LEGAL EYE
Your peek into the Indian legal scene
A.R.A. LAW
Advocates & Solicitors

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Dear Readers,

With this edition of Legal Eye we bring to you our analysis, comments and updates on various aspects of mergers & acquisitions in India, such as Cross Border Mergers, implications of the transition to the Company Law Tribunal, the mechanics of the Corporate Debt Restructuring scheme introduced by the Reserve Bank of India and the treatment of combinations under the Competition Act.

Each one of the above mentioned topics has been chosen to give our readers an overview of those issues relating to M&A that are currently being discussed and debated upon by the corporate, legal and financial sectors in India.

As always, the snapshot section is intended to give an over view of recent developments in the Indian legal arena. It is our constant endeavor that this section contains updates that are concise and that cover all important legal developments in Indian law over the bi-monthly period of our newsletter. This section has therefore been immensely popular amongst our readers and we hope that it continues to be so.

We trust you will find this issue of Legal Eye as interesting and informative as the previous ones.

We would appreciate your comments or thoughts on the contents and formats or on any aspect of Legal Eye.

Rajesh N. Begur, Editor-in Chief, Legal Eye

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Cross Border Mergers

With globalization becoming the flavour of trade and commerce across the world and the increasing inter dependence of business communities across various countries becoming a norm rather than a rarity, cross border transactions have come to the limelight as an effective tool of structuring. However, there is a great deal of ignorance and curiosity on the method of structuring cross border transactions, leave alone the legal sanctions binding the same. This article seeks to analyse the sanctity of cross border mergers, being one of the least experimented yet the most sought form of cross border transactions, from an Indian law perspective.

Companies Act, 1956

Section 390 – 394 of the Companies Act, 1956 (“Act”) governs mergers and amalgamations. Section 394 of the Act provides that the Court may sanction the amalgamation of companies where the whole or any part of the undertaking, property or liabilities of the transferor company is transferred to the transferee company.

Section 394 (4) (b) of the Act clarifies that for the purposes of Section 394, the term "Transferee Company" does not include any company, other than a **company** within the meaning of the Act. "Company" is defined under the Act (Section 3 (1) (i)) to mean a company that is formed and registered under the Companies Act, 1956. This would mean that a "Transferee Company" in an amalgamation governed by Section 394 has to be an Indian Company incorporated under the Act.

On the other hand, the term "Transferor Company" is defined under Section 394 (4) (b) of the Act to include any **body corporate**, whether a company within the meaning of the Act or not. The term "body corporate" is defined under the Act to include a company incorporated outside India (Section 2 (7)). This would mean that, a transferor company in an amalgamation governed by Section 394 of the Act can be a foreign company. In this connection, please see Bombay Gas Co V. Central Government (1997) 89 Com Cas 195, where it was held that from the special provisions of laws contained in Section 394 (4) (b) of the Act, it is quite clear that the transferor company could be a body corporate incorporated outside India.

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On an analysis of the above provisions, it may be concluded that Section 394 recognises merger of a company incorporated abroad into an Indian company, the condition being that the transferee company (i.e. surviving entity) should be an Indian entity. The object is to facilitate arrangement between foreign companies as transferors and Indian companies as transferees.

However, analysis as to the treatment of cross border mergers under the laws of the transferor company, being the entity losing its existence becomes extremely relevant. If the law of the country, where the transferor company is incorporated, requires the filing of the scheme of amalgamation in the courts of that country also, then the process may get tedious. On the other hand, if the law governing the transferor company stipulates that merger to be governed by laws of the country where the surviving entity is incorporated, then the scheme can be filed only in India and the transferor company would be wound up upon merger, by following simple reporting formalities with the statutory authorities of the country where the transferor company is situated.

Foreign Exchange Management Act ("FEMA")

FEMA is silent on cross borders mergers. Regulation 7 of (FEMA transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 envisages the issue of shares to foreign shareholders as a result of merger of two or more Indian companies. But this does not cover mergers between Indian and foreign companies. If the activities undertaken by the transferee company do not fall under the list of activities in which foreign investment is prohibited or restricted then the transaction of issue of shares to the shareholders of the transferor company, as part of the merger, should ideally fall under the automatic route, obviating the requirement of Reserve Bank of India (RBI) approval. However, since there is no inflow of foreign funds into the transferee company, in cash, in exchange of issue of shares, it would be necessary to obtain the prior approval of Foreign Investment Promotion Board and RBI for the transaction.

It is also important to identify the debts, obligations, liabilities and assets of the transferor company before the consummation of merger. This is because pursuant to merger, such debts, obligations, liabilities and assets of the transferor company would become the debts, liabilities, obligations and assets of the transferee company. Hence, a detailed due diligence may be conducted before initiating any steps for the consummation of merger. As per the FEMA Regulations, approvals are necessary for lending and borrowing from

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Non residents, holding foreign securities, holding foreign insurance and foreign currency accounts. However, the approval obtained from the Foreign Investment Promotion Board and Reserve Bank of India should be all encompassing and no separate approvals may be necessary.

Income Tax Act, 1961

The term "amalgamation" is defined under Section 2 (1-B) of the Income Tax Act, 1961 (the "IT Act") to mean merger of one or more companies with another company in such a manner that all the property and liabilities of the amalgamating company, immediately before the amalgamation, becomes the property and liabilities of the amalgamated company by virtue of such amalgamation. Moreover, the shareholders holding not less than three fourths in value of the shares in the amalgamating company should become shareholders of the amalgamated company, by virtue of such amalgamation.

