

“No man is above the law and no man is below it; nor do we ask any man's permission when we ask him to obey it. Obedience to the law is demanded as a right; not asked as a favor.” - Theodore Roosevelt

## CHANGES IN THE FOREIGN DIRECT INVESTMENT POLICY

In this edition of our Newsletter we examine few of the changes introduced in the Foreign Direct Investment Policy (“FDI Policy”) by the Department of Industrial Policy and Promotion (“DIPP”) in its latest edition of the Consolidated Foreign Direct Investment Policy, Circular 1 of 2011 that comes into effect from April 1, 2011.

### A) Pricing of convertible instruments:

Until now, the price at which convertible instruments (such as preference shares or debentures) could be converted into equity had to be pre-determined. Since such instruments are primarily used in private equity transactions this requirement imposed a severe restriction on investors seeking to link the conversion price to the future performance of the investee company. It also prevented the promoters of a company from fully realizing the fruits of their company’s growth and limited their upside. Equally the investors could not guard against under-performance.

The latest amendment to the FDI Policy has introduced some scope for flexibility in the pricing structure. The revised clause reads as follows:

3.2.1 Indian companies can issue equity shares, fully, compulsorily and mandatorily at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations [the DCF method of valuation for the unlisted companies and

## News 10 @ a glance

### Now, Listed Cos on PE Firms’ Radar:

More private equity funds are choosing to invest in publicly held companies as stocks of many listed firms are now trading at attractive prices on the bourses. The most recent deal is General Atlantic’s 67-crore investment in Hindujas-promoted IndusInd Bank through an open market purchase. Last month, Chrys Capital picked up around 10% stake in Punebased IT consulting firm KPIT Cummins Infosystems for over 110 crore. “With the price correction in the capital market, valuations are much more realistic and attractive for private equity firms to deploy funds in listed entities,” said Sanjiv Kaul, MD at ChrysCapital. The firm invests a substantial amount in publicly-listed entities.

“With the industry maturing and greater focus on global funds in India now, investments in publicly-listed companies are bound to go up in the years to come,” said Mayank Rastogi, partner (private equity) at consulting firm Ernst & Young. Besides, investments in listed entities offer better transparency and accountability compared to private companies. It also makes exit routes for investment firms easier. Typically, a single private equity investment cycle lasts three to five years, where public listing for private equity firms is one of the most common routes to exit. A host of private equity backed firms in the past have not been able to list on the bourses, which have made exits of investors difficult. Some of the prominent investments in listed companies include Apax Partners’ \$375-million fund infusion in IT firm iGate and Orient Global’s \$278-million investment in Cairn India.

### HC Says NTPC Can’t Disqualify Gammon Arm:

The Delhi High Court ruled against NTPC’s

valuation in terms of SEBI (ICDR) Regulations, for the listed companies].

Investors and promoters are now free to negotiate a pricing formula for convertible instruments such that the conversion price is closely linked to the performance of the company. The discounted cash flow method which is commonly used in investment transactions to achieve this result has now been conferred validity under the FDI Policy. The only pre-condition is that the conversion price should not be less than the fair value of the company at the time of issuance of the instruments.

## B) Issue of shares for non-cash consideration

As a general rule, the FDI policy allows Indian companies to issue shares to foreign investors only against cash remittances received through normal banking channels. Until now, the only exceptions to this rule were instances where companies issued shares in lieu of their repayment obligations towards external commercial borrowings or payment obligations towards lump sum fees or royalties payable under technical collaborations.

A discussion paper issued by the DIPP in September 2010 had earlier outlined several heads of circumstances under which shares could be issued for non-cash consideration including import of capital goods/ machinery/ equipment, services and raw material, pre-operative/ pre-incorporation expenses, share swaps, intangible assets such as franchisee rights and one-time extraordinary payments such as arbitration awards.

However, the latest amendment includes only two of the scenarios proposed earlier. These are (para. 3.4.6 of the Policy):

- (a) import of capital goods/ machinery/ equipment (including second-hand machinery); and
- (b) pre-operative/ pre-incorporation expenses (including payments of rent, etc

The amendment also prescribes measures for valuation and verification of expenditure under these heads along with time limits within which such issuances must be undertaken. All other types of non-cash consideration will require the prior approval of the Foreign Investment Promotion Board ("FIPB").

decision to disqualify Ansaldo Caldaie India from tendering for an equipment supply contract. NTPC could not exclude Ansaldo, a subsidiary of Gammon India, from the tendering process. "Consequently, NTPC will allow the writ petitioner (Ansaldo Caldaie India), in accordance with the terms of the bid documents, not only to proceed to the next stage i.e., stage-II (price bid), but also permit it to participate in the technical discussions and the tendering process," the court said in its judgment.

