EYE ON INDIA

A Cyril Amarchand Mangaldas Thought Leadership Publication

2nd Edition

cyril amarchand mangaldas
advocates & solicitors
character • competence • commitment

EYE ON INDIA

A Cyril Amarchand Mangaldas Thought Leadership Publication

2nd Edition

cyril amarchand mangaldas
advocates & solicitors

character • competence • commitment

FOREWORD

I am tempted to look back at the decade gone by, as I bring to you the next edition of 'Eye on India', and I am amazed, but not surprised, at the extent of India's growth and development. From being one of the fragile five to becoming a super power in Asia, along with China, India has come a long way. Indians in general are hardworking and honest. This coupled with timely regulatory interventions, and the demographic dividend, India's growth was and is a foregone conclusion. I am confident that India will continue to remain a treasure trove of opportunities in the next decade as well.

When I think about it, I believe one of India's biggest achievements is establishing itself as a favoured investment destination. This is primarily because India's macroeconomic fundamentals have improved, even if our near-term outlook remains clouded, the country remains a long-term growth story. Availability of skilled manpower and ever-widening consumption base will continue to be the pillars of India's growth story, going forward. Additionally, as per World Bank's Doing Business Report 2020, India's ranking has improved significantly, it has jumped 14 places from last year to be ranked at 63. Crucially, India has performed exceptionally well across parameters such as Starting a Business, Dealing with Construction Permits, Trading across Borders and Resolving Insolvencies.

The last few years marked the end of an era of debt-fuelled growth, and the start of a technologically-enabled, purpose-led and strongly-governed new era, signalling a corporate renaissance with an entirely new genre of business leaders. While talking about corporate renaissance, it would be imprudent to leave out the timely policy changes and regulatory interventions like the amendments to the Insolvency and Bankruptcy Code (**IBC**). In many ways, IBC formed the genesis of new-age business leaders. No longer can errant promoters get away unscathed. In some ways, this has led to consolidation, which has opened up opportunities in the deals space in a big way. The second half of 2019 witnessed 28 M&A deals worth USD 1.53 billion, despite a slow start. In 2020, I see significant amount of deal activity being driven by stressed assets and amendments to key laws, including the IBC, which will make acquisitions of stressed assets more attractive.

Besides, there is an implied acknowledgment among global investors that India continues to have a large appetite for foreign investments, with strong macro drivers such as growing consumerism, and a government that is committed to promote favourable business environment by providing transparency and certainty through regulatory changes and policies, which is always a good catalyst for robust M&A activity.

At the time of going to Print, the world would have witnessed increasing geopolitical tensions between the US and Iran with fears of an imminent war, the markets worldwide have been impacted negatively with a resultant rise in prices of oil and safe haven assets such as gold. Coupled with that, United Nations Conference on Trade and Development (**UNCTAD**) Report 2019 stated that 'the world economy is heading into troubled waters, with recession in 2020 now a clear and present danger'.

Despite the geopolitical tensions and the slowdown forecasts, I believe the stage is set for artificial intelligence, machine learning and data science to make a big impact, big breakthroughs in bio-science, manufacturing, fintech, education, among others. In fact, I believe the world will progress much faster in the next ten years, as compared to the prior hundred years.

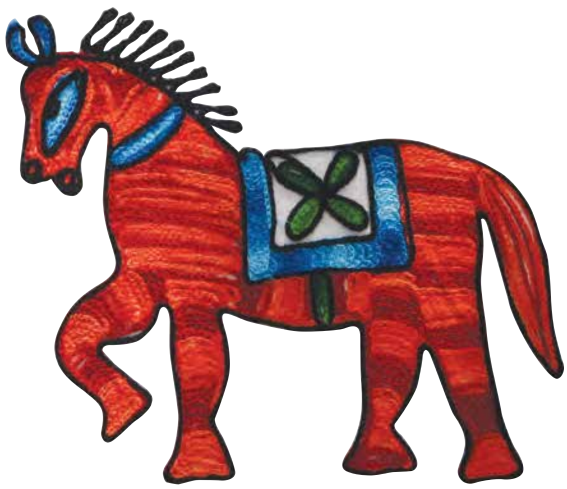
In this edition, we showcase some of the themes and trends that will drive the discussion around India as an investment destination. We have summarised developments with regard to certain policies of the Government, which have brought about a systemic change in the Indian economy or have the potential to do so, including amendments to the reporting of the Significant Beneficial Ownership (**SBO**), amendments to the insolvency code, strengthening of corporate governance framework and the data protection or the Personal Data Protection (**PDP**) Bill that was tabled in Parliament in December 2019, among others.

There is no denying that these are interesting times to be in India and we hope that our selection of essays will provide you with an equally interesting insight on these, and other issues of your interest. I look forward to your comments and suggestions as we continue to capture India's growth and journey through our thought leadership publications.

Cyril S. Shroff

Managing Partner
Cyril Amarchand Mangaldas
cyril.shroff@cyrilshroff.com
January 10, 2020

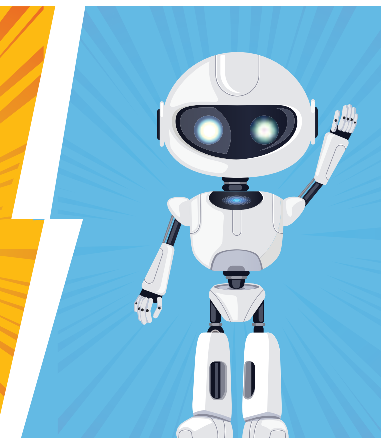
CONT



51

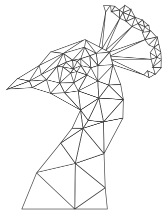
ENTS

84



88

112



BIRD'S EYE VIEW ON THE INDIAN M&A LANDSCAPE – TRENDS, OPPORTUNITIES AND RISKS

As this nation of 1.3 billion people charts its own course towards greater economic prosperity, with bespoke solutions to unique challenges, opportunities for growth, consolidation and optimisation are abound.

Introduction

The last two years experienced several market-moving factors, like tariff and trade wars, including the uncertainties around the US-China trade war, geopolitical instability and the impending Brexit, creating a sense of macroeconomic uncertainty. Despite this, it is encouraging to note that 2018 witnessed a decent rise in deal making, Global M&A deals worth at USD 3.52 trillion was struck in 2018, out of which cross-border mergers accounted for USD 1.35 trillion. Global headwinds and ongoing economic slowdown have not thawed the India M&A scene, which remained stable through 2019. By the end of this financial year, the country is expected to see M&A deals of over USD 52 billion, according to a report prepared by Baker McKenzie[1].

In this backdrop, India remains one of the fastest growing major economies of the world and is rife with opportunities for M&A transactions. The economic fundamentals and the present Government's policies and structural reforms created a more dynamic

1 See: https://economictimes.indiatimes.com/industry/banking/finance/india-to-see-ma-deals-worth-52-bn-in-2019/articleshow/71920252.cms?from=mdr

atmosphere for investment. Its business-friendly initiatives ensured that India sustains a high growth trajectory which will continue to bolster the economy. Consequently, the concerns in the minds of the investors relating to stability and ease of doing business, have, to a great extent been put on the back-burner. Given that India's economy is primarily consumption driven, India is seemingly well placed to be insulated from the theoretical arguments of impact of trade barriers.

India's financial growth has directly resulted in an increased number of business transactions. While the cash-rich Indian corporates are constantly vying for exponential and inorganic growth both in India and abroad, the debt-ridden Indian companies are busy mending their balance sheets, thereby propelling internal restructuring and consolidation amidst increased domestic competition. The Indian M&A landscape, therefore, stands at an interesting cusp – one that presents a lot of corporate restructuring and consolidation in the domestic Indian market and offers continued enthusiasm for global shopping by large conglomerates.

In terms of the M&A activity which India has witnessed over the last few years, 2018 saw the value of announced deals involving Indian companies reaching an all-time high of USD 129.4 billion, while 2019 saw a slight dip in the first half of 2019 due to the general elections overhang. It picked up steam over the second half, despite the economic slowdown, with 812 deals amounting to USD 33 billion from January to November, 2019.[2] The average M&A deal size for transactions with disclosed values increased to USD 127.8 million in 2018 compared to USD 82.8 million in 2017, and the year witnessed five deals above USD 5 billion (with a combined value of USD 39.8 billion) compared to only one in 2017 when the USD 11.6 billion Idea-Vodafone merger was announced.[3] While M&A activity witnessed a downward trend in 2019, with the average deal size falling to USD 81 million, it saw a spur due to the sale of distressed assets under the Insolvency and Bankruptcy Code, 2016.

“The Insolvency and Bankruptcy Code 2016 (IBC) has overhauled the existing framework dealing with insolvency of corporates, individuals, partnerships and other entities, and is currently the biggest driver of M&As in India.”

There has been a substantial increase in all the three M&A segments, viz – inbound, outbound and domestic transactions, as evidenced by the statistics which have been reported and the deals which have been consummated. Domestic and inbound deals were the main contributors to both deal volumes and the deal value, with domestic deals contributing to 64% in terms of deal count and 58% in terms of disclosed value, constituting the largest part in 2019. The acquisition of Yatra Online Private Limited by Ebix Inc. for USD 338 million and of Paytm E-Commerce Private Limited by eBay Inc. were some of the marquee inbound acquisitions of 2019 in the tech space. In addition, the acquisition of Flipkart by the US-based Walmart Inc. for USD 16 billion is the largest deal reported till date. On the domestic front, ONGC acquired a majority stake in the Hindustan Petroleum Corporation Limited for USD 5.2 billion and UPL Ltd, a maker of crop protection and agrochemical products, acquired Arysta LifeScience Inc., the farm pesticides business of the US's Platform Specialty Products Corp, for USD 4.2 billion. The year 2019 saw several domestic buyouts with ReNew Power acquiring Ostro energy platform for USD 1.6 billion, L&T Infrastructure acquiring Sadbhav Inrastructure Project for USD 959 million and Adani Power acquiring GMR Chhattisgarh Energy Limited for USD 512 million. The acquisition of 51% stake in Catholic Syrian Bank by Fairfax is the first of its kind and has paved the way for similar acquisitions of banks by foreign institutions.[4]

2 See: https://www.business-standard.com/article/pti-stories/deal-street-gets-deserted-in-2019-as-debt-obligations-cast-shadow-over-m-as-119122500184_1.html
3 See: https://www.livemint.com/Companies/VD0HHHQHCUwiCjsxeTGCLN/Indian-companies-log-record-129-bn-in-MA-deals-in-2018.html
4 See https://www.business-standard.com/article/finance/rbi-nod-for-fairfax-s-51-stake-acquisition-in-catholic-syrian-bank-118071400468_1.html

Private equity-backed M&A deals also saw increased activities in 2019 with the Blackstone Group alone investing USD 3.6 billion across sectors that included real estate and education. While e-commerce and manufacturing-related sectors garnered interest among the investors, other sectors which saw substantial activity during the course of 2018 and 2019 were healthcare, technology, energy, start-up pharma, retail, financial services and real estate.

