that where the "law governing the arbitration agreement is Indian law", the Foreign Award Act of 1961 shall itself not apply. The judgement of the Supreme Court in NTPC Singer 1993, in which I had the privilege of appearing for the winning party NTPC held that, where the contract provides that "courts of Delhi shall have exclusive jurisdiction" and that "Indian law shall be the law applicable to the contract", the arbitration proceedings and the award would be held to be domestic qua Indian law notwithstanding the existence of an ICC arbitration clause in the contract.

The Supreme Court judgement in *NTPC Vs. Singer* AIR 1993 SC 998 reverses two earlier concurrent decisions of the Delhi High Court (Single Judge and Division bench) and caused much consternation in international arbitration circles and particularly the ICC. The result of the NTPC judgement appeared at first blush to be anomalous since, in that case with an ICC Arbitration Tribunal clause, the dispute between NTPC (Indian company) and Singer (a US company) sitting in London was held liable to be controlled as a domestic arbitral forum under the 1940 Act.

A number of articles were written all over the world in respected international arbitration journals severely castigating and condemning the NTPC judgement. At many international conferences I had exchanges with eminent detractors of the NTPC Singer judgement like Jan Paulsson, an internationally acclaimed arbitration lawyer.

The issue may not arise in the future since Sec. 9 stands repealed. I, however, continue to subscribe to the view that the NTPC judgement is justifiable and supportable on the peculiar facts of that case and in particular, on the most peculiar language of the arbitration clause occurring in that case. Since that clause clearly stated that "courts of Delhi shall have exclusive jurisdiction", it is not entirely astonishing that even a tribunal sitting beyond the shores of India was held to be subject to the jurisdiction of the Delhi court. As far as the new 1996 law is concerned, sec. 2(f) clearly states the conditions which alone would render an arbitration an international arbitration. Substantially the conditions involve the situation where at least one party is a non-Indian person or a foreign corporation. Thus, if one of those conditions is satisfied but the venue of the arbitration is in India, the arbitration would constitute an international commercial arbitration and not a domestic arbitration. However, lex loci (i.e. Indian law) and Indian court jurisdiction would clearly apply to procedural matters simply because the venue of the arbitration is India. This is also intended to promote India as a venue and a centre for international arbitration. Finally Sec. 2(2) may also be noted, which limits the application of the entire Part I of the 1996 law (dealing substantially with domestic arbitration) to cases where the place of arbitration is India.

In conclusion, one must not forget to underline some of the problems which necessarily arise under the Act in view of the somewhat limited time available for its drafting and passage as a Bill through Parliament. Some of these interpretational issues which have arisen in the last few years of its existence may be briefly highlighted:

1. Following the UNCITRAL model, the Act deals with Indian-based arbitration and foreign arbitration in separate parts viz. Part I and Part II respectively. Section 2(2) of the Act specifically stipulates that Part I shall apply only where the place of arbitration is in India. The question frequently arises as to whether several provisions occurring in Part I of the Act, which appear to be of general nature but do not find any counterpart in Part II of the Act, are nevertheless applicable to foreign arbitration (e.g. New York Convention arbitration) under Part II of the Act. For example, Section 9 occurring in Part I of the Act specifically empowers a Court (which must necessarily mean an Indian court) to make interim orders on an application by any party before initiation of arbitration, during arbitral proceedings or after making of an award. No similar provision exists under Part II of the Act. However, Section 48(3) of the Act does provide that an enforcing court in India may defer and adjourn matters while an action to set aside the foreign award has been made or is pending before a competent authority of the country in which, or under the law of which, the award was made.