Ansaldo has accused T Sankara Lingam, Managing Director of BGR Energy and NTPC's former chairman, of using influence to get the Gammon India subsidiary out of the race. Mr Sankaralingam has served a legal notice to Ansaldo for "character assassination". NTPC decided to scrap original tenders for boilers issued in October 2009 and call new bids in June 2010, as BHEL was the only bidder left in the race after L&T's disqualification. Ansaldo was not eligible for participating in the tenders in October 2009 and had sought extension of bid deadline then.

### Real Estate Redefinition to Hit FDI:

The government plans to widen the definition of real estate in its foreign direct investment (FDI) policy to include consultants, advisers, valuers and brokers, a move experts say could restrict entry of foreign players in these specialized services. The department of industrial policy and promotion, or DIPP, has circulated a draft note for comments of various ministries on the proposal.

The wider definition is likely to be included in the half-yearly update of FDI policy due to be released by the end of this month. The current FDI policy lacks clarity on several issues, including what constitutes real estate. The policy prohibits FDI in real estate business but allows 100% foreign investment in construction and housing development. In construction and housing, the FDI is subject to several riders including a three-year lock-in period, minimum capitalisation of \$10 million for wholly-owned subsidiaries and \$5 million in case of joint ventures. The government hopes to clear the air by defining the scope of the real estate business. According to the proposal, consultancy or advisory services related to locational space and property issues of any kind will be included in the real estate business. Agents, advisers, brokers and consultants dealing with any facet of residential, commercial and industrial property will also be included if they offer certain services.

#### Grey Blocks

- Foreign direct investment in real estate business not allowed;
- Real estate business defined as dealing in land, immovable property with a view to earn profit;

## C) Downstream investments

The latest amendment to the FDI Policy has also simplified the rules governing downstream investments made by Indian companies with foreign investment. The earlier framework on this topic categorized such intermediate companies into operating companies, operating-cum-investing companies and investing companies.

The FDI Policy has now been streamlined to simplify this analysis and determine whether or not a particular investment will require prior FIPB approval.

The relevant clause of the FDI Policy reads as follows:

4.6.4.1 Downstream investment by an Indian company, which is owned and/ or controlled by an Indian company, in which investment is being made, is operating.

Further, if the intermediate company is an investing company, then foreign investment is allowed into it only under the approval route in accordance with the following clause:

4.6.3.1 Foreign investment into an Indian company, engaged only in the activities specified in paragraph 5.2.18 of this Circular.

Those companies, which are Core Investment Companies (CICs), will have to additionally follow Reserve Bank India's Regulatory Framework for CICs.

## D) Existing joint ventures

In terms of Press Note 1 of 2005, foreign investors which were party to existing joint ventures/ technology transfers/ trademark agreements as on January 12, 2005 within a particular field of business required FIPB approval in order to make new investments within the same sector. This often meant that the foreign investor had to obtain a 'no-objection' certificate from the Indian joint venture partner in its previous venture.

This requirement has now been removed. Foreign investors are no longer constrained by previous or existing joint ventures if they wish to invest in another joint venture or commence independent operations within the same field as their existing joint venture.

To summarize, the latest set of amendments to the FDI Policy is certainly a step in the right direction and it is hoped that these investor friendly

- But 100% FDI allowed in construction, residential housing; causes confusion;
- Wider definition to include even service providers involved in real estate biz;
- Service providers could face FDI restrictions if the changes are included.

### **A Small SEBI Note Takes Some Load off MFs:**

Less than a month after UK Sinha took charge as Sebi chief, the capital market regulator has taken the first step to live up hopes among fund houses, which have been hit by a flight of investors following severe restrictions on broker commission.

In an innocuously-worded circular issued Wednesday, Sebi redefined the use of exit load by mutual funds, which will now have a little more liberty in the way they remunerate distributors. During former Sebi chairman CB Bhavé's tenure, the regulator had banned entry load—the up-front fee MFs charged investors to pay distributors—and restricted the use of exit load—another fee collected from investors who sell out prematurely. The rules were put into effect from August 1, 2009, amid bitter resistance from MFs and distributors.