India's budding M&A story, which underscores investor confidence, can be attributed to various catalysts like election of a government with a clear majority, led by a decisive Prime Minister, for a second time running, and bolstered by initiatives such as 'Make in India', 'Start-up India', 'Digital India' and 'Stand Up India'. Add to it tax incentives and exemptions for registered start-ups, manufacturing sector reforms, recent amendment to the Income Tax Act, 1961, reduction in corporate tax rates for India-incorporated companies, continued liberalization of the foreign investment regime, the systemic overhaul of laws related to indirect tax, corporate tax, insolvency and real estate firms etc have improved Indian macro-economic environment. Simultaneously, domestic M&A has also received a significant impetus for a host of reasons, including a gradual slowdown in greenfield opportunities particularly in highly-competitive Indian sectors like telecom and e-commerce.

Few factors which impact the trend of M&As in India are set out below.

Recent Policy Changes that Aided M&A Growth

The Companies Act, 2013 (**2013 Act**) replaced a nearly six-decade old legislation and brought about certain changes that enabled faster completion and more flexibility in structuring M&A deals thereby resulting in a simpler and uniform amalgamation or demerger processes. Such changes include framework and facilitation of cross-border mergers (both inbound and outbound), fast-track mergers between a holding company and its wholly-owned subsidiary as well as for small companies, and setting up of the National Company Law Tribunal (**NCLT**) framework which has subsumed the powers of the Company Law Board and the High Courts.

Additionally, the Securities and Exchange Board of India (**SEBI**) amended the erstwhile insider trading regulations in 2015, to facilitate due diligence of listed companies. Also, the process and regulatory requirements for reverse listing of unlisted companies has been substantially clarified by SEBI offering structuring flexibility to companies. Additionally, SEBI has permitted issuance of shares carrying differential voting rights in certain sectors which provides an effective tool to receive investments without losing control. Further, in order to make India a globally integrated economy, SEBI has recently proposed listing of equity shares of Indian companies on international stock exchanges and also allowing non-Indian companies to access Indian capital markets, which could provide better value recognition and investment and exit options to investors.

The Insolvency and Bankruptcy Code 2016 (**IBC**) has overhauled the existing framework dealing with insolvency of corporates, individuals, partnerships and other entities, and is currently the biggest driver of M&As in India. With an increase in gross non-performing assets by 59.3% in 2016 and the resultant stress of bad debts on financial institutions, the Reserve Bank of India (**RBI**) had sought to revise the stressed asset resolution process in June 7, 2019. But it suffered a setback due to a Supreme Court decision setting aside RBI's directive. However, the creditors as well as many of the borrowers are finding ways of proceeding with their debt resolution plans since the only other option would be liquidation of defaulters. However, the Supreme Court's recent judgement on the stressed asset sale of the fallen steel-sector giant Essar Steel provided much needed clarity for all stakeholders involved in IBC process. The two suitors

ArcelorMittal and Numetal engaged in a bidding war, vying for the company's assets.[5] But following the apex court verdict on the Essar Steel resolution plan, ArcelorMittal completed the acquisition of Essar Steel on December 16, 2019 for USD 5.91 billion and formed a joint venture with Japan's largest steel producer Nippon Steel to own and operate the debt-ridden ESIL.

The IBC has introduced more attractive dimensions to the distressed M&A space in India. Despite the legal/ regulatory challenges of the insolvency process under IBC, foreign and domestic players are extremely optimistic about the turnaround potential of several distressed companies. While strategic investors seem to have the edge currently, private equity funds are also actively exploring various structures to fund distressed M&A (e.g. platform deals, ARC and AIF set up etc.).[6] Since its inception in 2016, more than 900 companies have been referred to the NCLT, out of which proceedings worth approximately USD 42.5 billion have been resolved already.

India has also taken the right steps on the Foreign Direct Investment (**FDI**) front. These include allowing FDI up to 100% under the automatic route in the single-brand retail, commercial coal mining and manufacturing sector, up to 49% in the civil aviation sector through the approval route, and introduction of the 'Foreign Investment Facilitation Portal' to aid FDI applicants. These changes would go a long way in attracting more investments and resolving the procedural difficulties faced by foreign investors in the past. Contrary to expectations, the Government, however, imposed additional conditions and restrictions on the marketplace e-commerce activities *vide* Press Note dated December 26, 2018. New limitations have been imposed on the ability of e-commerce market places to sell products sourced from its affiliate entities, thereby resulting in many foreign-owned marketplace players to restructure their business model. As it appears, the ground impact seems to have been minimal so far.

Previously, the Indian growth story was shadowed by a weak corporate governance machinery. Considering all M&A transactions are ideated and structured at the board level, having an accountable board is a necessity for any company eyeing growth. The 2013 Act and the LODR Regulations are aimed at addressing this by, *inter alia*, stipulating a fixed number of independent directors in certain categories of companies, separation of powers of the managing director and chief executive officer, and providing a detailed 'code of conduct' for independent directors. Notable recommendations of the Kotak Committee, set up by SEBI, include enhanced monitoring of group entities, revising the eligibility requirements for independent directors and establishing a transparent mechanism for regulating information rights of controlling promoters. Moreover, with stricter legislation came stricter implementation by the judiciary. Courts have held directors liable in several cases calling out business tycoons on their fraudulent acts vis-à-vis the company.

Moreover, the introduction of the Goods and Services Tax (**GST**), which subsumes a vast majority of indirect taxes in India, has brought in much-needed regulatory clarity, particularly in respect of asset sale transactions.

A Word of Caution

Given the rapidly-evolving Indian regulatory regime, it remains imperative for investors to keep pace with policy and regulatory developments, and structure the deals keeping in mind the changes. The Tata and Docomo dispute over enforceability of a put option was finally settled towards the end of 2017, with Tata paying over USD 1.2 billion to Docomo[7] towards the arbitral award enforced by the Delhi High Court.[8] Thereafter, in the Cruz City case, the High Court opined that put options that seek to recover a fixed rate of return in the event of default by an Indian promoter/company would not violate India's foreign exchange regulations and accordingly, do not amount to violation of public policy.[9] While the ruling of the High Court lends more flexibility to parties in

5 See https://www.businesstoday.in/current/corporate/essar-steel-bidding-ruia-family-numetal-arcelormittal-insolvency-promoters/story/270482.html.
6 See:http://www.mondaq.com/india/x/779542/M+A+Private+equity/The+Way+Forward+Indian+MA+and+PE+Projections+for+2019.
7 See https://www.businesstoday.in/sectors/telecom/ntt-docomo-gets-usd-1.2-bn-from-tatas-puts-behind-bitter-feud/story/262993.html.
8 See https://economictimes.indiatimes.com/news/company/corporate-trends/court-accepts-tata-docomo-agreement-rejects-rbi-objection/articleshow/58415100.cms.
9 (2017) 239 DLT 649.

structuring put option clauses, it underscores the importance of bespoke structuring in order to prevent protracted disputes.

The importance of risk identification and effective mitigation in large-scale M&A transactions through due diligence and adequate legal and commercial remedies cannot be over emphasized. To this day, the Daiichi-Ranbaxy deal serves as a cautionary tale to investors and M&A practitioners. Daiichi had termed the on-going investigations by the US Foods and Drugs Administration (**FDA**) on Ranbaxy as just a 'risk call' and may not have spent enough time on evaluating the risk.[10] Subsequently, a USD 500 million settlement with the FDA and the US Department of Justice compelled Daiichi to go in for a distressed sale of Ranbaxy to Sun Pharma. Daiichi has successfully established its claim against the sellers, both in the arbitration at Singapore and in the Indian courts, and should be able to rein in its losses.

It is also important for parties to avoid the pitfall of 'gun-jumping', which essentially means consummating the transaction without the required notification to and/or clearance from the Competition Commission of India.[11]

In recent years, SEBI has heightened its scrutiny over schemes of arrangement for listed companies. Prior to 2013, the mechanism for the same was flexible. However, in February 2013, SEBI decided to widen the ambit of disclosures and requirements to be fulfilled by listed entities that involved issues such as inadequate disclosures by entities, convoluted schemes of arrangement, schemes used as mechanism to reduce public shareholding and exaggerated valuations computed under such schemes of arrangements.[12] Since then through

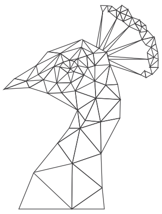
10 See http://www.rediff.com/money/report/column-the-mistakes-daiichi-sankyo-made-in-the-ranbaxy-deal/20160512.html.
11 See https://corporate.cyrilamarchandblogs.com/2016/11/part-consummation-ma-transactions-rhetoric-gun-jumping/
12 See http://www.mondaq.com/india/x/585688/Shareholders/Revamping+The+Scheme+Of+ArrangementAmalgamation+Requirements+For+Listed+Entities+Sebi+Overhauls+The+Regulatory+Framework

successive circulars, in November 2015, March 2017 and January 2018,[13] SEBI has established a robust regulatory framework for schemes of arrangement for listed companies. However, on the downside, with the revised framework, the timeline for effecting a scheme of arrangement has increased.[14] Also, the various benches of the NCLT, which are now vested with the power to approve schemes, have adopted varying approaches on similar schemes or legal points, which has created an element of uncertainty that did not exist when schemes were approved by High Courts.

Recent M&A Trends and Sectors that Made a Giant Leap

A recurring trend witnessed over the last few years was that of consolidation among domestic players. This was propelled due to various factors, primarily expansion of customer base, elimination of competition, off-loading debts by selling distressed assets and access to better resources. Consolidation has been the main contributor for deal volume in 2018, mostly led by transactions in the technology, media and telecom and financial services space. Walmart's acquisition of Flipkart, (proposed) Indus' merger with Bharti Infratel, UltraTech Cement's acquisition of Jaypee Cement in 2017 and Binani Cement in 2018, Reliance's acquisition of Hathway and Den, and Capital First's merger with IDFC bank are some of the marquee examples for such consolidation transactions. It was also a time of distressed deals led by Fortis Healthcare that saw intense bidding war culminating into a boardroom drama, and the acquisition of Religare's NBFC and housing finance arms by The Chatterjee Group. The sectors in focus continue to be financial services, consumer, e-commerce, technology, healthcare and real estate.

13 See https://www.sebi.gov.in/web/?file=../../../sebi_data/attachdocs/jan-2018/1514978804579.pdf#page=1&zoom=auto,-23,800.
14 See http://www.mondaq.com/india/x/577526/Shareholders/Revised+SEBI+Guidelines+for+Schemes+of+Arrangements+by+Listed+Entities.



Further, the current finance minister, Nirmala Sitharaman, recently announced the consolidation of 10 publicly-owned banks to be merged into four larger banks, along with an infusion of USD 7.77 billion.

The start-up sector, in particular, experienced significant M&A activity in the last two years. The acquisition of Indian online travel booking company, Yatra by Ebix for USD 337.8 million and acquisition by OYO of Gurugram-based co-working start-up Innov8 for USD 31.84 million are illustrations of acquisitions in the start-up sector.