2. The question arises: whether the general power of passing interim orders entrusted to Indian courts under Section 9 would extend to the same court when it is acting as an enforcing court under Part II in a foreign award case. On principle, the answer, in my opinion, must necessarily be in the negative. However, attempts are frequently made in Indian courts to apply section 9 by analogy to foreign arbitration since section 8, which also occurs in Part I and specifically empowers an Indian court to refer the parties to arbitration if it finds that it is faced with an action (e.g. a Suit) on a subject matter covered by an arbitration agreement, has been held by a learned single Judge of the Delhi High Court to apply also to Part II. In respect of Section 9, the argument has been raised that, although a Part II arbitration is held beyond the shores of India, interim protection while the main matter is decided can and must only be sought from the enforcing court while the main international arbitration continues. It is added that, in the absence of applying Section 9 to Part II arbitration, the aggrieved party may be left with no possibility of emergency recourse to a court for emergent interim relief for protection and preservation of the subject matter of the dispute. Clearly, Part II of the Act ought to have provided specifically for a bar against interim intervention by Indian courts in respect of a foreign arbitration. Such intervention would involve the peculiarity of an Indian court issuing extra-territorial interim directions to arbitral tribunals sitting beyond its reach and may even involve subject matter of dispute beyond its reach. Moreover, it would lead to overlapping, concurrent and simultaneous jurisdiction of 3 fora for purposes of interim orders: the international tribunal sitting in a foreign country, the local sovereign courts of that foreign country applying lex loci as also the Indian court.

3. The scheme of Part II Chapter 1 of the Act dealing with New York Convention Awards clearly provides firstly for the coming into existence of a foreign award; secondly for enforcement of that foreign award in an Indian court by a party seeking enforcement in India (Sec. 47); thirdly, for the enforcing court (namely the Indian Court) to hear the party resisting enforcement as to whether any of the conditions and grounds in Section 48 are made out; and lastly, for allowing or rejecting the application of the party seeking enforcement by not only passing an enforcement order, but also deeming that order automatically to be an enforceable decree of the court (Section 49).

4. Although this scheme and sequence appear to be clear, a judgement of the learned single judge of the Delhi High Court has held that a foreign award obtained by a party may directly be filed in an Indian court in the format of an application for execution of a decree prescribed under Order 21, Rule 10 of the CPC. Upon such execution of the application, the court holds interim directions for judgement and/or provision of security can be passed immediately by an enforcing court against the party resisting enforcement. Although the grounds of defence of Section 48 clearly cannot be overridden, the learned single judge holds that Section 48 grounds would be examined during the execution proceeding itself and after attachment orders have been issued in the interim.

5. It is submitted that the judgement is clearly erroneous and proceeds on an untenable, unsustainable and erroneous interpretation not only of the scheme and sequence of Chapter I of Part II of the Act but also accords undue importance to the changes made in the Act from the scheme of its predecessor 1961 Foreign Awards Act. No doubt, the 1961 Act telescopes Sections 4, 5 and 6 of the 1961 Act into Section 48 of the Act. There is, however, no basis for the further inference, erroneously drawn by the learned single judge of the Delhi High Court, that this telescoping can permit a party to leapfrog over Sections 47 and 48 of the Act directly from the stage of foreign award to the stage of enforceable decree without first complying with the vital, crucial and core stage of applying for an enforcement of the foreign award, of hearing substantive objections on various grounds set out in Section 48 and only thereafter of passing an order which is deemed to be a decree under Section 49 of the Act.

6. Related to the first issue is the issue as to whether, in deciding if an actual case would be covered by the Act or by the old law, the test of Section 21 occurring in Part I of the Act should be applied to Section 85 or not. Clearly the Section 85 test would apply to all arbitration, domestic or international where the issue may arise as to the date as to whether the arbitration is covered by the 1961 Act or the Act. In most cases, the issue may be quite clear and factually there will be no dispute as to whether the arbitration commenced before or after the January date which, according to the judgement of the Supreme Court in Konkan Railway (1998), has been held to be the cut-off date, after which all matters would be covered by the 1996 Act. However, cases do arise when an issue of interpretation is raised in respect of some correspondence exchanged between the parties regarding arbitration, say for example in 1995 while another formal request for arbitration is made again (say) in late 1996. The question that arises is whether the language and content of the correspondence of 1995 can constitute commencement of arbitration because if it can, clearly the old Act would apply and not the new one. Section 21 alone gives a clear definition of “commencement", viz. commencement occurs on the date on which the respondent receives a request for that dispute to be referred to arbitration.

   While this precise definition is undoubtedly helpful, the question remains as to whether it can be utilised for Part II arbitration. Since Section 21 occurs in Part I, on my reasoning given above, the answer would have to be in the negative. However, the analogy of the principle contained in Section 21 may well be more easily applicable to Part II arbitration since Section 21 is a general definitional clause and can therefore to be seen as qualitatively different in nature, content and scope from Sections 8 and 9 of the Act which, as opined by me earlier, would not apply to Part II arbitration.