It is to be noted that under the IT Act (unlike the Companies Act, 1956), the term "Company" is defined under Section 2 (17), to include any body corporate incorporated by or under the laws of a country outside India. Hence the amalgamation of an entity incorporated outside India into an entity incorporated in India is contemplated under the IT Act.

Under Section 47 (vi) the IT Act, any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company is exempted from the purview of capital gains tax, provided the amalgamated company is an Indian company. However, with respect to transfer pricing guidelines, it needs to be verified by the transferee company's auditors as to whether the contemplated transaction complies with the transfer pricing guidelines.

Conclusion

Cross border mergers can be an effective tool of integration and consolidation of cross border entities and their respective businesses. However, successful consummation of such mergers depends a lot on the recognition of the same under the laws of the country where the transferor company is situated. It is also to be noted that Indian laws recognise only those mergers where the Indian company is the surviving entity into which the foreign entity is merged. It is not clear as to what the treatment of Indian laws would be where an Indian entity is merged into a foreign entity. Keeping with the times of liberalization and

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globalisation, it is high time that Indian laws are amended to recognise such cross border mergers where an Indian entity is merged into a foreign entity thereby providing greater freedom for the entrepreneurs to structure cross border transactions and thereby providing a level playing field for Indian companies in the global market.

Dhanya Menon

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Transition to National Company Law Tribunal

Introduction

The Companies (Second Amendment) Act, 2002 (Act XI of 2003) (the "Act") has brought about significant and far-reaching changes to the Indian Companies Act, 1956. One such amendment is the constitution of the National Company Law Tribunal and an Appellate forum thereto. This article discusses the issues of concern that arise as a result of the transition to the National Company Law Tribunal Regime.

Role of the National Company Law Tribunal (*the Tribunal*)

The Tribunal will have a maximum of 62 members with its benches scattered throughout the country. The Principal Bench will be at New Delhi presided over by the President of the Tribunal. The Tribunal will have the powers to review its own orders. The Tribunal will perform the functions of the Company Law Board (*CLB*), the High Court (*HC*), and the Board for Industrial and Financial Reconstruction (*BIFR*). The Appellate Authority for Industrial and Financial Reconstruction (*AAIFR*) would also be dissolved. The Act also provides for the establishment of an appellate forum for appeal from any decision of the Tribunal, called the National Company Law Appellate Tribunal (*NCLAT*). Any person aggrieved by the order of the NCLAT may file an appeal to the Supreme Court on any question of law arising from such order. The objective is to have a single body to deal with matters related to revival, amalgamation, capital reduction and winding-up and avoid multiplicity of litigation and inordinate delay before various courts or quasi-judicial bodies. The Tribunal will have the powers of a court, including the power to punish for its

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contempt. A practicing chartered accountant, company secretary, cost accountant or a legal practitioner can appear before the Tribunal or the NCLAT.

Areas of Concern

Although the Act seeks to dissolve the CLB for expediting proceedings, the amendments do not meet this purpose effectively. The main reasons for this are that are several unresolved issues regarding interpretation of the amended statute and the functionality of the Tribunal. Discussed below are some such concerns:

Ø Dissolution of the CLB

The CLB shall stand dissolved on and from the commencement of the Companies (Second Amendment) Act, 2002 ("Second Amendment Act"). Though the Second Amendment Act has been passed by the Indian Parliament and assented by the President, only two sections (section 2 and section 6) have been notified (vide a notification dated 31st March 2003) and have come into force from 1st April 2003. The National Company Law Tribunal, which was to be constituted by the Central Government by notification in the Official Gazette, has not yet been notified. In this light it is not clear whether the CLB is construed to have been dissolved since a few sections of the Second Amendment Act have already come into force even though the Tribunal has not been constituted to take charge of the cases pending with the CLB.

Ø Status of cases with CLB

All cases pending with the CLB on or before the constitution of the Tribunal shall on such constitution stand transferred to the Tribunal. The Amendment Act is unclear about whether the pending cases of the CLB or the High Courts, which shall stand transferred to the Tribunal, would require fresh proceedings or if there would be a continuation of the proceedings including in respect of all submissions already made before its predecessor.

Ø Appeals from the CLB to the Appellate Tribunal

Any person aggrieved by the order of the Tribunal may file an appeal to the NCLAT. It is unclear whether the similar right of appeal should be available for decisions already passed by the CLB or the HC in a reasonable period in the past. This is particularly

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important as the parties in whose cases orders have been passed by the CLB or the HC immediately prior to the transfer of cases to the Tribunal, would then be deprived of the right to have an access to another appellate forum.

Ø Tribunal not to be bound by Code of Civil Procedure

The Tribunal and the Appellate tribunal shall not be bound by the Code of Civil Procedure, 1908 and shall be governed by the principles of natural justice. This may result into dominance by the administrative body and undue discomfort to the affected parties, unless the central government notifies any exhaustive procedural rules.