Given the rigid regulatory framework governing acquisitions in India, including the 2013 Act and the Takeover Regulations, hostile takeovers were never a major feature of the Indian corporate landscape. However, India saw its first successful hostile takeover of Mindtree by Larsen & Toubro earlier this year.

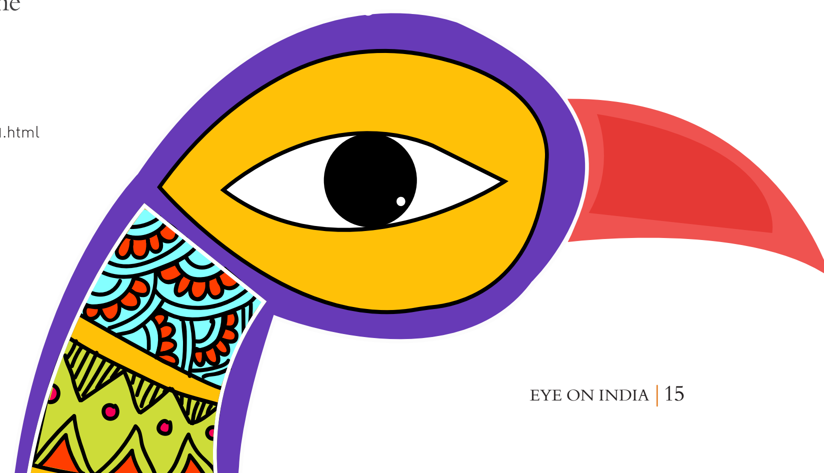
Another trend to mitigate risk in Indian M&A and private equity transactions, is the emergence of representations and warranties insurance (**R&W Insurance**). Given the concerns around the aggregate indemnity exposure for representations and warranties and withholding tax concerns, R&W Insurance arrangements are becoming increasingly popular in M&As to bridge a warranty gap.

In the private equity investment space, investors are often seeking majority control in Indian companies as it allows them to facilitate their exit from the investment. Global investment firm KKR invested over USD1.2 billion to acquire majority stakes in Analjit Singh's health care assets (in Max India) as well a 60% control in Chennai-based Ramky Enviro Engineers. Similarly, Blackstone acquired a majority stake in Akash Educational Services Limited, Byjus-Qatar Investment and Aadhar Housing Finance Limited. Other control deals in the private equity space which explains the trend include – AION Partners' (which tied up with JSW) 74.3% acquisition of Monett Ispat for INR 24 billion and Advent International's acquisition of a majority stake in PET manufacturer Manjushree Technopak.[15]

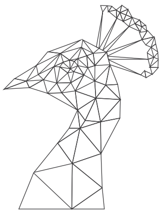
Although 2018 witnessed record-breaking M&A activity, the same was not true for primary market transactions which experienced a dip in the second half the year till. Even the first half of 2019 remained subdued. , However, deal street picked up steam in the second half of 2019 with 28 M&A deals worth USD 1.53 billion signed in the month of October alone. At a time of rampant corporate frauds and overnight bankruptcy cases, the due diligence exercise, termed as a 'measure of prudence' has gained immense importance prior to the negotiation of any M&A transaction. That being said, there is an implied acknowledgment amongst global investors that India continues to have a large appetite to accept foreign investments with strong macro drivers. These drivers include growing consumerism and a government committed to promote favourable business environment in the country by inter alia, providing transparency and certainty through regulatory changes and policies.

Conclusion

Interestingly, while the global economy seems to have been bottoming out, the Indian economy has not only shown resilience, but has also contributed to the growth of the nation due to clarity, transparency and certainty of the current government which brought in regulatory and policy changes. In order to sustain the rapid rate of economic growth and an enhanced deal flow, the new government will be under pressure to formulate and implement suitable policies and structural reforms at the same pace as the previous government.



15 See: https://www.business-standard.com/article/companies/rewind-2018-private-equity-firms-bet-on-control-deals-high-value-exits-118123000659_1.html



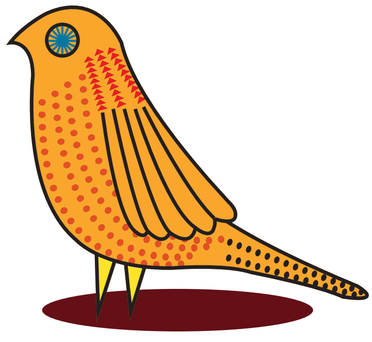
AN OVERVIEW OF BENEFICIAL OWNERSHIP REGIME IN INDIA

Introduction

Structures for doing business have come a long way from the seventeenth century when joint stock charters, awarded by British crown to monopolies, were detested for limitation of liability and regarded as a drop in standards of probity, to sophisticated modern structures focusing on owner shielding and/or entity shielding. In fact, the legal invention of 'limited liability' was once called the 'greatest single discovery of modern times'.[1]

It is thus no surprise that determination of beneficial owner of assets and income to stem misuse of corporate structures for the purpose of evading tax or laundering money for corrupt or illegal purposes, including terrorist activities, became an exercise across several jurisdictions and international bodies, including the Financial Action Task Force (**FATF**).[2] India too has progressively tightened the framework for determination of identities of the beneficial owners through various legal and regulatory changes.

This article provides an overview of the key provisions of the Indian laws and regulations that stipulate the tests for determination of beneficial ownership and regulations that impose reporting obligations in relation to holdings in listed and unlisted securities of Indian companies.



Significant Beneficial Ownership under the Companies Act

With the objective[3] to prevent misuse of corporate vehicles for propagating corrupt or illegal purposes such as tax evasion, money

1 Nicholas Murray Butler, President of Columbia University, in a 1911 speech called "Politics and Economics" to the 143rd Annual Banquet of the Chamber of Commerce of the State of New York in 1911 (pp. 43-55).
2 Guidance on Transparency and Beneficial Ownership (Recommendations 24 & 25).
3 Paragraph 7.1, Company Law Committee Report dated February 1, 2016.

laundering and terrorist activities, the Companies Act, 2013 (**2013 Act**) was amended in 2017 to introduce provisions dealing with identification and disclosure of significant beneficial owners (**SBOs**). This was shortly followed by the notification of the Companies (Significant Beneficial Owners) Rules, 2018 (**SBO Rules**). However, due to interpretative hurdles and lack of clarity on disclosure requirements, the SBO Rules could not be brought into effect immediately. It was only post the introduction of amendments to the SBO Rules on February 8, 2019 (**Commencement Date**) that the regime was finally operationalised.

WHO QUALIFIES AS A SBO

A SBO, in relation to a reporting company as per these SBO Rules (**Reporting Company**), is an individual, who acting alone or together, or through one or more persons or trust, possesses one or more of the following rights or entitlements in such a Reporting Company:

(i) holds indirectly, or together with any direct holdings, not less than 10% of the shares;

(ii) holds indirectly, or together with any direct holdings, not less than 10% of the voting rights in the shares;

(iii) has right to receive or participate in not less than 10% of the total distributable dividend or any other distribution, in a financial year through indirect holdings alone, or together with any direct holdings;

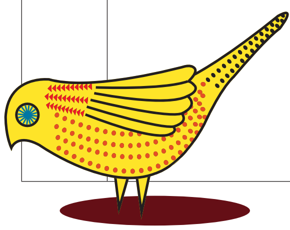
(iv) has right to exercise, or actually exercises, significant influence or control, in any manner other than through direct holdings alone.

Thus, as is evident from the above, the SBO Rules prescribe 10% as the minimum threshold when it comes to assessment of ownership of shares/ holding of voting rights/ right to receive dividends in order to identify an individual as the SBO. However, as an exception to this 10% threshold, an individual who has the right to exercise (or actually exercises) significant influence[4] or control[5], in any manner other than through direct holdings, could also be classified as a SBO.

ASCERTAINING SBO *VIS A VIS* LEGAL FORM OF MEMBER

Depending on the legal form of the member of the Reporting Company, the SBO Rules have prescribed different rules for identification of SBOs, as tabulated below:

Sl. No.	Legal Form of member of the Reporting Company	Who shall be regarded as the SBO
1.	Body corporate (whether incorporated or registered in India or abroad), other than a limited liability partnership	An individual who: (a) holds majority stake[6] in that member; or (b) holds majority stake in the ultimate holding company (whether incorporated or registered in India or abroad) of that member
2.	HUF (through *karta*)	An individual who is the *karta* of the HUF
3.	Partnership entity (whether represented by itself or through its partner)	An individual who: (a) is a partner; (b) holds majority stake in the body corporate, which is a partner of the partnership entity; or (c) holds majority stake in the ultimate holding company of the body corporate, which is a partner of the partnership entity.
4.	Trust (represented through trustee)	An individual who: (a) is a trustee in case of a discretionary trust or a charitable trust; (b) is a beneficiary in case of a specific trust; or (c) is the author or settlor in case of a revocable trust.



4 The term "significance influence" means the power to participate, directly or indirectly, in the financial and operating policy decisions of the reporting company but is notcontrol or joint control of those policies.

5 The term "control" means the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

6 The term "majority stake" means – (i) holding more than one-half of the equity share capital in the body corporate; or (ii) holding more than one-half of the voting rights in the body corporate; or (iii) having right to receive or participate in more than one-half of the distributable dividend or any other distribution by the body corporate.

Sl. No.	Legal Form of member of the Reporting Company	Who shall be regarded as the SBO
5.	Pooled investment vehicle or an entity controlled by the pooled investment vehicle, based in a member State of the FATF, and the securities market regulator in member States of the International Organization of Securities Commissions.	An individual in relation to the pooled investment vehicle, who: (a) is a general partner; (b) is an investment manager; or (c) is a CEO where the investment manager of such pooled vehicle is a body corporate or a partnership entity.
6.	Where the member of a reporting company is a pooled investment vehicle or an entity controlled by the pooled investment vehicle, based in a jurisdiction other than mentioned at Serial Number 5 above.	SBO to be determined as per principles set out at Serial Numbers 1 to 4 of this table.