7. In the realm of domestic arbitration, Sec. 16 in Part I clearly brings about a substantial and substantive change in the law. A question may arise as to whether the clear mandate of the Act of minimal judicial interference in arbitration (see for e.g. Section 5) and the if-clear intent and object of the Act to disallow

court interference in an ongoing arbitration are diluted and indeed frustrated by Section 16(5). Section 16(5), while appearing to suggest that the arbitration should continue and interim jurisdictional issues are to be decided only along with final challenges to the award, may inadvertently have achieved the opposite results. Section 16(5) reads thus - "The arbitral tribunal shall decide on a plea referred to in sub-section (2) or sub-section (3) and, where the arbitral tribunal take a decision rejecting the plea, continue with the arbitral proceedings and make an arbitral award".

Suppose a party to an ongoing arbitration in India under Part I raises jurisdictional objection to say that the entire arbitration is not and cannot be under the auspices of the ICC rules and therefore the arbitral tribunal sitting under ICC Rules in India is acting without jurisdiction.

Section 16(5), on one reading, appears to support the argument that, if the aforesaid plea is rejected, the tribunal should continue with arbitral proceedings and make the arbitral award. (Conversely, if the plea is accepted, the existence of the arbitral tribunal itself comes to an end.) However, while it mandates the continuance of the arbitration, what is clear in Section 16(5) is the assumption that a tribunal shall decide the jurisdictional plea at the threshold and cannot and ought not to postpone decision of this plea till the final award. This is clear both from the opening words of Section 16(5) ("the tribunal shall decide") as also from the later words "where the arbitral tribunal takes a decision". In other words, section 16(5) can be read to mean that the arbitral tribunal must decide the jurisdictional plea one way or the other. And the case of continuance with the arbitral proceedings shall arise only when the plea is rejected since obviously, in the converse case, if the plea is allowed, the arbitration proceedings cannot continue. If, therefore, as in my opinion is the case, the arbitral tribunal is obliged to decide as a preliminary issue any jurisdictional issue raised before it, this decision can only take the form of an interim award, which in turn under Section 2(i)(c) would also constitute an arbitral award. If this constitutes an arbitral award (as it must), this interim award would be disputable under Section 34 in an action for setting aside the arbitral award on the grounds delineated in section 34. Such a challenge to an Indian court would lead to a judicial order and would in turn be further contestable under section 37 of the Act.

Clearly, therefore, the paramount object of the new legislation to prevent interim piecemeal adjudication on preliminary issues, which would then be disputable in preliminary proceedings and further in an appellate proceeding on the preliminary issue and further yet by way of SLP to the Supreme Court, is subverted and lost. Given the enormous delays of the Indian legal system, this could constitute a potentially dangerous, happy hunting ground for litigants who wish to obstruct, derail and delay arbitration proceedings.

8. Sections 10 and 11 of the Act provide vital procedural rules regarding appointment of arbitrators (the number and under the new law can be only odd and not even) as also the elimination of the concept of the umpire. These are unique to the Act and are in marked contrast to the old Act. They pose no problem for all arbitration agreements entered into after the cut off date in 1996 when the new Act had come into force, since parties entering into such agreements after the date of the Act cannot be allowed to provide for even numbers or umpires. However, the Act contains no transitional provision to deal with the large number of pre-existing old arbitration agreements in hundreds and thousands of contracts entered into before the cut off date in 1996. Most of such contracts, especially several standard form contracts or contracts involving governmental agencies or public sector enterprises contain the concept of umpire which has been a fundamental part of Indian arbitration jurisprudence prior to the Act. Although such arbitral agreements have been in existence for several years prior to 1996, disputes under such agreements may arise only after the cut off date for coming into force of the Act. Sections 10 and 11 of the Act are incompatible with the pre-existing concept of umpires and of even number of arbitrators.

9. This could have potentially led to serious problems and avoidable litigation. Fortunately, the issue has been partly decided and set at rest by the judgement of the Supreme Court in *MMTC vs. Sterlite* (1997).

