



INDIAN LEGAL AND BUSINESS UPDATE

MAY 1-MAY 31, 2009

1. Government to simplify SEZ approval

The Commerce Ministry has initiated steps to reduce the time taken to develop Special Economic Zones (SEZs) by simplifying procedures to get the tax free industrial enclaves notified. Developers will now be able to get their land classified as an SEZ at the initial stage of approval by submitting legal documents that prove land ownership.

In the past, formal approval – the first step in notifying an SEZ was based on a statement by a developer confirming possession of land. Actual documents proving ownership were not required at this level of approval. Thereafter, the developer had to submit a series of documents including proof of ownership of land, a non encumbrance certificate and vacancy and contiguity certificates to get the zone notified. Now, all these documents will have to be submitted at the first stage. Since 2006 about 550 SEZs have been given formal approval. But the Commerce Ministry was concerned that only 320 were notified. This was because many of the developers adopted a wait and watch policy in the wake of the global economic crisis.

2. Government to seal all loop holes in Press Notes 2, 3, 4 of 2009

The Government is likely to significantly alter the controversial Press Notes 2, 3 and 4 to close loopholes that give corporate entities leeway to exceed limits on foreign direct investment (FDI) in various sectors. The press notes, issued in February this year, simplified the method for calculating FDI and broadly stated that as long as Indian promoters hold a majority stake (that is, more than 50 per cent) in an operating-cum-investment company, they can bring in investments up to 49.9 per cent through FDI. This company would be treated as an Indian company and can invest through a joint venture in any other company that may be operating in sectors in which there are limits on FDI participation. Before the February press notes were issued, all FDI was calculated on the basis of beneficial interest and this position is likely to be restored. Any operating cum investment company even with less than 50 per cent FDI would not be allowed to invest in step down subsidiaries that are engaged in restricted categories such as retails. Press Notes 2, 3 and 4 also included portfolio investments (through FIIs) in the total FDI limits. This is likely to be changed to the earlier position in which FII and FDI were distinct.

3. FDI into trusts under Venture Capital garb may be chained by lock-in

In a move to stop alleged misuse of the preferential treatment given to venture capital (VC) funds

by foreign as well as domestic investors, the Government proposes to tighten the norms regarding inflow of foreign direct investment (FDI) into trusts registered as VCs. The proposal aims to introduce a lock-in period and a minimum capitalization stipulation for such inflows. There are certain advantages to investing into India through VC funds. VC funds get tax pass through for investments in nine specified sectors – that is, the income accruing to them is not taxed before being passed on to those who have provided the corpus of the VCs there is no lock-in period, unlike in the case of foreign investment coming directly into real estate, for example. Further, VCs are exempt from making open offers to buy shares from the public after acquiring shares in excess of 15 % of a company's total equity. To take advantage of these concessional features and avoid the discipline of normal investment routes, some investors have been camouflaging their investment into India as VC investment. Such investors only have to register a trust in India and register the trust as a VC fund with markets regulator Securities and Exchange Board of India (SEBI). The VC route is being used to acquire companies for asset stripping, to avoid the stringent norms for foreign investment in a sector like real estate.

The legitimate objective of venture funds and private equity is to achieve substantial long term capital appreciation, primarily through privately negotiated equity and equity linked investments. (Private equity funds are also registered as VC funds). Apart from the present requirement of mandatory registration with SEBI, the foreign investor will also have to comply with the 'know your customer' (KYC) guidelines. However, details such as the duration of the lock-in period and the minimum capitalization amount are being worked out by the department. The Department Of Industrial Policy And Promotion (Dipp) would make FDI in trust subject to foreign investment promotion board's (FIPB) clearance. At present, there is a lack of clarity on the subject. The FIPB approves foreign investment proposals for the country. The new set of restrictions that are in line with RBI's directive will help prevent low capital base, circumvention of takeover guidelines and round tripping of investments, as the investments will remain locked in for a certain period.

4. Government may impose spectrum transfer fees on telecom companies going in for merger and acquisition

Telecom operators buying another telecom company may have to pay 10-20% of the acquisition price to the Government. A government committee looking into spectrum related issues is examining the possibility of specifying a certain percentage of the deal size as spectrum transfer fee in case of a merger and acquisition (M&A) in the telecom space.