GROUND RULES FOR DETERMINATION OF SBO

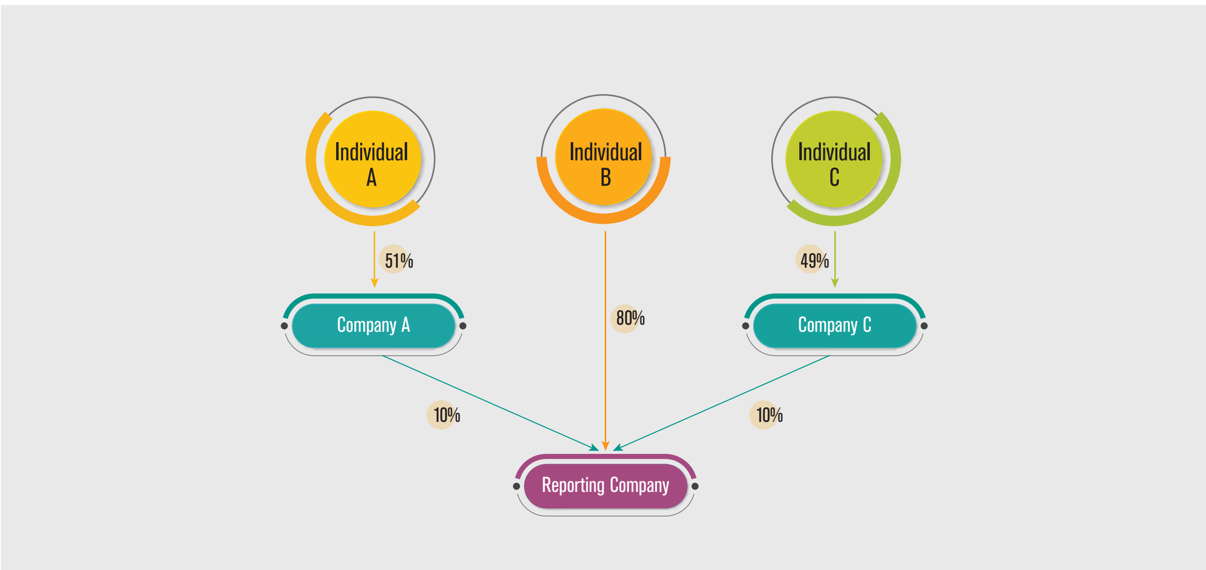
Apart from the provisions specified above, there are certain ground rules which have to be considered while determining a SBO depending on the legal form of the member of the Reporting Company. These are explained through the below illustration where the member of the Reporting Company is a company/body corporate:

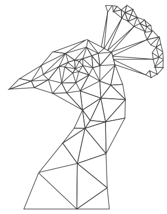
(i) Rule as to computing indirect interest
While computing indirect interest of an individual in a company, one does not require to apply the pro-rata calculation for percentage holding. Thus, in case of individual A, indirect holding in the Reporting Company is not to be determined by pro-rata method (i.e. 51% of 10% which shall be less than 10%). Rather, the entire interest (10%) of Company A in the Reporting Company is taken as the indirect interest of Individual A. Thus, Individual A qualifies as a SBO.

(ii) Rule as to direct shareholding
If an individual has only direct shareholding in the Reporting Company, he shall not be considered as a SBO. Thus, in case of individual B, he shall not be characterised as a SBO as he only has direct shareholding in the Reporting Company.

(iii) Rule as to majority stake
The chain of ownership will go right up to the top, but will stop at a level where the majority stake or significant influence or control cannot be determined/ identified. Thus, Individual C shall be a SBO if he exercises significant influence or control, even if he does not hold majority stake in Company C.

(iv) Significant influence and control test needs to be applied at every level of the ownership chain.





EXEMPTIONS FROM BEING CLASSIFIED AS A SBO

Certain classes of members in a Reporting Company are exempted from complying with the SBO Rules. Key exemptions include:

(i) Investment vehicles registered with the Securities and Exchange Board of India (**SEBI**), which include Alternative Investment Funds, mutual funds, Infrastructure Investment Trusts and Real Estate Investment Trusts registered;

(ii) Investment vehicles regulated by the Reserve Bank of India, Insurance and Regulatory Development Authority of India or the Pension Fund Regulatory and Development Authority.

KEY COMPLIANCES

(i) Every individual who is a SBO as on the Commencement Date is required to file Form BEN-1 with the Reporting Company within 90 days thereof (**Reporting Date**). Any changes to SBO holdings after such first filing, need to be reported within 30 days to the Reporting Company;

(ii) The Reporting Company in turn in required to file Form BEN-2 with the Registrar of Companies within 30 days from the Reporting Date. Pursuant to Circular dated January 1, 2020, the Ministry of Corporate Affairs (**MCA**) has extended the deadline filing of Form BEN-2 to March 31, 2020. This Form BEN-2, like other forms filed under the Companies Act, will be publically available on the website of Ministry of Corporate Affairs;

(iii) The Reporting Company is required to give a notice (in the format prescribed under Form BEN- 4) to any person whom the company has a reasonable cause to believe to (i) be a SBO or (ii) be having knowledge of the identity of a SBO or another person likely to have such knowledge or (iii) having been a SBO of the company at any time during the 3 years immediately preceding the date of such notice being issued by the company, and who is not a registered beneficial owner. Further, such notice is also to be issued to all non-individual members holding not less than 10% of its shares or voting/ dividend rights.

(iv) Every Reporting Company is required to maintain register of SBOs in Form BEN-3;

(v) Failure to disclose SBO holding may lead to fine. Further, such failure may also lead to restrictions on transfer of interest and suspension of all rights attached to the shares. Reporting Company and every officer of the Reporting Company could be exposed to a fine for failure to discharge its obligations under Companies Act and SBO Rules;

(vi) Any person willfully furnishing false or incorrect information or suppressing material information of which she/he is aware is liable to be prosecuted for fraud under Section 447 of Companies Act.

BO disclosures by listed companies under SEBI regulations

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) requires issuers of listed equities and convertible securities to disclose the identity of natural persons who are the ultimate beneficial owners of the proposed preferential issue. This has to be disclosed upfront in the explanatory statement of the notice convening a general meeting for approving the said issue.

Further, all listed entities are required to disclose SBO details as part of their shareholding pattern reporting. To align the disclosures under ICDR Regulations with the amended SBO Rules, the format for disclosure was amended and it has come into force? It has came into force on June 30, 2019, and will apply to all listed entities that are "reporting companies" as per the SBO Rules.

As per the PMLA Rules, the process for determination of BO is as follows:

Sl. No.	Legal Form	BO
1	Company	Natural person(s), who, whether acting alone or together, or through one or more juridical person, has a controlling ownership interest or who exercises control through other means. "Controlling ownership interest" means ownership of or entitlement to more than 25% of shares or capital or profits of the company. "Control" is defined to include the right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.
2	Partnership Firm	Natural person(s), who, whether acting alone or together, or through one or more juridical person, has ownership of/ entitlement to more than 15% of capital or profits of the partnership.
3	Unincorporated association / body of individuals	Natural person(s), who, whether acting alone or together, or through one or more juridical person, has ownership of or entitlement to more than 15% of the property or capital or profits of such association or body of individuals.
4	Trust	(a) author of the trust; (b) trustee; (c) beneficiaries with 15% or more interest in the trust; and (d) any other natural person exercising ultimate effective control over the trust through a chain of control or ownership.

7 A reporting entity has been defined to mean a banking company, financial institution, intermediary or a person carrying on a designated business or profession.

Beneficial Owners (BOs) disclosures under Indian anti money laundering law

Under the Prevention of Money Laundering Act, 2002 (**PMLA**) and rules issued thereunder (**PMLA Rules**), a reporting entity[7] is required to determine whether a client is acting on behalf of a BO, and identify the BO, at the time of commencement of an account-based relationship with the client. As per PMLA, a BO means an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control.

BO disclosures under the FPI Regulations

Under the Indian exchange control regulations, foreign portfolio investment is defined to mean any investment made, by a person residing outside India, in capital instruments where such investment is (a) less than 10 percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or (b) less than 10 percent of the paid up value of each series of equity instruments of a listed Indian company. Hence, a foreign entity desirous of making portfolio investments in India is required to seek registration under the SEBI (Foreign Portfolio Investor Regulations), 2014 (**FPI Regulations**) read with the Indian exchange control regulations.

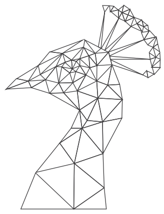
Under the FPI Regulations, only Category I FPIs have been exempted from the requirement of identification and declaration of BOs since such FPIs are either government or government related entities, which are perceived as low risk entities.

RULES FOR IDENTIFICATION OF BOs FOR CATEGORY II AND III FPIS.

BOs are defined as natural persons who ultimately own or control a FPI and are required to be identified in accordance with the PMLA Rules.

Additional Provisions for FPIs

For identification of BOs for a FPI, in addition to requirements under PMLA Rules, the following should be noted:



(i) The materiality threshold to identify the BO should be first applied at the level of FPI. Then, on look through basis, the identity of the BO of the intermediate shareholder/ owner entity should be identified. Only the BO and intermediate shareholder/ owner entity with holdings equal or above the materiality thresholds (25% in case of a corporate entity and 15% in case of a partnership or trust) in the FPI need to be identified on a look through basis. Thus, unlike in the case of determination of SBO for a company, the effective holding of the BO in the FPI should be calculated on a 'pro-rata' basis. Disclosure is required only in the event that such pro-rata shareholding is greater than the materiality threshold.

(ii) In respect of FPIs coming from "high risk jurisdictions", the materiality threshold of 10% shall be applied for identification of BO;

(iii) In the event that there is no identifiable BO, then the senior managing official (viz. an individual as designated by the FPI who holds a senior management position and makes key decisions relating to the FPI) shall be identified as a BO;

(iv) In case of companies/ trusts represented by service providers like lawyers/ accountants, FPIs should provide information of the real owners/ effective controllers of those companies / trusts;

(v) BOs of FPIs having General Partner/ Limited Partnership structure are to be identified on ownership or entitlement basis and control basis.

BO implications under the tax law

In international tax law, beneficial ownership is relevant for determining source country tax implications. These in turn depend on determination of eligibility to the provisions of the tax treaty between India and the country of residence of the recipient of income from India. The withholding tax rates applicable would be as per the treaty, e.g. on interest. But, this eligibility is based on the recipient being the beneficial owner of the income. Beneficial ownership has gained much more significance in recent times with the developments under the Base Erosion & Profit Shift Action (**BEPS**) plans of the Organisation for Economic Co-operation and Development under which several checks and balances have been incorporated to ensure that the benefit of a treaty is received only by those who are the beneficiaries of the income in terms of the standards of beneficial ownership prescribed either under the domestic law or under the provisions of the treaty. The anti-avoidance provisions in the domestic law such as General Anti Avoidance Rules (**GAAR**) and the limitation of benefits provisions under the treaties have substantiated this further. The legal form of the income recipient entity would also have a bearing on determining taxability. In case of entities which are tax transparent in their home jurisdictions, such as partnership or trust, the taxability would depend on the eligibility of each of the beneficial members to claim the treaty benefit. In essence, BO assessment from a tax perspective has evolved over the years to address the BEPS concerns by moving towards 'substance over form', recognising the difference between 'tax planning vs tax avoidance' and addressing treaty shopping.

Conclusion

To summarise, determination of SBO under SBO Rules requires careful consideration and detailed scrutiny especially in complex structures where the ownership is structured through several layers (of companies, partnerships or trusts) and through combination of direct and indirect holding through trusts. As mentioned above, for SBO identification indirect holding, significant influence or control is to be traced where it is held by the individual himself or when acting together with or through one or more persons or trusts. Further, in situations where more than one reporting of SBO is triggered under different regulations (e.g. in the case of a non-Indian member holding interest in a listed Indian Reporting Company, SBO reporting could be triggered under FPI Regulations, SBO Rules and ICDR Regulations) due care needs to be taken to ensure there are no inconsistencies in disclosures. Lastly, when making disclosures under various SBO reporting, it would be important to assess the implications of such disclosures on the tax structure and tax positions taken with respect to such holdings in the reporting companies.