Ø Legal representation

Section 10GD provides for an applicant to be represented by chartered accountants, company secretaries, cost accountants or any officer in the Tribunal. In all the cases where the functions of the High Court have been transferred to Tribunal, no procedure or requirements have been mentioned as to change in legal representation from legal practitioners to chartered accountants, cost accountants or company secretaries.

Ø Jurisdiction of High Courts

As regards amalgamation, as per the Act, the approval of different High Courts was required where the companies concerned had their registered offices in different States. This was as per the jurisdiction of courts as specified in Section 10 of the Act. However, the jurisdiction of the Tribunal in this matter is not clear. Also, Section 10 of the Act remains untouched in the amendments. The question, which now arises, is whether this section is still relevant, since all the powers of the HC have been transferred to the Tribunal.

The Tribunal to whom all proceedings related to amalgamation pending before different jurisdictional HC would get transferred is unclear.

Ø Review of decisions

The Tribunal has the power to review its own orders. It is unclear whether the Tribunal can review even the orders passed by its predecessors (i.e. CLB or HC).

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Ø **Rectifying mistake in decisions**

If any mistake is brought to the notice of the Tribunal by the parties, within two years from the date of the order, the Tribunal has the power to amend such order accordingly. It is unclear whether the Tribunal can rectify the mistakes brought to its notice from the orders of the CLB or HC.

Ø **Change in reference numbers**

No mechanism has been provided to trail the reference number, which would be granted by the Tribunal corresponding to the petition number or reference number previously assigned by the CLB and different HC's. Similarly, no provision has been made for intimation of such new reference number granted by the Tribunal to the affected parties.

Conclusion

In the past, a similar authority of the tribunal was constituted by the Companies (Amendment) Act, 1963, which was subsequently dissolved by the Companies Tribunal (Abolition) Act, 1967. We would assume that the regulatory bodies and the central government would take all adequate steps to come out with exhaustive rules before constituting the Tribunal to ensure its smooth functioning and in order to achieve the desired objectives.

Narendra Joshi & K Radhika

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Corporate Debt Restructuring (CDR)

Non - Performing assets (NPAs)* have been the bane of the Indian banking system and perhaps of the Indian economy itself. The high level of NPAs has been a matter of grave

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concern to the public as bank credit is the catalyst to the economic growth of the country. To combat this growing problem several measures have been taken by the Indian Government and regulatory authorities over the past decade.

'The Recovery Of Debts Due To Banks And Financial Act, 1993' was the first welcome step taken by the legislature for the speedy recovery of banks and FI dues. The Act provided for the setting up of the Debt Recovery Tribunal to hasten the recoveries of banks and FIs.

The next step was the 'Corporate Debt Restructuring' guidelines issued by Reserve Bank of India (RBI) vide a notification No.BP.BC.15/21.04.114/2000-01 dated August 23, 2001, on system for facilitating timely and transparent mechanism for restructuring corporate debts of viable corporate entities. However, the mechanism did not take off as envisaged, perhaps as the FIs and banks became aware of the Government's intention to introduce a new law on securitisation.

The eagerly awaited Securitisation And Reconstruction Of Financial Assets And Enforcement Of Security Interest Act, 2002 finally came into effect from June 21, 2002 and was received with mixed feelings. Its critics state that asset reconstruction companies (*ARCs*) might not be effective in tackling the NPAs, that ARCs may have to deal with large amount of bad debts that are difficult to restructure and that international experience suggests that in dealing with old NPAs, the success of AMCs has been supported by special circumstances that a developing country (like India) is unlikely to have. Further the constitutional validity of the Act has also being questioned in the Courts across the country.

The controversial debut of the Securitisation Act and the numerous unresolved issues arising from it, combined with the very immediate concern of rising NPAs prompted RBI to introduce a revised CDR mechanism vide its notification DBOD No.BP.BC.68/21.04.132/ 2002-03 dated February 6, 2003.

The revised CDR mechanism has been well received and has within a short period brought about impressive results. Therefore, this article now focuses on the salient features of this revised CDR mechanism and the industry perception of the same.

Eligibility & other salient features under the revised CDR mechanism:

· The mechanism will cover only multiple banking accounts/syndication/consortium

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accounts;

- The outstanding exposure by banks and institutions should be Rs. 20 crores and above;

- It will not apply to accounts involving only one financial institution or only one bank;

- The defaulting company need not be an NPA/sick for a specified period of time before reference to the mechanism;

- In case of defaulting companies where recovery suits have been filed by the lenders, resolution of the case under the revised CDR mechanism is possible provided 75% of the lenders (by value) agree to be part of the scheme and provided all other requirements of the mechanism as required under the revised CDR mechanism are fulfilled by the account;

- Cases referred to the Board for Industrial and Financial Reconstructions ("BIFR") are not eligible;

- Large BIFR cases maybe eligible, if specifically recommended by CDR Core Group on a case-to-case basis. The lenders must obtain approval of BIFR and then go ahead with the mechanism;

- Any one or more creditors who have a minimum 20% share in the term finance or working capital can refer the account to the CDR mechanism;

- The corporate itself, supported by the bank or FI having a stake as stated above can refer the matter to the CDR mechanism.