The judgement does not, however, deal with all aspects of pre-existing arbitration agreements under the old Act but may be used by analogy to set at rest specific issues arising.

Concluded. ❖

Taxation of Employee Stock Options: Issues in the Post-Budget Scenario

- HARI S. BHARDWAJ, NLSIU

The taxation of employee stock options is an issue of great complexity, not just in the Indian scenario, but also in the global context. In India, the Finance Minister went to great lengths in the 1999 Budget to clarify the exact position in this regard. Nevertheless, some critical issues remain which need to be addressed at the earliest. It should be noted in this context, that there has been no judicial interpretation to date, in India in relation to taxation of employees stock options, and this has led to a vacuum in so far as some aspects are concerned. Some of the issues are briefly discussed below:

1. The 1999 Budget has clarified that employee stock option plans (ESOP's) are to be taxed twice - once when the stock option is exercised, where the difference between the 'fair market price' and the 'exercise price' is taxable as perquisites in the hands of the employee; and again at the time of sale of shares issued, pursuant to exercise of options where any ensuing profit is to be taxed as capital gains. The Finance Ministry has completely failed to consider the argument of many corporates that such taxation is unfair and leads to double taxation. In this regard, it is noted that if the Ministry is unable to exempt all kinds of stock options from taxation, it can look into the viability of making some classes of ESOP's tax-free along the lines of Incentive Stock Options (ISO's) in the United States. Such a move, it is submitted, would be a boost both to industry and to employees.
2. Secondly, while the proposed scheme is feasible where the company is a listed one and the market value of shares is known, the Finance Ministry has failed to bring unlisted companies within the scheme of taxation. This is keeping in view the fact that the market value of shares is not known in the case of such companies. In this regard, it would be a good step to implement the system followed in Singapore, i.e., the net asset value less the amount paid for the shares be used as the basis for determining the amount taxable as perquisite.
3. Finally, irrespective of the scheme of taxation adopted by the Finance Ministry, there is a need to ensure non-discrimination and a level playing field in so far as employees of private companies vis-à-vis government companies. This is in view of Circular No. 710, dated July 24, 1995, through which shares transferred by the Government to its employees are exempted from taxation as perquisite because no employer-employee relationship is found to exist between the transferor and the transferee.

More and more companies, especially in fast-growth sectors such as the information technology sector, are issuing employee stock options. There is therefore an urgent need to put in place a comprehensive tax structure and for the Government to take into immediate consideration the above issues. ❖

LEGAL SNAPSHOTS

Stay on the Calling Party Pays regime

Under the Calling Party Pays (CPP) regime, calls from a fixed landline to a mobile phone would cost the landline phone user airtime charges in addition to normal call charges, which would work out to more than the cost of a local call, i.e. Rs. 2.40 per minute. The revenue earned was to be shared between the landline and mobile phone operators. The CPP regime was challenged by a public interest litigation from a consumer organisation and MTNL in the Delhi High Court. The CPP regime, which was to be implemented from 1st November 1999, was stayed by the Delhi High

Court till 16th November 1999. The Cellular Operators Association of India, however, filed an intervention application before the Delhi High Court on 11th November 1999, seeking to place additional information on the CPP regime before the court. The matter came up for hearing and was adjourned by the Delhi High Court to 30th November. The Ministry of Communications in the process of trying to resolve matters between the DoT and TRAI outside Court. ❖

Amendment to Port Trusts Act finalised

The ministry of surface transport has finalised the Major Port Trust Act Amendment Bill, which will allow major ports to acquire equity in joint ventures in the state sector and in corporate ports. The sections in the Major Port Trust Act that are being amended are 88(2b) and 90(2). Section 88(2b) refers to investment in public securities made from the general account out of the surplus generated by port trusts; section 90(2) deals with investments made from the sinking fund created by port trusts. Under these sections, investments are allowed only in approved government securities and do not include equity investments. The amendments have been made consequent to the Union Cabinet's decision last year to allow ports to enter joint ventures with either minor ports or foreign ports with a 26% stake.