INSOLVENCY AND BANKRUPTCY CODE: THE JOURNEY SO FAR AND FUTURE AHEAD

Recap Since Enactment in 2016

The Insolvency and Bankruptcy Code, 2016 (**IBC**) has been at the centre of attention for regulatory developments since its enactment 2016. The country has witnessed an unprecedented number of largescale distressed acquisitions and resolution of stressed companies in a time bound manner under the IBC regime. The economy now has a holistic framework to deal with defaults in repayment of debt and functional infrastructure relating to corporate insolvency resolution process (**CIRP**), comprising the Adjudicating Authority [The National Company Law Tribunal (**NCLT**)], the Insolvency and Bankruptcy Board of India (**IBBI**), Insolvency Professional Agencies, Insolvency Professionals and Information Utilities. In general, there has been a radical behavioural shift in financing transactions. and debtor-creditor relationship. Further, provisions governing the insolvency resolution process and the bankruptcy process of personal guarantors to corporate debtors(**CDs**) came into effect on December 1, 2019.

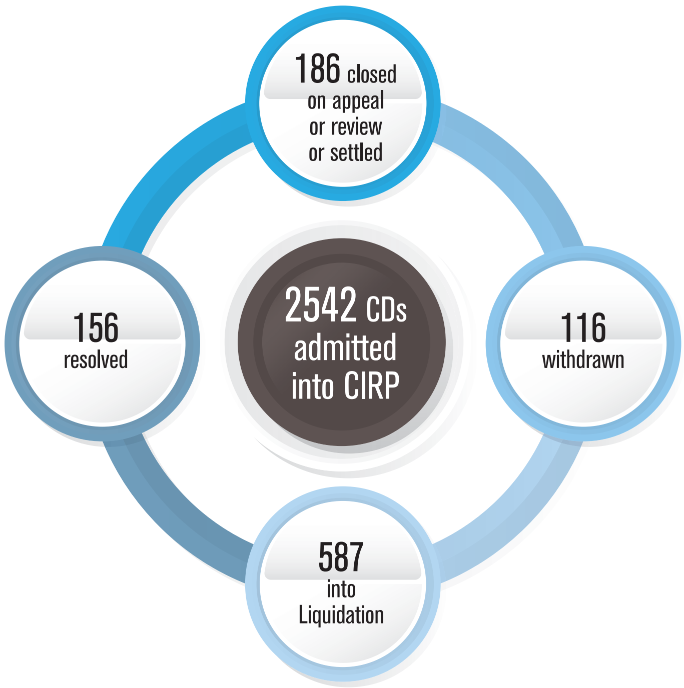
The provisions relating to corporate insolvency under the IBC have been operationalised with sizeable success. The provisions relating to CIRP came into force on December 1, 2016. A representation of the activity under the IBC in the past three years is set out below.[1]

1 The Quarterly Newsletter of the Insolvency and Bankruptcy Board of India, June – September 2019, Vol. 12 available at https://ibbi.gov.in/uploads/publication/cff2db5cfaa42ed5aad9544b04bfac8b.pdf.

> The fact that IBC, in the short span of two years, has been amended several times, shows that Indian legislature has been extremely proactive in addressing the ambiguities and plugging gaps surrounding the implementation of IBC

The CIRP of 1497 CDs are ongoing as on the end of September, 2019.

This implementation coupled with other legislative, regulatory and judicial developments have led to improvement in India's global ranking in World Bank's Ease of Doing Business by 14 ranks, form the year 2018. For the year ended on May 1, 2019, India stood at 63 position, earning the credentials of being a top global improver for a third consecutive year. Specifically, on the parameter of resolving insolvency, India has displayed remarkable improvement of 56 ranks from 108 rank to 52 rank in 2019.



The IBC also successfully passed the muster of constitutional validity with the Supreme Court of India, which upheld the validity of the provisions of the IBC in January, 2019.[2]

The Journey So Far

Timely Resolution is the Objective

The IBC prioritises '*rescue*' or '*resolution*' of a CD. The Hon'ble National Company Law Appellate

2 Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors (2019 SCC OnLine SC 73) (Swiss Ribbons).

Tribunal (**NCLAT**) has set out the objectives of the IBC in the following order of priority: (i) resolution, (ii) maximisation of value of assets of the CD, and (iii) promoting entrepreneurship, availability of credit and balancing the interests of stakeholders[3]. In *Essar* [4], the Supreme Court of India also observed that if resolution is possible, every effort must be made to try and see that it is made possible. In fact, in a few recent judgements, the NCLAT directed the liquidators of companies, whose CIRPs did not yield a resolution, to first consider a scheme of arrangement under the Companies Act,2013 to rescue the company and failing which, to consider a sale of the business as a 'going concern'. If both such efforts fail, the liquidators could liquidate the CD by selling assets piecemeal or in parcels.

A sale of the CD or its business on a 'going concern' basis can also be recommended by the Creditors Committee when approving a resolution plan or deciding to liquidate the CD. If such a recommendation has been made or if the liquidator is of the view that such sale shall maximise the value of the CD, he shall endeavour to first sell in this manner.

In view of the orders passed by the NCLAT, amendments were made to the IBBI (**Liquidation Process**) Regulations, 2016, which allows a compromise or an arrangement to be proposed in respect of CD undergoing liquidation. The process is required to be completed within 90 days of the commencement of liquidation.

To preclude initiation of proceedings in the first place, the amendments proposed under the Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019 (**Amendment Bill**), which is yet to come into force, allows for inclusion of last-mile funding availed to prevent commencement of CIRP, in the insolvency resolution process costs, which are accorded highest priority in repayment in resolution and liquidation.

"IBC has brought in behavourial shift in the financing transactions and paved the way for responsible borrowing and a resolution friendly ecosystem."

At the same time, realising the value destruction which accompanies delays in resolution, after recent amendments to the IBC, a 330 day timeline has been prescribed for completion of CIRP, including any time expended on litigation. However, in the case of Committee of Creditors of Essar Steel India Limited,[5] the Supreme Court has held the timeline to be

3 Rajputana Properties Private Limited v. Binani Industries Ltd and Ors, (NCLAT, orderOrder dated November 14, 2018).
4 ArcelorMittal India Private Limited v. Satish Kumar Gupta & Ors. (2018 SCC OnLine SC 1733) (Essar).
5 Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta (Judgment dated November 15,2019) (Essar Steel).

ordinarily applicable with extensions being permissible only if demonstrated that resolution is in the interests of stakeholders and achievable within a short period with the delay being a consequence of the court-process not attributable to the litigants. The timeframe for completion of liquidation process has also been reduced to one year from two years, earlier.

Evolution of 'Financial Debt'- Homebuyers, Guarantee Holder and Contractual Comforts

As originally enacted, the IBC was ambiguous on the characterisation of amounts raised by real estate companies from prospective homebuyers as the amount did not fall within the ambit of "*financial debt*" or "*operational debt*" given that the homebuyers were not goods and services suppliers. This issue came to the fore in the case of *Jaypee Infratech*[6], one of the "*Dirty Dozen*"[7] cases, where the debt of the construction financiers was roughly equal to the amounts raised by the company as booking advance from the homebuyers.

When this issue was argued before the Supreme Court in early 2017, the Supreme Court devised an *ad-hoc* arrangement to give limited representation to the homebuyers in the Creditors Committee through a court appointed counsel who would participate in the Creditors Committee meetings to represent the interests of the homebuyers. The Insolvency and Bankruptcy Board of India (**IBBI**), identifying the issue, amended the regulations for CIRP in August, 2017 to homebuyers the opportunity to prove their debts as 'other creditors'. In June 2018, this issue was finally resolved through an amendment to the IBC[8], wherein amounts raised from homebuyers[9] were deemed to have the '*commercial effect of borrowing*' and therefore brought within the purview of '*financial debt*'. The homebuyers (as class of creditors) are now entitled to a seat on the Creditors Committee and will be represented at the meetings by an authorized representative with all the attendant rights.[10] However, to prevent any misuse of the provision by a single homebuyer, the Amendment Bill contemplates introduction of thresholds[11] applicable to classes of financial creditors (including homebuyers) that should be satisfied for commencement of CIRP.

Another aspect of the scope and ambit of financial debt pertains to the classification of the debt owed by CDs undergoing insolvency, as corporate guarantors for the debt extended to another entity. The Hon'ble NCLAT in the matter of JEKPL Private Limited[12] held that maturity of a claim or default of claim or invocation of guarantee for claiming the amount has no nexus with filing of claim, and that such claims would be valid and construed as 'financial debt'.

In *Era Infra Engineering*[13], the NCLT held that a debt obligation arising out of a put option, a non-disposal undertaking, a promoter's undertaking, and a deed of pledge would qualify as a 'contract of guarantee' and would be construed as 'financial debt' under the IBC.

In Jignesh Shah v. Union of India,[14] the Supreme Court was required to decide whether amounts due on default of obligations under a letter of undertaking, effectively in the nature of a put-option, would be "financial debt". Citing that there was no disbursement, the letter was contended to be only a letter of comfort. This contention was rejected by the NCLT and subsequently by the NCLAT. The judgements observed that the amount had been raised for economic gain and had the commercial effect of borrowing as the terms included also the date by which the amount was to be repaid. Additionally, the requirement of "time value" of

6 Chitra Sharma v. Union of India (Supreme Court, order dated August 9, 2018).

7 In June 2017, the Reserve Bank of India ("RBI") issued directions to certain Indian banks to initiate insolvency proceedings against 12 identified Corporate Debtors, having debt value in excess of INR 50 billion (approximately USD 720 million) each; commonly referred to as the 'Dirty Dozen'.

8 Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 (with effect from June 06, 2018).

9 "Allottees" of projects registered under Real Estate Regulation Act, 2016.

10 The amendment was challenged before the Supreme Court and its constitutional validity was upheld in the case of Pioneer Urban Land and Infrastructure limited & Anr. v. Union of India & Ors. (Judgment dated August 9, 2019).

11 In respect of homebuyers, the Amendment Bill prescribes that an application can be filed "...jointly by not less than one hundred of such allottees under the same real estate project or not less than ten per cent. of the total number of such allottees under the same real estate project, whichever is less."less than one hundred of such allottees under the same real estate project or not less than ten per cent. of the total number of such allottees under the same real estate project, whichever is less."

12 Export Import Bank of India v. Resolution Professional JEKPL Private Limited (NCLAT, Order dated August 14, 2018).

13 Union Bank of India v. Era Infra Engineering (NCLT Principal Bench, Order dated December 6, 2018).

14 Jignesh Shah v. Union of India (Judgment dated September 25, 2019).

money was fulfilled since one of the conditions specified an internal rate of return. The Supreme Court set aside the order passed by the NCLAT solely on the question of limitation. Therefore, the NCLT and the NCLAT decisions will be of limited use in light of the Supreme Court decision.