Categories of Debt Restructuring under the CDR Mechanism

<u>*Category 1*</u>: Accounts that are classified as 'standard'* or 'sub-standard'* in the books of lenders will be restructured under this category. In this category, additional finance can be provided either by existing lenders or new lenders. The providers of additional finance will have a preferential claim under the restructuring package with respect to cash flows out of recoveries, in respect of additional exposure. It is expected that all the existing

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creditors will participate in the additional financing. The lenders outside the minimum 75% who have agreed for restructuring have the option either to commit or not the additional financing. However, in case of non-commitment, disincentive is provided to such creditors. Such creditor can: (i) either arrange for his share of additional financing to be provided by new or existing creditor; or (ii) agree to deferment of first year's interest due to him after the package becomes effective. This deferred interest will be paid without compounding along with the last installment of principal due to the creditor. The exit option will also be available to the lenders within the minimum 75%, provided the purchaser agrees to abide by the restructuring package approved.

Category 2: Accounts that are classified as 'doubtful'* in the books of the lenders will be restructured under this category. In this category, the existing loan only will be restructured. The promoter must firm up additional financing arrangement with new or existing lenders.

Legal Documentation

Definitive Legal Agreements: -

The CDR mechanism is based on two agreements i.e. (i) Debtor-Creditor Agreement (DCA); and (ii) Inter Creditor Agreement (ICA)

(i) DCA: - All future loan documentation must consist of the DCA wherein the borrower agrees for restructuring. In the case of existing loans, where no DCA has been executed, the borrower is required to execute the DCA before the restructuring exercise is commenced. An important clause of this agreement is the "stand-still" clause wherein both the creditor(s) and the debtor agree not to take recourse to any other legal action during the stand still period of 90 days or 180 days. Though the guidelines do not specify the commencement date of the stand-still period, one would logically conclude that it will begin from the date of referral to the CDR System. However stand-still clause is only for civil action and not any criminal action. The agreement also provides that for the purpose of limitation the documents stand extended. Furthermore, the borrowers will not approach any authority for any relief during this period and the directors of the borrowing company shall not resign from the Board during the stand-still period.

(ii) ICA: - The ICA is an agreement between the creditors wherein they commit to abide by the various elements of the CDR system. It consists of necessary enforcement

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and penal clauses.

Additional Legal Documentation

Besides the above agreements, depending upon the nature of the account being restructured, additional documentation in the form of agreements, deeds, letters, declarations etc shall be executed to ensure the positive culmination of the Rehabilitation Plan.

The approval process

The CDR system comprises of 3 levels of committees viz., CDR Cell, CDR Empowered Group and the CDR Standing Forum and its Core Group. All restructuring proposals are first to be made to the CDR Cell, which is required to decide on the viability of such proposals. If the proposal is viable then the Cell will prepare the Rehabilitation Plan with the help of the lenders and outside experts, if necessary, within 30 days, and is then required to submit the proposal to the CDR Empowered Group.

CDR Empowered Group will then examine the viability of the proposals, modify and/or approve the Plan within a specified time frame of 90 days, or at best within 180 days of reference to the Group. There is an inconsistency in the RBI proposals regarding the time period within which the Empowered Group is required to modify / approve the plan as paragraph 3.2.4. of the notification provides that the 180 days period is from date of reference to the Empowered Group whereas in paragraph 3.3.2. the 180 days period is from date of reference to the CDR Cell. Logically the time period should be from the date of referral to Empowered Group, as it is the deciding authority and its decisions will be final.

Perception of Foreign Banks

Foreign banks have invariably interacted with the borrowers through multiple banking arrangements, i.e. the borrower borrows from more than one bank. Unlike a consortium, there is no formal agreement between the member banks. No one bank calls the shots like the lead bank in a consortium. As a result foreign banks feel that they need not participate in the CDR mechanism. However RBI has been urging them to be part of the CDR mechanism.

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Corollary

The CDR mechanism has been well received. The industries applying for restructuring under the CDR mechanism are a mix of iron and steel units, cement units, fertilizer units and chemical units. About 60 applications have been received for restructuring till 31st March 2003. The sum involved is Rs.44, 369 crores. Of these, 29 applications involving Rs. 29,167 crores have been approved for restructuring, 13 applications involving Rs. 8, 376 crores are still being processed and 18 applications involving Rs. 6,828 crores have been rejected as they do not fulfill the criteria.

It is heartening to note that FIs have as on July 23rd 2003 cleared a restructuring package under this scheme of over Rs. 9, 000 crores of Essar Oil Limited paving the way for recommencement of its much delayed work on the 12 million tonne project at Vadinar in Germany. The revised CDR mechanism of RBI thus seems to have vindicated the stance that it is an effective and viable tool for reducing NPAs.

**For a clearer understanding of what an NPA is, including various classifications of NPAs such as sub-standard assets and doubtful assets, please refer to our note on non-performing assets in this issue of the Legal Eye.*

Rajesh N. Begur & Varalakshmi V

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Non Performing Assets (NPAs)

What is a NPA?

According to the Reserve Bank of India (RBI), a non-performing asset is an asset in respect of which interest or principal (or installment thereof) is overdue for a period of 180 days or more from the date of acquisition or the due date as per the contract between the borrower and the originator whichever is later. However with effect from March 2004, default status would be given to a borrower if dues were not paid

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within a period of 90 days. It is interesting to note that in case of guidelines for mutual funds issued by the Securities and Exchange Board of India ("SEBI"), an asset of a mutual fund is non-performing, if payment is outstanding for one quarter (i.e.90 days) from the date such income has fallen due.