Government committee is also considering another option which deals with charging a portion of the market value of the spectrum held by the seller as the spectrum transfer fee. The market value could be determined based on a recent spectrum auction in that particular telecom circle or a comparable one, or after extrapolation from past auctions. In this case, the fee will differ from circle to circle.

Government committee has also recommended that the Government should provide a huge discount on the spectrum transfer fee for a period of 12 months from the date of announcing the

new policy to stimulate consolidation in the industry. Current regulations do not encourage M&A in the telecom space. For instance, if a large operator like Bharti Airtel were to buy out a new player, then the combined entity would have to return excess spectrum within three months. At present, airwaves are allotted to telecom companies based on their subscriber base. In this instance, if Bharati Airtel has about 8 MHz of airwaves across the country, the acquisition of a new telecom company, which has 44 MHz of start-up spectrum, will take its figure up to 12.4 MHz. Since Bharti Airtel will not have the requisite subscriber base to hold onto so much spectrum. It would then have to return spectrum held by the new player. The Government had also rejected alternate frameworks that would have allowed operators to hold on to this excess spectrum after the merger until they reach the subscriber linked eligibility criteria. The government committee had conceded that some new players may sell their spectrum or merger with another company, thus making huge profits without rolling out any network.

5. Asset Reconstruction Companies can invest money into bad loans

The Reserve Bank of India (RBI) has exempted Asset Reconstruction Companies (ARCs) from norms that prevent banks from investing money into bad loans. At the same time, RBI has said that ARC's cannot buy bad loans from one another. By giving ARCs the go ahead to put money into business where promoters have defaulted, RBI has provided reconstruction companies one more avenue to get troubled businesses bought by them, back on the rails. Other avenues include affecting a change in management or selling whole or part of the business. While the ban on buying bad loans from other ARCs may hamper debt consolidation, it will ensure that ARCs do not pass bad loans among themselves and side step the rule that requires them to resolve bad loans in five years of acquiring the asset. ARCs were recognized by the regulator after the Government passed the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SRFAESI) in 2002. These companies buy bad loans from banks and attempt to get them back on rails. ARCs have been given up to five years to resolve the bad loans that they buy. RBI has recently allowed an extension of two more years for realization of the assets which have already completed five years. Banks cannot give money to defaulters, as it is seen as throwing good money after bad. But in the case of ARCs, RBI has made the observation that since they are not lenders and are only priming the assets for sale they can invest money. Restructuring of loans by securitisation companies/asset reconstruction companies is one of the measures allowed to be undertaken by ARCs for realisation of their dues. As such, there is not bar on these companies deploying their funds for undertaking restructuring of acquired loan account with the sole purposes of realizing their dues.

6. Government to increase penalty for firms unwilling to dispense data

The Statistics Ministry has started the process to operationalise the newly passed Collection of Statistics Act, 2008 by framing draft rules and guidelines that will enable better data collection and dissemination.

Under the new act, people or companies not divulging data would have to pay a fine of Rs. 1,000 and they would be given a 14 day notice period to comply. If the information is not provided even

after two weeks the penalty will rise to Rs. 5,000 per day. Under the old Act, which was passed in 1953, the penalty is only Rs. 500 for the first default and Rs. 200 per day thereafter. The increased fine will make it obligatory for companies to comply with MOSPI data collection activities and will ensure that most data are collected on time. The Act also makes willful manipulation or omission of data a criminal offence, punishable by a prison term that may extend up to 6 months. This penalty will also apply if a company prevents or obstructs any employee from collection data. The Government is also planning to finalise a list of data series that will be called as “core statistics”, that is, numbers which are of national importance, within the next three months. The Collection of Statistics Bill, 2008 gave powers to the Government to classify any statistics as “core statistics” and also determine the method to collect and disseminate the same.

7. Bar Council Open to FDI in law firms

The professional body of lawyers has signaled that it will reconsider its opposition to foreign investment in law firms to amid deep divisions within the legal fraternity and pressure from other countries. The Bar Council of India (BCI) has decided to call a meeting of its members in June to discuss the controversial issue.

A go ahead from BCI will pave the way for the Government to open up the legal sector to foreign investment, a decision it has kept in abeyance because of stiff opposition from lawyers and law firms in the council. But the traditional stance was modified somewhat last year when the council said it was “ready to discuss the issue”.

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