Expansion of the Scope of Moratorium

The moratorium ordered by the NCLT at the time of admission of an insolvency application in respect of the CD has been questioned in respect of guarantors of the CD undergoing insolvency. Clarifying the differing legal positions on application of moratorium to guarantors of debt owed by the CD, the Supreme Court in the case of *V. Ramakrishnan*[15] held that the period of moratorium under the IBC would not apply to the personal guarantors of a CD. This position was also clarified pursuant to an amendment to the IBC (with effect from June 6, 2018), wherein a specific carve out was created from the applicability of moratorium provisions with respect to a surety in a contract of guarantee to a CD.

Towards the goal of ensuring that the CD remains a 'going concern', the Amendment Bill seeks to extend the scope of moratorium to the following:

(a) suspension or termination of arrangements that involve conferment of rights by any government authority, on the 'grounds of insolvency' so long as there is no default in the payment of current dues arising out of use of such benefits during the moratorium period; and

(b) suspension or termination or interruption of arrangements relating to supply of goods and services that the resolution professional considers critical to, inter alia, protect the value of the CD, subject also to payment of dues arising out of use during the moratorium period.

Appropriation from accounts of a CD

Any appropriation of amounts lying with a creditor of a CD during the CIRP period is considered a breach of the moratorium under the IBC. The NCLAT in *Amtek Auto*[16] held that once moratorium is imposed under the provisions of the IBC, it is not open to any person including financial creditors to recover any amount from the account of the CD, nor it can appropriate any amount towards its own dues. Further, in the case of *Debashish Nanda*[17], NCLAT held that a bank cannot debit a ny amount from the CD's account after the order of moratorium, as it amounts to recovery of amount after the order of moratorium.

Role of Creditors Committee

The Creditors Committee is the decision-making body during the CIRP under the IBC of a CD, starting from appointment of an insolvency professional till the approval or rejection of a resolution plan in relation to a CD. The Supreme Court in *Swiss Ribbons* held that an insolvency professional is really a facilitator of the resolution process, whose administrative functions are overseen by the Creditors Committee and by the NCLT.

In *K. Sashidhar* [18], the paramountcy of decision of the Creditors Committee on resolution of a CD was confirmed by the Supreme Court. It was held that the legislature has consciously not provided any ground to challenge the "commercial wisdom" of individual financial creditors or their collective decision before the NCLT and therefore, the courts should not interfere with the same.

This received a further fillip with the Supreme Court explicitly observing in Essar Steel, that inancial creditors alone are adept at handling the affairs of the CD and deciding in respect of its resolution, including the manner of distribution of funds among the various classes of creditor in a resolution plan. At the same time, it was clarified that the Creditors Committee does not act in fiduciary capacity for any group of creditors, but is required to take a business decision by requisite majority, which binds all takeholders of the CD.

15 State of Bank of India v. V. Ramakrishnan & Anr. (2018 SCC Online SC 963)

16 Indian Overseas Bank v. Mr. Dinkar T. Venkatsubramanian. Resolution Professional for Amtek Auto Ltd. (Order dated November 15, 2017).

17 State Bank of India v. Debashish Nanda (NCLAT Order dated March 21, 2018).

18 K. Sashidhar v. Indian Overseas Bank & Ors. (Judgment dated February 5, 2019) (K. Sashidhar).

The Supreme Court also recognised the limitations o judicial review available with the NCLT and the NCLAT when examining the decision of the Creditors Committee. It was held that the inquiry was limited to whether the following eatures were considered by the Creditors Committee:

- the CD needs to keep going as a "going concern" during CIRP
- it needs to maximise the value of assets of the CD
- the interests of all stakeholders including operational creditors has been taken care of.

So long as the interests of each class of creditors are addressed, the NCLT and the NCLAT can not exercise jurisdiction in review of whether the distribution was "fair and equitable" in terms of ection 30(2) (b) of IBC.

Further, the amended IBC provides that the Creditors Committee may consider, when evaluating a resolution plan, the priority and value of the security interest of secured creditors. This amendment was upheld in Essar Steel.

Withdrawal of the insolvency proceedings

The IBC was amended in June, 2018 and withdrawal of insolvency proceedings is now permitted by the applicant with the approval of ninety per cent voting share of the Creditors Committee read with the timeline under Regulation 30A of the IBBI (**Insolvency Resolution Process for Corporate Persons**) Regulations, 2016 (**CIRP Regulations**). However, the Supreme Court in *Brilliant Alloys*[19], disagreed with these timelines

19 Brilliant Alloys Private Limited v. Mr. S. Rajagopal & Ors.,(Supreme Court, order dated December 19, 2018).

and held the same to be directory because the facts of a given case, an application for withdrawal may be allowed in exceptional cases even after issue of invitation for expression of interest under Regulation 36A. Now, amendments to CIRP Regulations have enabled withdrawal even post-issuance of the invitation provided that the underlying reasons are specified and approval of the Creditors Committee is obtained.

Resolution Plans: Scope and Limitations

Nature of Resolution Plan

The resolution plan once approved by the NCLT, becomes binding on all stakeholders of the company and assumes the nature of a binding contract framed under a statute. Section 74 of the IBC provides for stringent penalties for non-implementation of the resolution plan, including a jail term. Learning lessons from certain errant resolution applicants who failed to implement the approved resolution plans, the requirement to provide a performance bank guarantee along with the resolution plan has been made mandatory vide the recent amendment dated January 24, 2019 to the CIRP Regulations. In fact, recently it was reported that the IBBI has initiated criminal proceedings pursuant to the IBC against a resolution applicant for failing to implement an approved resolution plan.

Distributions pursuant to Resolution Plan

Recent amendments to the IBC and the CIRP Regulations have put to rest controversies surrounding the differential treatment of different categories of creditors as well as the treatment of creditors within a class. The NCLAT, in its various orders, placed reliance on the concept of equality and held that with respect to distribution pursuant to a resolution plan, no distinction could be drawn between creditors.

Now, Section 30(2) (b) stipulates that all dissenting financial creditors will receive the liquidation value on priority over other financial creditors, under the resolution plan. Further, operational creditors will be entitled to receive either the i) liquidation value; or ii) due amount under the resolution plan, whichever is higher, if payment is made as per the waterfall set out in Section 53

In respect of "equality for all" approach, Essar Steel observed that this would incentivise secured financial creditors to vote in favour of liquidation. It was explained that the equality principle does not mean un-equals should be treated equally since that would destroy the very objective of IBC, i.e. resolution of stressed assets. Instead, the requirement is that equitable treatment be accorded to each creditor, depending upon their class. Secured or unsecured, financial or operational. In the course of this discussion, the Supreme Court reiterated that the Creditors Committee may, when taking a commercial decision, decide on differential payment to different classes of creditors and negotiate for better or different term, which may involve differences in distribution of amounts between different classes of creditors.

Challenges to the Resolution Process

During the early days of the IBC, the resolution process was challenged at various stages, beginning with invitation of expression of interest, approval of a resolution plan by the Creditors Committee and the NCLT. For instance, in the case of *Bhushan Power*[20], the NCLAT allowed one of the resolution applicants to submit its bid subsequent to the last date specified in the process document and the Creditors Committee was directed to consider the same.

Another aspect was Section 29A, the wide sweep of disqualifications led to myriad litigations and resultant delays in the resolution process in a time-bound manner. The Supreme Court in Essar laid down the following key principles:

1. Section 29A of IBC is a "*see through provision*", ignoring the corporate veil so as to arrive at persons who are actually in 'control', whether jointly, or in concert, with other persons.

20 Punjab National Bank v. Bhushan Power & Steel Limited (Order dated April 23, 2018).

2. The expression '*management*' refers to the *de jure* management of a CD, which would ordinarily vest with the Board, and would include, in accordance with the definitions of manager, managing director and officer, as specified under the provisions of Companies Act, 2013 and the expression 'control', suggests positive or proactive control, as opposed to mere negative or reactive control, under the provisions of Sections 29A(c) and 29A(g).

The Supreme Court also held that a resolution applicant has no vested right that its resolution plan be considered by the Creditors Committee, in light of which, no challenge can be preferred before the NCLT by a resolution applicant, at a stage where (a) the resolution plan has been turned down by the Insolvency Professional for non-compliance of Section 30(2) of the IBC; or (b) a resolution plan is not approved by the requisite majority of the Creditors Committee after considering the feasibility and viability of the resolution plan. A challenge can only be preferred once a resolution plan is approved by the NCLT, before the NCLAT and thereafter the Supreme Court.

Fresh Slate start

Settling a significant legal issue, the judgement in Essar Steel expressly allows the resolution professional to, in respect of claims which are not capable of being quantified (e.g., disputed claims), admit the same at a notional value. Stressing on the desire of resolution applicants to acquire a CD with a "fresh slate", the Supreme Court noted that even "undecided" claims can be dealt with, in a resolution plan and the creditors cannot thereafter re-agitate the claim as the potential resolution applicant cannot suddenly be faced with such claims after taking over the business of the CD.

Ring-fencing from criminal proceedings against erstwhile management

In recent past, uncertainty regarding the continuation and attachment of the CD's criminal liability against the successful resolution applicant has increased. In view of the same, the Amendment Bill provides that the liability of the CD with respect to offences committed before CIRP shall cease and actions against CD's property (covered under the resolution plan) shall be barred, provided that there is a change in control or management of CD and the potential resolution applicant is not connected with the CD or involved in abetting or commissioning of the offence in question.

The Future ahead

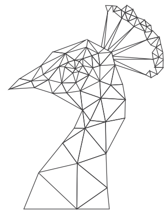
Group Insolvency

Currently, the IBC does not provide for simultaneous insolvency of group companies. An entity-wise approach with different members of an interconnected group undergoing separate proceedings is bound to be value destructive on account of information asymmetry and potential lack of coordination among different creditors and NCLT benches thereby also causing delay. The IBBI has, on January 17, 2019 constituted, a working group to recommend a comprehensive regulatory framework to, facilitate insolvency resolution and liquidation of debtors in a corporate group under the IBC. While a statutory framework is awaited, the NCLT[21] and the NCLAT[22] have in some instances directed consolidation of proceedings laying down broad principles which call for and govern the merger of insolvency processes.

Introduction of pre-packaged insolvency resolution

Currently, under the IBC, running a 'bid-like' process is mandatory to get any resolution plan approved. There is a need to propose a CIRP where groundwork for resolution can be undertaken by the insolvency professional confidentially, prior to the commencement of the CIRP. However, it will be binding on all stakeholders through a quick court approval akin to a 'pre-pack' process common in many other jurisdictions.

21 In the matter of Videocon Industries (NCLT Mumbai Bench, Order dated August 8, 2019).
22 In the matter of Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd. (NCLAT,Order dated September 20, 2019).