Classification Of Assets:

According to RBI guidelines assets can be classified as: (i) standard assets (ii) sub-standard assets (iii) doubtful assets and (iv) loss assets.

Standard Asset: It is an asset in respect of which no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business.

Sub-standard Asset: It is an asset, which is a non-performing asset for a period not exceeding 18 months.

Doubtful Asset: An asset that has remained a NPA for a period exceeding 18 months is a doubtful asset.

Loss Assets: Loss is identified by the banks concerned or by internal auditors or by external auditors or by Reserve Bank India (RBI) inspection.

It is pertinent to note that in case of NPAs, if any advance or credit facilities granted by bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances / credit facilities having performing status.

The above classification is only for the purpose of computing the amount of provision that should be made with respect to bank advances and certainly not for the purpose of presentation of advances in the banks balance sheet. The Third Schedule to the Banking Regulation Act, 1949, solely governs presentation of advances in the balance sheet.

Varalakshmi V

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A Few Thoughts on Combinations and Competition

The Competition Act ("Act") has been passed by both houses of the Parliament and is now awaiting notification.

These are early days yet and the market is rife with speculation on the impact of the Act. It would take a far greater column space to discuss all the issues that may crop up in relation to the Act therefore this short piece merely seeks to highlight some preliminary issues that came to mind regarding the impact of the Act on mergers, amalgamations and acquisitions.

Option to refer to the Competition Commission ("Commission"):

Combinations have been defined under Regulation 5 to mean transactions including acquisition of assets, shares or voting rights, mergers or amalgamation of enterprises, which fall within certain monetary limits prescribed under Regulation 5 in respect of each such transaction. Regulation 6 provides that combinations, which cause or are likely to cause an adverse effect on competition will be void. Sub-clause (2) of Regulation 6 provides an opportunity for the concerned entities to approach the Commission to approve the combination by providing a notice to the Commission within 7 days of approval of the proposed transaction by the board of directors of the concerned companies for mergers and amalgamations under Regulation 5(c) or the execution of any agreement or document for acquisition under Regulation 5 (a) or (b).

While this would probably be an ideal solution for those parties who are unable to decisively determine whether the merger, amalgamation or acquisition would be "likely" to violate Regulation 6(1) read with Regulation (5) the cumbersome time frame for resolution of such referrals (discussed later in this article), defeats the advantages of providing such an opportunity.

The provision also puts the onus of the referral on the parties to the transaction i.e. "…*any person or enterprise who or which proposes to enter into a combination, may, at his*

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option, give notice to the Commission… ”. The Commission is empowered under Regulation 20 to set up an inquiry, at any time up to a period of one year from date of such combination coming into effect, to determine whether the combination has caused or is likely to cause an appreciable adverse effect on competition. Assuming that the parties to the combination in exercise of their option under Regulation 6(2) do not refer the matter to the Commission, the combination “takes effect” and the Commission thereafter finds against the combination, what would be the next step? How would the Commission “undo” the merger or amalgamation? It will be interesting to track the developments in this respect.

Disclosures:

The time period for the referral process under Regulation 6(2) seems to be rather tortuous.

The Commission upon receipt of referral can issue a show-cause notice to the parties and thereafter direct the parties to publish details of the combination in such manner as it thinks fit for bringing the same to the knowledge of the public. The Commission may invite members of the public who may be affected by such combination to file their written objections, call for such additional information as it thinks necessary and thereafter proceed to either approve the combination as per Regulation 31(1), refuse to approve such combination or suggest modifications in the manner provided under Regulation 31.

The extent of disclosure to the public is not clear and left to the discretion of the Commission. There are good reasons why corporate entities attach a premium on confidentiality in respect of such transactions. Considering the possible time lag between a public disclosure and a final decision from the Commission, there seems to be scope for competitors to hinder the transaction or at least desired outcome of the combination.

Time frames:

Regulation 31(1) stipulates that where the Commission is of the opinion that a combination is not in violation of Regulation 6(1) it may approve such combination.

If however, the Commission thinks that the proposed combination is violative of Regulation 6(1) it can either order that such combination shall not take effect or it can suggest modification to the combination. In the event that the parties to the combination do not

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agree with the modification suggested by the Commission, they can within 30 days submit an amendment to the modification. In the event the Commission finds such amendment unacceptable, they may provide an opportunity to the parties to come up with a fresh proposal and extend the period to another 30 days.

Sub-regulation 11 to Regulation 31 states that if the Commission does not, within 90 days of publication of the notice under Regulation 29(2), pass an order either approving the combination, or declaring that the combination shall not be given effect, or approving the modified or amended combination structure, the parties can assume that the combination has been approved. This 90-day period is exclusive of any 30-day extensions allowed by the Commission for the parties to revert with amendments or modification or any other extensions of time sought by the parties.

We are therefore talking about a substantial time frame for either any referral to be conclusively decided or for any inquiry by the Commission to by finally disposed. Any number of events could occur during this time lag, alert competitors could use this period to enter into similar arrangements and blunt the edge off a swift decisive transaction, certain events could occur which may upset the valuation of the transaction or may even render the transaction unfeasible.

Commission vs. the Court

Imagine the time frame one is talking about if the chosen route of restructuring is through a court approved merger or amalgamation.