The other amendment refers to Section 92, to allow ports to access resources directly, on the same lines as other public sector organisations, from the financial market. Under the existing provisions, port trusts are not allowed to raise resources from the market without the Centre's permission. ❖

Telecom PSU's to come under Department of Telecommunications (DoT)

In a notification issued on 15 October 1999, the government transferred administrative control of all Public Sector Units previously under the DoT, including MTNL and VSNL, to the newly formed DoT Services. The new department will be responsible for all matters 'other than policy matters'. Policy matters will be handled by the Telecom Commission. DoT will be responsible for the administration of laws like the Indian Telegraph Act and the Telecom Regulatory Authority of India Act. It is unclear, however, whether the new department will oversee DoT's service provision functions as well. ❖

Corporate governance

The Kumar Mangalam Birla Committee on corporate governance has recommended that the government should issue an ordinance to allow postal ballot in the case of companies. The draft report of the committee stated that the Securities and Exchange Board of India has already made recommendations in this regard to the Department of Company Affairs. Some of the critical matters which, according to the Committee, should be decided by a system of postal ballot include matters relating to alteration in the memorandum of association of the company, sale of the whole or substantially the whole undertaking, sale of investments in companies, where the shareholding or the voting rights of the company exceed 25%, further issue of shares, corporate restructuring, entering a new area of business and variation in the rights attached to class of securities. ❖

Bank accounts considered property by Supreme Court

Section 102 of the Criminal Procedure Code, 1862 allows the police to seize any property suspected to have been stolen or linked to any criminal offence. Most high courts earlier held that bank accounts were not property and hence could not be seized. This was a major stumbling block to investigating officers. The Supreme Court has, in its latest judgement, made Section 102 applicable to corruption cases as well. As a result, the criminal investigative machinery can now seize or prohibit the operation of bank accounts suspected to be linked to any offence. ❖

Privatisation of the Registrar of Companies

The privatisation of the Registrar of Companies (ROC) is likely to be brought about. The Department of Company Affairs (DCA) is currently evaluating the pros and cons of this move. The privatisation of ROC would take the form of the opening up its information collection and dissemination function. Policy making, inspection, regulation and prosecution of companies would continue to remain with the government. ❖

Money Market Mutual Funds

Control over Money Market Mutual Funds (MMMF's) has been relinquished by the Reserve Bank of India and has been taken over by the Securities and Exchange Board of India (SEBI). RBI will be withdrawing the guidelines for MMMF's and ask the entities registered with it to seek SEBI registration. They would be governed by SEBI guidelines for mutual funds. The trust structure prescribed under SEBI's Mutual Fund norms will apply to them. Banks and financial institutions will be asked to not offer money market deposit accounts under MMMF's. The move brings the MMMF's on par with liquid funds. They will no longer have to comply with the requirement of a 15-day lock in period and can invest in securities as defined in their offer documents, subject to SEBI norms. ❖

Stock exchanges more accountable

SEBI has revamped its reporting format with a view of making stock exchanges more pro-active. Stock exchanges would now be required to provide details with regard to disabling of members' terminals, suspension of scrips for short as well as indefinite periods, investigations and disciplinary actions taken against errant members, verification of rumours and the procedure of dissemination of facts to members. Stock exchanges would also be required to provide SEBI with details of corporate announcements and other important price-sensitive news on companies. Weekly and monthly reports on the action taken by the stock exchanges in the areas of surveillance and investigation have to be submitted. SEBI is confident that the system of 'Stock Watch' will make the exchanges the first line of regulators and it will be able to tackle market manipulation more effectively. ❖

Stock exchanges allowed to set up terminals nationwide

The Securities and Exchange Board of India (SEBI) has decided to allow stock exchanges to set up terminals at any place in the country. This breaks the monopoly enjoyed by the National Stock Exchange, and will allow the Bombay Stock Exchange (BSE) to compete with the NSE at a national level. ❖

Cap on MF investments

The Securities and Exchange Board of India (SEBI) has prescribed new limits for investments by mutual funds in group companies, equity, debt and unlisted companies. A mutual fund shall not invest more than 25% of the net asset value (NAV) of any single scheme in the listed securities of group companies. SEBI has also made it mandatory for transactions to be disclosed along with the half-yearly and yearly results. In order to ensure that funds are not blocked in illiquid investments, SEBI has decided to restrict investments in unlisted shares to a maximum of 10% of the NAV of close-ended schemes and 5% in the case of open-ended schemes. A limit of 10% of the NAV of a scheme has been imposed on amounts invested in equity shares. The limit is not applicable in the case of index and sector-specific funds. ❖