Cross –Border Insolvency

The IBC currently has provisions relating to cross-border insolvency, but these are not adequate to effectively deal with cases where the CD has a global footprint. The Ministry of Corporate Affairs in India had set up an Insolvency Law Committee on November 16, 2017, to make recommendations to the Government of India in relation to adoption of the UNCITRAL Model Law on Cross Border Insolvency, 1997. The committee submitted its Report in October 2018. The committee decided to attempt to provide a comprehensive framework for this purpose, based on the UNCITRAL Model Law on Cross-Border Insolvency. The Government of India proposes to bring about the changes by amending the IBC and adding a chapter on cross-border insolvency, a report said. The amended law is aimed at giving comfort to foreign investors in India and efficient handling of assets situated in India and outside India.

This lacunae became evident in the case of Jet Airways (**Jet**), when the Dutch Court passed an order of insolvency of Jet on a petition of creditors in Netherlands and appointed a Trustee. The Mumbai Bench of the NCLT, when directing the admission of petition filed under the IBC against Jet, directed the interim-resolution professional to ignore the order of the Dutch Court. However, being cognizant of the need of a sustainable insolvency resolution outcome for Jet, the NCLAT advised exploration of a framework of cooperation. After extensive negotiations, a Cross Border Insolvency Protocol (**Protocol**), based on the principles of UNCITRAL Cross Border Insolvency Model Law, was agreed upon. The Protocol was approved by the NCLAT and is a significant milestone in this area of law.[23]

Regime for Financial Service Providers

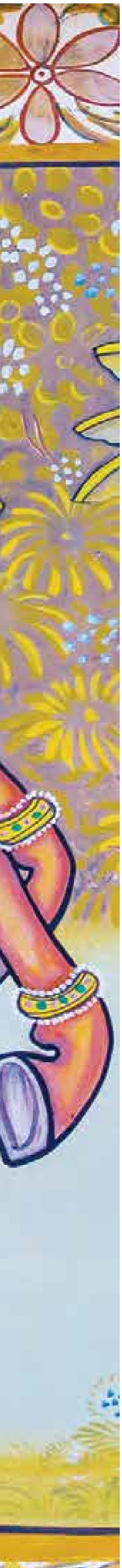
Considering the special status of financial service providers (**FSPs**), the Central Government enjoys the power to notify FSPs for the purposes of prescribing applicability of the IBC.[24] At present, non-banking financial companies with asset size greater than INR 5 billion are governed by the IBC,modified by the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (**FSP Rules**).[25]

In addition to the framework applicable to other entities, this regime envisages involvement of the appropriate regulator (i.e., RBI for such entities), which alone can initiate CIRP and has to be heard at the stage of resolution and liquidation. In case of FSPs, the resolution applicant has to provide a statement as to how it intends to satisfy the requirements applicable to the FSP's business and is also subject to the test of "*fit and proper*" criteria applied by the regulator.

Individual Insolvency

Part III of the IBC envisages insolvency resolution of three categories of entities, namely, personal guarantors to CDs, partnership firms and proprietorship firms, and other individuals. Each category is unique and needs a separate dispensation for resolution of its insolvency. Given the complexities involved, an appropriate phasing and sequencing of implementation of individual insolvency is considered essential, in sync with the legislative intention. The IBBI plans to implement the regime governing individual insolvency in a phased manner. In completion of the first phase, the provisions of the IBC dealing with insolvency and bankruptcy of personal guarantors to CDs have already been implemented. The provisions of the IBC, dealing with insolvency of partnership and proprietorship firms, may be implemented in the second phase. In the third phase, the provisions of the IBC dealing with insolvency of other individuals may be implemented.

23 Punjab National Bank v. Bhushan Power & Steel Limited (Order dated April 23, 2018).
24 Section 227 of the IBC.
25 Ministry of Corporate Affairs, Notification dated 18th November 2019 under Section 227 of the Insolvency. and Bankruptcy Code, 2016, available at https://ibbi.gov.in//uploads/legalframwork/7bcd2585a9f75b9074febe216de5a3c1.pdf.



A NEW REGIME FOR FOREIGN PORTFOLIO INVESTORS

The Securities and Exchange Board of India (**SEBI**) has notified the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019 (**2019 Regulations**) on September 23, 2019, which supersedes the SEBI (Foreign Portfolio Investors) Regulations, 2014 (**2014 Regulations**). This was followed by a consolidated operational guideline issued in November this year, for Foreign Portfolio Investors (**FPIs**) and Designated Depository Participants (**DDPs**) (**Operational Guidelines**) to ensure efficient transition from the previous regime.

The new regime has come on the back of an expansive review undertaken in the past year. On May 24, 2019, the SEBI had released a report on redrafting the 2014 Regulations by the Working Group constituted under the chairmanship of HR Khan for public comments (**HR Khan Report**). The HR Khan Report categorised recommendations to liberalise the FPI regime into four heads, viz.:

(i) ease of registration;
(ii) simplification of know your client (**KYC**) requirements
(iii) revision of investment limits and
(iii) other miscellaneous liberalisations.

Subsequently, SEBI has issued revised norms for FPIs in terms of the 2019 Regulations, with a number of changes incorporated from the HR Khan Report, also consolidating the extensive guidance and requirements prescribed by it, vide amendments to the 2014 Regulations, as well as circulars and FAQs issued thereunder.

The Operational Guidelines provide guidance with respect to, inter alia, simplification of registration procedures, enhanced KYC requirements, specified investment conditions, guidelines for the issuance of Offshore Derivative Instruments (**ODIs**) and participation/functioning of Eligible Foreign Investors (**EFIs**) in International Financial Services Centre (**IFSC**).

Key changes as per the new FPI regime are detailed below:

Simplified registration process and enhanced KYC norms: A welcome move: A significant change is the re-categorisation of FPIs into two categories, instead of three categories as specified under the 2014 Regulations, after reviewing their risk profile.

The Operational Guidelines specify the process of re-categorisation of all existing FPIs, and allow DDPs time up to February 6, 2019, to accept the in–transit FPI applications received under the 2014 Regulations. Guidance for determination of specific categories of entities such as banks, insurance/ reinsurance entity/ pension fund/entities investing on behalf of clients as "*appropriately regulated*" has been elucidated.

Under the 2014 Regulations, in Multiple Investment Manager (**MIM**) structures, the same legal entity was required to obtain multiple registrations. Under the new FPI regime, an entity engaging a MIM for managing its investments can obtain multiple FPI registrations under the same PAN. However, these investments will remain clubbed for the purposes of monitoring of investment limits.

FPIs with segregated portfolios are required to provide Beneficial Owners (**BO**) declaration for each fund/sub-fund/share class/equivalent structure that invests in India.

It is pertinent to note that an applicant or an existing FPI that does not meet the above requirements will have to comply *within a period of two years from the date of registration or by December 31, 2020,* whichever is later.

Adherence of Investment conditions/ restrictions by FPIs: In the new FPI regime, FPIs shall be permitted to request for '*Off Market*' transfer of assets between FPIs operating under MIM structure to their DDPs, and to sell off market unlisted, illiquid, suspended and delisted shares in accordance with the applicable pricing guidelines under foreign investment rules. FPIs shall also be permitted to acquire "*to be listed*" shares pursuant to initial public offers, follow-on public offers, rights issue, private placement or shares received through involuntary corporate actions, including schemes of merger/demerger.

With respect to corporate debt securities, FPIs will also have to comply with the terms, conditions or directions, specified or issued by the Reserve Bank of India (**RBI**). FPIs are eligible to invest in corporate debt issues, which are "*to be listed*" without any end-use restriction as applicable to unlisted debt securities. FPIs are permitted to trade in the currency derivatives segment of stock exchanges, subject to prescribed terms and conditions.

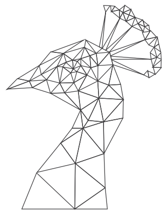
If the available headroom is 3% or less than 3% of the aggregate NRI investment limit/ aggregate FPI investment limit, a *red flag* shall be activated for that company. It is important to note that a *proportionate disinvestment methodology* shall be followed for disinvestment of excess shares so as to bring the foreign investment in a company within permissible limits.

Modifications to the ODI regime: While SEBI has, on the one hand, adopted a liberal approach by allowing the issuance of ODIs under the FPI regime against all securities, including unlisted equity securities; on the other hand, it has narrowed the scope of subscribers to the ODIs. The 2019 Regulations stipulate that only Category I FPIs shall be allowed to issue ODIs, and such ODIs shall be permitted to be subscribed only by persons eligible to seek registration as Category I FPIs with SEBI.

It is clarified that FPIs shall not be allowed to issue ODIs referencing derivatives and that no FPI shall be allowed to hedge their ODIs with derivative positions on Indian stock exchanges. ODIs issuing FPI, which hedges its ODI only by investing in securities must *segregate its ODI and proprietary derivative investments* through separate FPI registrations, under the same PAN.

An important point to be noted is that synthetic short activities, where ODIs are issued, which has the effect of short sale in the Indian securities, continue to be prohibited for FPIs.

ODIs issuing FPIs shall maintain with them, at all times, the KYC documents regarding ODI subscribers, and shall identify and verify the BOs in



the ODI subscriber entities, as applicable to FPIs.

It must be noted that, *no fresh derivative positions,* which are not in compliance with the above requirements shall be allowed henceforth. FPIs have time up to February 5, 2020, to comply with these requirements.

IFSC: a Route worth exploring: IUnder the 2019 Regulations, funds set up in an IFSC also qualify to be registered as FPIs. The Operational Guidelines have clearly stated that EFIs operating in IFSC shall not be treated as entities regulated by SEBI. Further, SEBI registered FPIs, proposing to operate in IFSC, shall be permitted, without undergoing any additional documentation and/or prior approval process.

It is important to note that FPIs presently operating in Indian securities market and proposing to operate in IFSC also, shall be required to ensure clear segregation of funds and securities.

Setting up of FPIs in the IFSC may prove to be an attractive prospect for investment managers from non-FATF member countries interested in investing in India through the FPI route, to avail tax benefits accorded to entities in IFSC.

FPI Rules 2.0: Disruption or Innovation?

While most of the changes are welcome clean-ups and streamlining and simplification of the laws are always welcome, the impact of these modifications will also have to be assessed in light of the existing market structures.

Regulated funds that are not from a FATF member country and whose investment manager is not registered in India as a Category I FPI will have to examine their business strategy and operating models, due to restriction on ODIs.

Another pertinent point is that under the FPI route, there is increased participation by ETFs, which are listed offerings with a continuously changing investor base. It would be practically impossible for such ETFs to ascertain their BOs based on their controlling ownership interest as prescribed under the PMLA Rules, since the exemption thereunder does not cover ETFs that are foreign entities. An exemption to listed companies incorporated outside India is desirable.

We also await clarity on the road ahead from the tax department. If the current tax structure endures the changes to the FPI regime, Category II FPIs will be on the same footing as Category I FPIs in relation to indirect transfer tax benefits. With the transition, investment funds set up in the non-FATF jurisdiction that do not qualify for the Category I FPI licence may see a significant challenge in subscribing to ODIs.