It is probably advisable to get the scheme approved by the Commission before approaching the court. The Commission is authorised under Regulation 31(3) to suggest a structure, such modified structure may be very different from one approved by the shareholders or creditors of the company, and submitted before the courts. This would mean that fresh approvals would have to be taken from the shareholders, the board and the creditors, and that an application would have to be made for amendment of the scheme to the court.

The above highlights a few of the many issues which may come up during the course of implementation and interpretation of the Competition Act and which will no doubt be interesting to study. It is hoped that the Commission will have a keen appreciation and understanding of the commercial aspects of transactions so that many of above

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mentioned issues are resolved effectively by the Commission itself.

Anooshree Chakravorty Sinha

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Legal Snapshots

Bill Proposing Amendments to the Banking Regulation Act

The Banking Regulation (Amendment) and Miscellaneous Provisions Bill, 2003 was recently introduced in Parliament. The Bill states that any move to acquire more than 5% of a banking company whether hostile or not, will need Reserve Bank of India (RBI) approval. It also provides for mergers of banks with non-banking finance companies. It allows banking companies to issue irredeemable or redeemable preference shares as per the international practice. The minimum capital requirement for foreign and domestic banks has been fixed at Rs 100 crore. For local area banks it has been fixed at Rs 5 crore and Rs 25 lakh for banking co-operative societies. The Bill also contains certain provisions that will be applicable to specified financial institutions to facilitate their regulation by the RBI.

Cabinet Clears Depository Act and Securities Act

Amendments to the Securities Contracts (Regulation) Act, 1956 (SCRA) and the Depositories Act, 1996 to remove legal hurdles to the corporatisation and demutualisation of stock exchanges have been approved by the Cabinet. Corporatisation will streamline business operations and demutualisation will resolve the conflict of interest arising due to member brokers of stock exchanges being involved in governance of the bourses. The SCRA has also been amended to include interest rate derivatives within its purview. Derivatives based on the Mumbai Inter-Bank Offer Rate (Mibor) will now be included. As the Mibor is not a security, derivatives based on it were not legally recognized under the SCRA but this defect has now been remedied.

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Basic Operators vs. Cellular Operators - Developments

The much awaited judgment of the Telecom Disputes Settlement and Appellate Tribunal ("TDSAT") was finally passed in the controversial examination by the TDSAT (on the direction of the Supreme Court), of two key issues: (a) If basic operators are legally permitted to provide limited mobility services (using the wireless-in-local loop) (b) If they are, whether it would disturb the level playing field between the basic and cellular operators.

In a majority judgment, the three member TDSAT upheld the legality of the limited mobility services (using the wireless-in-local loop). At the same time, TDSAT also directed the Department of Telecommunications (DoT), in consultation with the Telecom Regulatory Authority of India (TRAI) to ensure that: (a) The distinction between fully mobile cellular service and limited mobile service is maintained; and (b) The level playing field between basic and cellular operators is evened out by the levy of an additional entry fee on basic service operators.

Pursuant to this judgment, the industry is now keenly awaiting developments relating to the outcome of three main factors discussed below.

One, the enforcement of the terms of the TDSAT judgment of which one of the crucial terms of enforcement is to ensure that the limited mobility handsets are used only in the short distance charging area (a defined radius of a city or town) and handover of calls are curtailed altogether beyond this pre-defined radius through appropriate software.

Two, the outcome of the case filed by cellular operators with TDSAT involving deployment of V5.2 interface (which restricts value added services such as SMS, ring tones, video clips) by limited mobility operators. The hearings on this case from both basic and cellular operators began on August 19.

Three, industry opinion on levying the additional entry fee on basic operators for allowing them to offer limited mobility. Industry opinion is expected to provide some indications of the nature and quantum of fee to be levied on them.

Another major development in this area came in mid-July, when TRAI put out a Consultation Paper on "Unified Licence between Basic and Cellular Services" which aims to discuss allowing the players in these two services to enter into each other's domain.

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Introduction of this proposal ahead of the TDSAT verdict resulted in a storm of protest from the industry, particularly the cellular operators. Bowing to pressures from different sections, the scope of the proposal was enhanced to include "convergence" of long-distance and other value-added services. The discussions on "Unified Licence" is to run parallel to TRAI recommendations for enforcing the TDSAT verdict.

CAS Rollout Conditions Bleak

The fate of conditional access system (CAS) remains uncertain. A large number of issues remain unresolved and the date of implementation in the two metros of Delhi and Mumbai has already been further postponed from 1st September, 2003. Some of the issues which remain unresolved are:

- Implementation of CAS in the second zone of metros seems conditional;
- Revenue-sharing arrangement between broadcasters and cable service providers has not been sorted out;
- Demand for set-top boxes is negligible;
- Broadcasters are still fighting over platform-sharing like HITS;
- Operators are demanding an increase in the basic tier rates;
- Mumbai's Shiv Sainik (a local political organisation) community cable operators, numbering around 7000, are threatening to stop CAS, if channel prices are not made consumer-friendly; and
- Government has become a silent observer now after being an active participant in the CAS drama over the last few months.