The new circular gives funds more flexibility in the use of accumulated exit load corpus, known as load balance. Exit loads are normally charged when investors redeem before one year. While this will not make a dramatic impact on MFs, fund officials are hoping this may well be a beginning towards a more flexible commission regime. They, however, feel the entry load system—under which a generous commission structure helped MFs mop up money—will not return in a hurry. SEBI, in the latest circular, said mutual funds should segregate the load balance into two accounts—one to reflect the balance on July 31, 2009, and the other to reflect accumulation since August 1, 2009. It said funds can use the exit load accumulated after July 31 to pay fees to distributors. The regulator, in an order on June 2009, had placed restrictions on the use of exit load proceeds.

### **Drug Cos Oppose DCGI's new Barcode Plan:**

Indian drugmakers are set to appeal in the Allahabad High Court against the drug regulator's plans to make it mandatory for every medicine sold in the country to carry a new barcode besides a unique numeric code to prevent sale of spurious medicines.

Drug Controller General of India (DCGI) had last week told several pharmaceutical associations representing both large and small firms to ensure

changes will help sustain India's position as an attractive destination for FDI.

### "Intellectual Property Rights violation in the Internet"

With the ever expanding web, remarkable technology and e-commerce, the intellectual property infringement in the internet has become rampant. Invariably, it leads to countless and extensive range of legal tribulations. Some of the most frequent and critical issues that intellectual property rights holders face on the internet, Social Media vis-à-vis copyright and trademark violation are:-

- 1) Erosion of brand value, trust, integrity and reputation of the brand in the social media
- 2) High possibility of negative publicity or bad press as the brand in a social media
- 3) Problem of squatting or fraudulently registering a profile, using an organization's name
- 4) Trademark misuse in the form of dilution of the brand, false association, direct infringement
- 5) Identity fraud by dishonestly registering the name of a company, as well as trademark
- 6) Third-party registration of the well-known trademark as a domain name, or reverse domain name hijacking
- 7) Brand squatting, misrepresentation in social media, resulting into Brand infection
- 8) Extremely difficult and intricate enforcement of the Trademark on social media

There are plenty instances of trademark infringement, of which, domain name infringement being significantly high over the past one decade.

Interestingly, India has a fairly robust and well-defined legal regime which is amply supported with a far more progressive Judicial System. Indian Courts have repeatedly taken lead in land marking decisions, having impacted on issues including goodwill and trans-border reputation, domain names and issues relating to conflict between company names, trademarks, customs and in some cases even in defining remedies.

Pertinent to note are some extremely momentous decisions that unquestionably depict the commendable endeavors of Judiciary in enforcing rights of a person accruing from intellectual property.

The first ever decision of the Supreme Court in *Yahoo v Akash Arora*, was a milestone judgment where the Delhi High Court held that the domain name serves the same purpose as the trademark and hence entitled to equivalent degree of safeguard.

Delving further into the intricacies, Court in *Adobe Systems Incorporated v. Rohit Rathi and Anr*, emphatically held that the registration of a domain name containing a registered trademark or trade name is unauthorized,

all medicine packaging has a 2D barcode and a unique randomly generated numeric code.

Drugmakers say they will have to buy new machines, digitalise huge data and set up a whole new team which would require large investments and would be difficult to execute. The government can already track and verify whether a medicine is spurious by checking the existing barcode system, said Mr Wakankar. But the government estimates that putting a 2D barcode besides the numeric code will allow instant verification without being expensive and eventually cost just about 10 paise for a strip of medicines once it is adopted by everyone. DCGI has to report progress on the matter to the Allahabad HC later this month.

#### Orissa Mining Moves SC Against MoEF's Order:

The Orissa government-owned Orissa Mining Corporation on Tuesday moved the Supreme Court challenging an earlier Ministry of Environment and Forests order to withdraw permission to mine at Niyamgiri hills in Kalahandi. Instead of going to the apex court as a direct applicant, the Orissa government challenged the decision through the state-owned Orissa Mining Corporation. State advocate general Ashok Mohanty had approved the plan to proceed legally. According to people familiar with the government's plan, the state government opted to follow this indirect route to avert criticism by Opposition parties, including the Congress and the BJP, that the Naveen Patnaik government was desperate to facilitate bauxite mining by Vedanta Aluminium, the joint venture partner of OMC.

#### State Opts for the Indirect Route

- Instead of going to the apex court as a direct applicant, Orissa government challenged the decision through the state owned Orissa Mining Corporation;
- OMC had formed a joint venture with Vedanta Aluminium to mine bauxite for Vedanta's refinery at Niyamgiri;
- After a lot of litigation, Union environment minister Jairam Ramesh on October 24, 2010, cancelled the permission for mining bauxite at Niyamgiri, due to alleged violation of environmental norms.