Well-diversified mutual funds regime

In order to make sure that investments by mutual funds are well diversified, SEBI has amended the mutual fund regulations. Some of the amendments are:

- Investments in rated, investment-grade debt instruments by a single issuer restricted to 15% of NAV. Limit may be extended to 20% with prior approval of the Board of the asset management company (AMC) and the Board of Trustees of the fund;
- Investments in unrated and rated, but below-investment grade, debt instruments of a single issuer to not exceed 10% of the NAV. The total investments in such instruments are restricted to 25% of the NAV. These restrictions are not applicable to government securities and money market instruments;
- In case of a change in control and fundamental attributes of open-ended schemes, unit holders will be given the option to exit at NAV without an exit load. Such change will not be allowed within one year of the date of allotment of the units. Also, unit holders will have to be informed through newspapers, communications, etc.;
- AMC's permitted to carry out portfolio management activities subject to conditions;
- Advertisement regarding performance to be supported by relevant figures and the NAV/yields/returns to be given for past three years wherever applicable. Selective extracts from the offer document, which could be misleading, cannot be published; nor may celebrities be used in the ads;
- The code of conduct has been elaborated to include clauses pertaining to integrity, due diligence, fairness in dealings, etc. which are to be adhered to by the trustees and the AMC;
- Net worth of an AMC has been redefined to bring it in line with international practices. ❖

Market Making

The Securities and Exchange Board of India (SEBI) Committee on market making has in its final report made the following recommendations:

- ➢ Market making should be permitted only in illiquid stocks of good companies;
- ➢ Investment institutions should be asked to encourage their broking firms to take up market making;
- ➢ Clearing banks of stock exchanges to be asked to open special cells for lending to market makers;
- ➢ RBI should encourage banks to participate in lending to market makers;
- ➢ All stock exchanges should adhere to norms on selection of shares, capital adequacy and price bands;
- ➢ Market maker will be eligible to avail of all lending/borrowing facilities under the Stock Lending Scheme 1997;

- Market maker can draw shares from the promoters in a fair and transparent manner;
- If he fails to provide two-way quotes for more than three consecutive days, the registration will be cancelled.

Bans on negotiated cross deals

The Securities and Exchange Board of India (SEBI) has banned negotiated and cross deals for trades in stocks and corporate debt instruments. The ban would be across all scrips in all stock exchanges and there would no longer be any off-market transaction and all trades would have to be on-screen through order matching system of stock exchanges.

SEBI is expected to relax the ban on negotiated deals for foreign institutional investors (FII) in the event of their holding reaching the maximum permissible levels in a scrip. ❖

Rights issue norms eased

The Reserve Bank of India (RBI) has granted general permission to companies to issue and remit rights and bonus shares to non-residents. This is subject to the conditions that the percentage holding of foreign investors does not change. The general permission applies only to those projects where the original project cost as approved by the Foreign Investment Promotion Board (FIPB) does not exceed Rs. 600 crores. The shares should not be issued to non-resident investors at a price lower than what has been offered to resident shareholders. ❖

New format for NBFC accounts

The Reserve Bank of India committee in charge of the department of non-banking supervision has suggested a revised format for redesigning financial statements of non-banking financial companies (NBFC's). The new format includes additional disclosure in respect of maturity profile of assets and liabilities, sector-wise concentration of assets and liabilities, details in respect of overdue loans and other credits, non-performing assets and provisioning, valuation of investments as schedules to the main balance sheet and profit and loss account. ❖

RBI caps dividend on preference shares to foreign entities at 15%

The Reserve Bank of India has set a 15% dividend cap on preference shares issued to foreign entities. This covers all forms of preference share dividends. ❖

Bank service fees

The Reserve Bank of India (RBI) has given banks the freedom to independently fix service charges for their customers, instead of following the benchmark Indian Banks Association rates (IBA). RBI stated that, while fixing such charges, the banks should ensure that the charges are reasonable and not out of line with the average cost of providing the service. IBA's rates will now form the level below which no bank may set its rates. Banks will have to do a cost study for themselves to arrive at the pricing of their products. The move is aimed at promoting competition in the banking sector, finer pricing and better service by banks. RBI has also cautioned banks to ensure that customers with low volumes of activity were not penalised. ❖