DoT Considers Raising FDI Cap in Telecom

The Department of Telecommunications (DoT) has once again reviewed the proposed increase in the Foreign Direct Investment (FDI) cap in the telecom sector. The key elements of this proposal are as follows: FIIs will be permitted to buy up to 49% stake in

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a company that holds a cellular or basic service license. FDI will be allowed up to 25%. The remaining 26% may be held by an Indian investment company in which the promoters hold 51% and 49% is by FDI. Effectively this means that an additional FDI of 12.74 % (49% of 26%) will be allowed though the indirect route. So the Indian promoter will have management control with a mere 13.26% holding. This might prove to be a viable solution to the wrangle over unified telecom licenses.

The government plans to block the holding company option for routing new foreign equity investments in telecom service companies in favor of the FDI option with an increase in the FDI cap as discussed above. Foreign promoters who have already invested in cellular/basic services though the holding company route will be given a transition period to reorganize their equity investments.

Liberal policy for foreign news agency on cards

The Ministry of Information and Broadcasting has called for opinions and suggestions on continuation and modification to the existing policy governing foreign news agencies within the country. While the issue is only just thrown open to debate, if changes are brought in it could be in the shape of allowing foreign investments in Indian news agencies, as has been done in case of newspapers. Feedback from the media and news agencies will help the government take a view of whether FII investments can also be allowed.

SEBI Directive On Fortnightly Reporting By FIIs

In an effort to closely monitor Foreign Institutional Investors (FII) inflows, the Securities and Exchange Board of India (SEBI) has asked all registered FIIs to report their outstanding offshore derivatives exposure as on August 15 and subsequently, to provide such information on a fortnightly basis. SEBI has directed FIIs to provide information about:

· investors to whom these derivatives were subsequently transferred after the first transfer;

· specific names and locations of the persons to whom the offshore instruments are issued the nature of investments - whether they are hedge funds, corporates or pension funds;

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- the quantity and value of offshore instruments and the underlying Indian securities on the basis of which these synthetic securities are created; and

- a declaration that they have not issued/ subscribed/ purchase any of the offshore derivative instrument directly of indirectly to/from Indian resident/ NRIs/ PIOs/ OCBs.

Naresh Chandra Committee Recommendations for Small Private Companies and Partnerships

The Committee has sought relaxation of regulations for private companies in general and creation of a new category of small private companies (SPC) that would be entitled to additional exemptions from the rigors of regulation.

The report also calls for legislation for the incorporation of limited liability partnerships (LLPs) by professionals like chartered accountants, company secretaries, lawyers and architects. An LLP would be a hybrid between a company and a partnership, closer to the private company in form. There would be no limit on the number of partners who would have limited liability while a few partners would have unlimited liability. Liability would be assumed by the LLP in the event a partner of the LLP commits an act of commission or omission for or on behalf of the partnership. The liability of the partner would be limited to his contribution to the partnership. The Committee has also recommended certain amendments to the Indian Partnership Act, 1932 to adopt a legal framework for registration of mortgage charges on the lines of the Companies Act and for legal suits against a partnership firm only for contracts made in the course of business as also relaxation of the rate of interest payable to a partner from the current cap of 6%. The report is on its way to being incorporated into the Companies Amendment Bill 2003.

Naresh Chandra Committee Recommendations for Independent Directors' Fees and Liabilities

The Committee recommended that non-executive and independent directors be exempted from criminal and civil liabilities and regulations be eased to allow independent directors an easy exit from the boards of companies. The Committee also recommended liberalizing the managerial remuneration ceilings for companies implementing projects that require long gestation periods, such as infrastructure projects or insurance companies.

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The recommendation for increasing the fees of independent directors has been officially notified. Directors of companies with a paid-up capital and free reserves of Rs. 10 crore or more or a turnover in excess of Rs. 50 crore can be paid up to Rs 20, 000 per meeting of the board and its committee. Directors of all other companies can be paid up to Rs. 10, 000 per meeting. An amendment bill has been moved in the Rajya Sabha proposing that at least 50% of the directors on the board should be independent.

Legislation To Make Auditors More Accountable

With effect from July 1st 2003, the Manufacturing and Other Companies (Auditor's Report) Order is being replaced with a tougher Companies (Auditor's Report) Order. The new Order places increased responsibility on auditors and calls for more disclosures. The auditor will now have to correctly assess end use of funds. Auditors have to report whether any fraud on or by a company has occurred and if so, the nature and amount have to be indicated. The burden of identifying fraud has shifted from the company's directors to its auditors. Auditors are also required to report defaults in repayment of dues to banks, FIs, or debenture holders. They are required to provide reasons for offering unfavorable or qualified opinions for transactions.

Companies to Add Reinvestments in FDI Reports

The RBI has commenced efforts to overhaul the currency reporting system to further broadbase the definition of FDI by capturing currently unreported elements of foreign investment. Companies with FDI component in their equity base will have to mandatorily report the earnings they reinvest in the country so that the foreign share of such reinvested earnings (REs) can be ascertained. This will result in an increase in the FDI figure. A permanent reporting system is also being planned segregating external commercial borrowing transactions – including debt securities and trade credits – between related entities for recording such FDI inflow. Additionally, the RBI is also putting in place an integrated forex management system from August to capture FDI in all forms as per the IMF norm.