#### Government can Attach NBFCs' Properties:

In a major relief to lakhs of depositors duped by "fly-by-night" non-banking financial companies, the Supreme Court on Tuesday ruled that the government has the power to attach the properties of such fraudulent organisations.

The apex court said such a legislation was

unless the proprietor of the said registered trademark licenses or authorizes the same.

Taking the advancement further, in *Satyam Infoway Ltd. v. Sifynet Solutions Pvt. Ltd.*, the Court held that the original role of a domain name was undeniably to provide an address for computers in the internet. But since the internet has developed from a mere means of communication to a mode of carrying on commercial activity and with the increase of commercial activity in the internet, a domain name serves the function of a business identifier. The goods/services associated with the domain name are therefore associated with the good/service provider.

Reiterating the same, in *Times Internet Ltd. v. Belize Domain Whois Service Ltd. and Ors.*, the Court directed the defendants to transfer the domain name “*indiatimetravel.com*” to the plaintiff.

Courts have not hesitated in also upholding the principles of passing off in domain name infringement cases. In *Tata Sons Ltd v Fashion ID Ltd* Court affirmed that internet is a market place where people buy and sell different products, and any confusion in any manner, over a domain name would mislead the customers and eventually cause damage to the prior user of the name. The Court went a step ahead and also awarded damages to the plaintiff.

Yet another noteworthy verdict is *British Telecom Plc. Vs One in a Million* wherein the Court held that in the case of registration of domain names of third party trademarks of well-known names, there was jurisdiction to grant injunctive relief when the defendant was equipped with or was intending to equip another with an instrument of fraud. It was also held that a name which would by reason of similarity to the name of another, inherently lead to passing off, was such an instrument.

In *Rediff Communications Ltd. Vs Cyberbooth* the user of the website “*www.radiiff.com*” was enjoined as it was held deceptively similar to the plaintiff’s website “*www.rediff.com*”. The Court further reiterated and re-affirmed that the domain names should be given the shielding against passing off.

Needless to state that the mounting cyber squatting occurrences call for vigorous and exceptionally well-built domain name protection and a complementing efficient domain name dispute resolution mechanism.

The Uniform Domain Name Dispute Resolution Policy (“UDRP”) is a process

constitutionally valid and not repugnant to the Reserve Bank of India rules, or the Companies Act, as it was a welcome measure in view of thousands of such cases being reported in the country.

We are of the opinion that the act of the financiers in exploiting the depositors is a notorious abuse of faith of the depositors who innocently deposited their money with the former for higher rate of interest.

#### **SEBI yet to decide on 25 MF Licence Applications:**

Mahindra and Mahindra Financial Services, India Infoline and Indiabulls Financial Services are among the 25 companies waiting for over three years for markets regulator SEBI to clear their applications to start a mutual fund business. There has been no communication to explain the delay, said two people familiar with the impasse.

The business plans of many of these companies are stuck since they can neither scrap the project nor proceed with it since they have invested capital and hired people. An internal memo circulating within SEBI talks about the strengths and weaknesses of the various companies that have sought a licence to start an asset management company, but it does not specify if any of the companies should be given a licence, those people said.

The difficulty in reaching out to investors in the far-flung areas of the vast nation and the downturn in 2008-09 had deterred some applicants from pursuing their plan, the people said. For others, the delay could be because they had faced charges of regulatory violations in the past. SEBI had fined Indiabulls Securities 15 lakh in 2007 for unfair trade practices in the derivatives segment. Karvy Stock Broking and Indiabulls were accused in the 2006 initial public offering scandals, but Indiabulls was given a clean chit later. Karvy was banned for three months from trading. First Global Financial Services, too, was banned from trading for a year in 2009. India Infoline was penalised 25 lakh.

#### **Telecom Companies at War, Centre Tells SC:**

The Centre on Wednesday described the ongoing legal battle in the Supreme Court on the issue of 2G spectrum allocation. In an indirect reference to leading GSM telecom operators — Airtel, Vodafone and Idea — who along with their association, COAI, have approached the court with a plea to be made parties in the case. The GSM service providers had submitted that they should be heard in the matter as they have challenged the Centre’s policy of allocating GSM

established by the Internet Corporation for Assigned Names and Numbers ("ICANN") for the resolution of disputes regarding the registration of internet domain names.