EPCG norms relaxed for IT

The Directorate General of Foreign Trade (DGFT) has simplified procedures for export of software and electronic goods and decided to give export promotion capital goods (EPCG) license on the basis of self-declaration by exporters. The applicant would have to provide a bank guarantee that would be encashed if the EPCG panel rejects the export-import ratio. Duty would be imposed on re-export of defective capital goods brought into the country under the EPCG scheme. Customs duty would be levied from the local company which re-exported the machinery. ❖

ISP's to set up their own gateways

The government is likely to allow private Internet Service Providers (ISP's) to set up their own gateways, subject to security clearance. This would end the monopoly of the government owned Videsh Sanchar Nigam Limited. There are already six applications from various companies pending with the Government, seeking permission to set up gateways. ❖

MF's to trade in securitised bonds

The Securities and Exchange Board of India (SEBI) has approved the concept of mutual funds floating dedicated schemes to buy securitised debt from financial institutions. The funds would, however, have to disclose the purpose, credit rating of the securitised bonds and the names of the instruments to the investors. ❖

MF's allowed to trade in GDR's/ADR's

The Securities and Exchange Board of India (SEBI) today permitted Indian mutual funds to invest in Global Depository Receipts (GDR's) and American Depository Receipts (ADR's) of Indian companies subject to a minimum of US$20 million and a maximum of US$50 million per mutual fund. In a joint decision the RBI, SEBI and the Government of India have also fixed an investment cap of 10% of the net assets managed by the funds and an overall investment limit of US$500 million. Fund managers were not too impressed with the permission to invest in ADR's/GDR's abroad, as the markets for these instruments are far more illiquid than those in India. Besides, GDR's are non-voting shares, whereas those in the Indian market are voting shares. ❖

Separate Information Technology Ministry

The Government has created a new ministry know as the Information Technology Ministry to promote Internet, e-commerce and knowledge-based industries without stepping on the toes of existing ministries. There would be no interlapping between the Telecommunications Ministry and the newly formed IT Ministry. ❖

Stiff investment norms for foreign film companies

The government has imposed stiff investment norms for foreign investors seeking entry into the domestic film industry. This includes a minimum paid-up capital limit of US$10 million in the case of majority holdings, curbs on raising debt and disclosures to prove credibility. If the foreign player holds a majority stake or is the single largest stakeholder, it would have to bring in US$10m. If it were between the smallest and the largest shareholder, the commitment would have to be US$2.5-5m. The scope of all permissions includes several activities such as production, distribution of films, film financing, exhibition, marketing and associated activities relating to the film industry. ❖

Automatic FDI route for more sectors

The government has stated that only a small list of items would be kept out of the automatic list for foreign investment. According to government sources, certain sectors like defence, small-scale industries may be put on this small list which would be more like a negative list. ❖

Insurance Bill re-introduced in Parliament

The Insurance Bill, seeking to allow 26% foreign equity in life, general and re-insurance businesses, was re-introduced in the Lok Sabha. The Bill, which was ratified by the Cabinet in the third week of October, incorporates the provisions of the earlier Insurance Regulatory Authority Bill, 1998 (IRA Bill), as well as the amendments suggested by the Parliamentary standing committee on finance. It is now in the process of being considered by the Parliament. The earlier IRA Bill, which was introduced in the Parliament, could not be passed due to the dissolution of the Lok Sabha. This Bill should hopefully be passed with some amendments as suggested by the Congress party. ❖

EDITOR IN CHIEF
Rajesh N. Begur
EDITORIAL TEAM
Beryl Moses
Bhavna Singh
Statira Ranina
CIRCULATION
M.P. Madhusoodanan

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If we can be of assistance, or if you have any questions, please feel free to contact us at:

A.R.A. LAW
Agra Building, 1st Floor
121 M.G. Road
Fort, Mumbai 400023
India
Tel: +91 22 2631700
Fax: +91 22 2631800
e-mail: aralaw@vsnl.com