No Cheque Facility For Regular Defaulters

RBI has directed that banks can discontinue cheque facility to account holders whose cheques for Rs. 1 crore and above bounce more than thrice in a financial year. Cash credits and overdraft facilities may also be withdrawn. Banks can even consider closing

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such current accounts at its discretion. Banks have also been asked to report data in respect of each dishonored cheque for Rs. 1 crore or more. The RBI has also asked banks to extend full cooperation and furnish documentary proof of dishonor of cheques whenever legal action is taken against such issuers.

Finance Ministry tightens eligibility norms for duty sops to SEZs, suppliers

The Finance Ministry has decided to tighten eligibility norms for duty concessions available to special economic zones (SEZs), suppliers from the domestic tariff area (DTA) to SEZs and also developers of Greenfield SEZs. The Finance Ministry has further clarified that the supplies to SEZs will not be eligible for Duty Entitlement Pass Book and duty drawback entitlements unless payments for such supplies are made in foreign exchange. Supplies from SEZs will be governed only by the provisions of the Customs Act 1962 and not by the Central Excise Act since these zones will be considered 'foreign territory' for trade, duties and taxes. All supplies from SEZs to the domestic market will be treated as imports. SEZ developers or the unit will have to execute a multi purpose bond with the customs authority in the zone along with a security or surety prior to commencing duty-free procurement or import of goods in the zone.

Introduction Of Service Tax Act

The government will soon introduce a comprehensive legislation on service tax, which is required in light of India's WTO obligations. All conceivable services will be brought under its purview allowing for credit across all goods and services.

Turn-key projects may attract 8% service tax

Service providers who undertake turn-key projects and show consolidated charges without assigning a separate value for the commissioning and installation of goods, will be required to pay 8% service tax on the consolidated amount. Commissioning and installation services figure in the list of new services, which will attract 8% levy, along with nine other services from July 2003. The Ministry has confirmed that the service tax will be levied on erection and commissioning charges only, and not on the materials or goods supplied. However, it is up to the service provider to show the break-up of commissioning or installation charges.

India To Partially Open Up Services Sector

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In the course of ongoing WTO negotiations on trade in services the government plans to open up accounting, bookkeeping and auditing services to overseas players. Indian auditing firms would get reciprocal market access in all WTO member countries abroad. Full market access is likely to be provided in accountancy, while foreign players would be allowed to enter auditing through three modes – commercial presence, consumption abroad and movements of natural persons. Foreign firms would be able to set up offices in India and also send in specialists to handle short-term assignments. However, foreign companies will be permitted to handle only non-statutory audit; statutory audit will remain the preserve of domestic players. Legal services and distribution will not be opened up due to domestic opposition.

Airport Privatisation Cleared for Take Off

The Rajya Sabha (Upper House of Parliament) has cleared the Airports Authority of India (Amendment) Bill 2003. The Bill had already been passed by the Lok Sabha (the Lower House of Parliament). The Bill enables the government to lease out airports to private parties, providing a legal framework for private investment in 'greenfield' airports. Previously only the Airports Authority of India (AAI) was allowed to build and operate airports. The Bill also provides for levying of development fees on passengers, setting up an Airport Authority Tribunal and for eviction of unauthorised occupants of airport premises.

Centralised Drug Licensing

The Mashelkar Committee on spurious drugs and drug regulatory revamp has recommended centralisation of the drug regulatory system in India as well as up gradation of the regulatory infrastructure. The Committee suggested that a new central drug administration be set up by upgrading the present Central Drug Standard Control Organisation. The Committee also recommended a stringent punitive system for spurious drug makers including death penalty for those who cause 'grievous body harm or loss of life". Also that offences related to spurious drugs should made congnizable and non-bailable.

Group of Ministers (GoM) okays contract labour in 13 jobs

The group of ministers (GoM) on labour reforms have agreed to allow employment of

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contract labour in thirteen non-core areas including IT-enabled services, security, house keeping and laundry. In case of export-oriented units (EoUs), contract labour would be allowed even for core activities. EoUs would be defined as those exporting at least 75% of their output. The Labour Ministry would draw up a draft bill on the basis of the discussions; the bill would then go to the Cabinet, subject to the approval of the GoM members.

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Meet the A.R.A. LAW Team

In each issue, we profile one person who is a part of A.R.A. LAW. They will also be sharing their experiences of being with A.R.A. LAW.

Varalakshmi Venkatraman was admitted to the Bar in 1987 and as a solicitor on the rolls of the Bombay Incorporated Law Society in 1991. After qualifying as a solicitor she worked for a leading Indian law firm, where her skills in corporate law and commercial transactions were honed. Thereafter, she was the legal adviser to one of the leading investment banks in the country where she could put into practice the skills acquired while she was working in the law firm. She then took a short hiatus and joined ARA thereafter. Lakshmi, as she is popularly known, has a lot to say on working with ARA LAW

"*I was a little apprehensive getting back to work after the break. I am proud to say that I work in a firm where people are an ideal combination of professionalism and humaneness too. In the professional front, what is truly commendable is the seamless flow of theoretical and practical knowledge and experience that one comes to accept as a matter of course while working here. The cornerstone of ARA is the emphasis on quality work, client satisfaction and focus on teamwork. The logical consequence of which has been continued success and healthy respect and popularity with clients. Each day is an enriching and learning experience at ARA Law. I am truly glad to be back in the profession working with such wonderful people.*"

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