In India, we have the ".in Domain Name Dispute Resolution Policy" ("INDRP"), adopted by the National Internet Exchange of India. INDRP has been formulated in line with UDRP, internationally accepted guidelines, and with the relevant provisions of the Indian IT Act 2000. INDRP sets out the terms and conditions to resolve disputes between the Registrant and the Complainant, arising out of the registration and use of an ".in" Internet Domain Name.

spectrum to CDMA operators under dual technology to service providers such as Reliance Communication and Tata Tele Services. It was alleged that the two companies were allotted GSM spectrum under the dual technology regime, ignoring several applicants who had applied for the licence.

#### **Government Planning to Make Motor Vehicles Act More Stringent:**

For the first time, the government has decided to introduce strict penalties, including imprisonment and a fine of Rs 1 lakh on car manufacturers for faulty vehicle systems. A new provision would be included in the Motor Vehicles Act, 1988 that would make car manufacturers liable for penalty in case of faults. The penalty would be a fine of Rs 1 lakh or imprisonment of up to three months or both.

The new provision is one of the 30-odd amendments that the Ministry of Road Transport and Highways has decided to introduce in the two decade old Motor Vehicle Act. One of the major amendments is enhancing penalties for speeding, drunken driving and using mobile phones while driving. At present speeding carries a fine of Rs 400. The government has decided to introduce a graded system of penalty by imposing Rs 1,000 fine if the speed exceeds the permissible limit up to 10 km per hour and Rs 2,000 if it exceeds 10 km per hour up to 25 km per hour and Rs 5,000 if it exceeds by 25 km per hour. Even if you ask your driver to speed, a similar penalty will apply to you.

## **COURT ROOM NEWS**

- The Supreme Court of India in the case of Omnia Technologies (P) Ltd. V/s. W M A VAN Loosbroek, reported in 2011 (3) SCALE 176, has held that in cases where parties to an original international commercial agreement which contains arbitration clause have agreed to the appointment of sole arbitrator by Chief Justice of India/his designate to adjudicate all the disputes (which includes disputes related to the existence of arbitral dispute) arising under the said agreement, the designate judge will appoint the arbitrator without any reason being there.
- The Hon'ble Supreme Court of India in the case of Kaniyalal Lalchand Sachdev and Others V/s. State of Maharashtra and others, reported in (2011) 2 SCC 782, has held that in cases falling under section 14 of Securitization Act for taking possession of secured assets constitutes an action taken after the stage of sub-section (4) of Section 13 for recovering secured debt, and the same would fall in the ambit of sub-section (1) of

Section 17 which provides an efficacious remedy of appeal. In such cases, High Court will be justified in declining to exercise its jurisdiction under articles 226 and 227 of the constitution and thereby are right in refusing to entertain writ petition against the order of possession under section 14 of the act as there is specific remedy under section 17 of the act.

- The High Court of Delhi in the case of Manjit Jaju V/s. Registrar of Companies, reported in [2010] 159 CompCas 112 (Delhi), has held that in cases of Criminal offences under section 63 and 628 of Companies Act, 1956 read with section 468 of the Code of Criminal Procedure, the limitation period would start from the date when the Registrar of Companies acquires knowledge about false statement made in issuing prospectus or filing of balance sheet and certificate.

- The High Court of Gujarat in the case of Vodafone Essar Gujarat Limited, In re, reported in [2011] 161 CompCas 144 (Guj), has held that in cases of schemes of arrangement under section 391/394 of Companies Act, where the scheme seeks to evade the income-tax by transferring their passive assets to the Transferee Company, which is void under section 281 of Income-Tax Act, 1961, the Petition for sanction of the scheme has to be dismissed.

- The High Court of Madras in the case of Dr. K Balasundaram V/s. Coromandel Engineering Co. Ltd. and Others, reported in [2010] 159 Comp Cas 561, has held that Company Law Board can pass interim order under section 403 and that also for regulating the conduct of the affairs of the Company and nothing else.

- The High Court of Madras in the case of Dallah Albarka (Ireland) Ltd. V/s. Pentasoft Technologies Ltd., reported in (2010) [157 Comp Cas 413], has held that winding up proceedings are not proceedings for the purpose of recovery of debt from a defaulting borrower and the petitioner is bound to disclose the grounds on which he wants the company to be wound up. The only fact there is some decree granted by English court or a guarantee executed, per se, would not result in to company court exercising the winding up jurisdiction.