In the event of a breach of aggregate limits or sectoral caps, foreign investors shall be liable to disinvest the excess holding within five trading days. Such excess should be sold to domestic investors.

Conclusion

Historically, the basis of portfolio investments has been FEMA laws and the relevant FDI/FII related regulations. As a universal model of portfolio investments into India, the FPI regime significantly changes the landscape and brings in several efficiencies in market entry as well as in the investment process. The changes to be brought into FEMA laws is more a subject of Government policy, rather than that of the central bank.

The Operational Guidelines, issued with the intent to facilitate effective implementation of the 2019 Regulations, introduces significant changes to the FPI regulatory framework, primarily aimed at easing the registration process, removing redundant regulatory conditions and reducing compliance requirements. The 2019 Regulations seek to simplify FPI investments into India, towards giving a much-needed boost to FPI participation in the market, which has seen a significant drop in recent times. SEBI has taken positive steps towards making the FPI regime less cumbersome and complicated, making it more attractive and accessible as an investment route.

GOVERNANCE SPIRIT IN LODR REGULATIONS: ARE WINDS OF CHANGE GAINING A STRONGHOLD?

"Corporate Governance is a means, not an end."

– Marty Lipton (Founding Partner, Wachtell, Lipton, Rosen & Katz)

Introduction

The evolution of corporate governance norms in India over the last two decades has witnessed significant progress after the enactment of the Companies Act, 2013, which introduced several measures for protection of minority shareholders as well as the concept of shareholders' approval on a "*majority of minority*" basis. Specifically for the entities in the listed space, the foundation for the current provisions on corporate governance was laid down in the year 2014 by virtue of the amendments to Clause 49 of the listing agreement between listed companies and stock exchanges. Subsequently, the introduction of the Securities and Exchange Board of India (Listing Obligations and Disclo sure Requirements) Regulations, 2015 (the **LODR Regulations**) provided a comprehensive framework, widening the scope of responsibilities and accountability of listed companies (especially their board of directors (the **Board**)).

The amendments and additions to the LODR Regulations during the last two years were in the wake of increased regulatory focus on recalibrating corporate governance in the Indian listed space (specifically equity listed entities), including by way of constituting the Committee on Corporate Governance (the **CG Committee**) and considering the recommendations made in its report dated October 5, 2017. These amendments may have been accelerated by the incidents of corporate governance failures, questionable promoter conduct, boardroom battles, alleged diversion of funds from listed entities, conflict of interest issues, whistle bloweer complaints and non-disclosure/insufficient disclousre of information which came to light since the introduction of the LODR Regulations. The rise of proxy advisory firms, activist shareholders and media focus on recent scandals that befell corporate India have also been key catalysts in driving regulatory reforms.

This article explores the governance reforms ushered in by the LODR Regulations and the impact of substantive changes thereto in the lives of the Indian companies.

The Over-Arching Principles

A key feature of the LODR Regulations is the balanced mix of principle based and prescriptive regulations. This is critical as an overly prescriptive governance regime is bound to increase cost of compliance and may lead to "tick-the-box" approach for compliance by listed entities. Chapter II (Regulation 4) of the LODR Regulations sets out the principles that govern disclosures and other obligations of listed entities. The principles clearly set out that the disclosures by the listed entity have to be adequate, accurate, explicit, timely and should be presented in a simple language. The listed entity has to be follow its disclosure obligations in letter and spirit, taking into consideration the interest of all shareholders. In addition, Chapter IV of the LODR Regulations has been specifically identified as the chapter containing corporate governance provisions, which have to be implemented, keeping in mind the broad principles specified in Chapter II, such as: (i) protect and faciliate rights of shareholders on effective participation; (ii) ensure equitable treatment of all shareholders; (iii) recognise rights of stakeholders in corporate governance; (iv) timely and accurate disclosure and transparency; and (v) detailed principles on responsibilities of the Board. In fact, it is clearly specified that in case of any ambiguity or incongruity between the principles and the relevant regulations, the principles specified in Chapter II (Regulation 4) will prevail. As the regulator of the Indian securities market, i.e the Securities and Exchange Borad of India (**SEBI**) sharpens its focus on enforcement action in cases of corporate governance failures, it is likely to place reliance on these broad principles to pre-empt and reject any technical defences to violation of the regulations.

Perfecting the Board Composition and Board Dynamics

Indian laws have vested the Board with the primary responsibility of decision making and accountability to various stakeholders. As such, getting the structure and composition of the Board right has been crucial. On this front, the regulatory attention in terms of LODR Regulations (including by way of the recent amendments) has been on fixing the minimum Board size[1], providing for optimal combination of executive and non-executive directors[2], setting the minimum number of independent directors on the Board (**IDs**)[3] and gender diversity on the Board [4]. Concomitant with revamping the Board composition, the regulatory reforms are aimed at ensuring that the directors have the necessary skill–set and expertise[5], they devote adequate time in discharging their responsibilities[6] and shareholders' endorsement is taken for non executive directors appointed or continuing beyond the age of 75 years. Specifically, in the case of IDs, gradual reforms have been aimed at strengthening their eligibility criteria to ensure the "spirit of independence" by introducing additional objective criteria and subjective and qualitative assessment of the independence by Board[7] and such ID herself.

One of the key changes recommended by

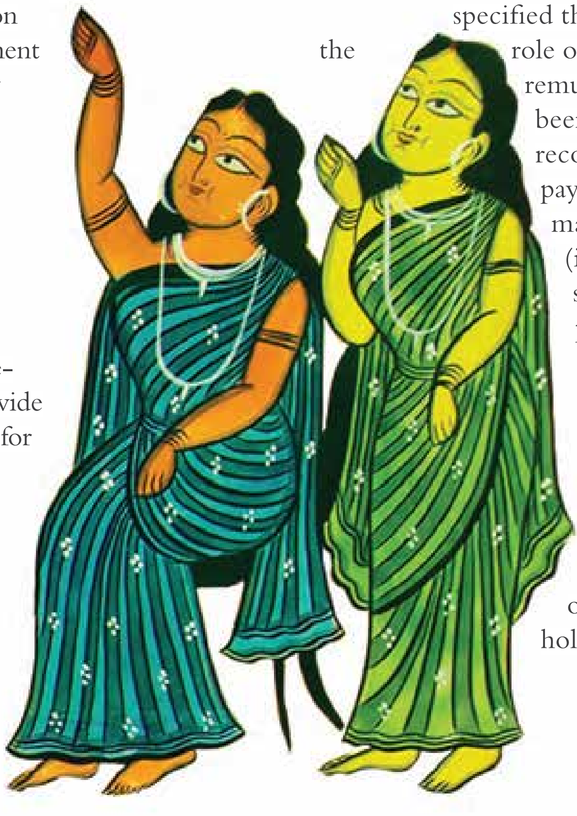
1 Regulation 17(1)(c) of the LODR Regulations requires increase in the minimum number of directors from 3 to 6 in case of top 1,000 listed entities (w.e.f. April 1, 2019) followed by top 2,000 listed entities (w.e.f.April 1, 2020).
2 Regulation17(1)(a) of the LODR Regulations.
3 Regulation17(1)(b) of the LODR Regulations.
4 Regulation 17(1)(a) of the LODR Regulations requires at least 1 independent woman director in top 500 listed entities (w.e.f. April 1, 2019) followed by top 1,000 listed entities (w.e.f. April 1, 2020).
5 Regulation 34(3) of the LODR Regulations and Schedule V, Part C(2)(h) mandates disclosure of the required and available skills and expertise of the Board members (w.e.f. March 31, 2019), as well as names of the relevant directors (w.e.f. March 31, 2020).
6 For instance, Regulation 17A(1) of the LODR Regulations requires directorships held in equity listed companies to be limited to 8 (w.e.f. April 1, 2019) followed by 7 (w.e.f. April 1, 2020).
7 Continuous subjective assessments have been introduced in Regulation 25(8) of the LODR Regulations by requiring (a) a declaration from the ID on his/her independence, based on self-assessment, which is required to cover the ID not being aware of any circumstance that could impair or impact his ability to discharge his duties with objective independent judgements, and (b) a confirmation of the veracity of such declaration by the Board.

the, CG Committee based on the global best practices and subsequently introduced in LODR Regulations was separating the roles of Chairman and MD/CEO in case of top 500 listed companies (excluding companies which do not have an identifiable promoter) and that the Chairman shall be a non-executive director who is not be related to the MD/CEO. This is aimed at providing a better and more balanced governance structure by enabling better and more effective supervision of the management, reducing excessive concentration of authority on a single individual and creating a Board environment that is more egalitarian and conducive to debate. Given the extent of impact and changes that this amendment will require, this requirement was to come into effect from April 1, 2020, which period has recently been extended further by 2 years by SEBI.

As flag-bearers of corporate governance reforms, the proxy advisory firms, while issuing their recommendation in relation to voting on proposals for appointment/re-appointment to a joint Chairman and MD position, have been highlighting it as a governance concern, even for entities which are not in the list of top 500 listed companies. In view of this, it is likely that these reforms may trickle down to companies for which compliance with this requirement is not compulsory. It will be interesting to see whether the mere separation of chairmanship and management achieves the desired regulatory outcomes.

Expanding the role of Board and Committees

Over the years, the legal framework has been tweaked to provide for mandatory Board approval for ever-expanding scope of matters, oversight over management, codification of duties of directors, responsibilities towards various stakeholders. In particular, the provisions of LODR Regulations are indicative that the regulator sees the Board as the lynchpin in the governance discourse. As mentioned above, the LODR Regulations provide detailed principles on responsibilities of the Board. Unsurprisingly, these are principle based and subjective and included in Chapter II. The LODR Regulations also provide for a list of minimum information that has to be placed before the Board. In view of the recent international trends in corporate governance, the LODR Regulations now require top 500 listed entities to disclose the initiatives taken by them from an environmental, social and governance perspective as part of business responsibility report issued every year. SEBI has recently decided to extend this requirement to top 1000 listed companies.



The committees of the Board, functioning under the overall supervision of the Board, are seen as an extension of the Board with the added advantage of more focussed and expert analysis of critical issues pertaining to audit, remuneration and risk management. With the increased emphasis on governance, the role of these committees has seen and is expected to see gradual expansion. For instance, audit committees have recently been vested with duties to oversee fund-usage by subsidiaries of listed companies (subject to certain specified thresholds). Similarly, the role of the nomination and remuneration committee has been expanded to include recommending remuneration payable to additional senior management employees (including the company secretary and CFO and persons reporting to the CEO / managing director/ whole time directors). The role of stakeholders relationship committee has been increased to cover various aspects of interest of security holders including, review of measures taken for effective exercise of voting rights by shareholders.

The increasing responsibility and accountability of the Board and its committees is also indicative of the regulatory sentiment that the buck has to stop with someone. Recent judicial pronouncements also indicate that the courts are taking into consideration how proactive the Board has been once they become aware of irregularities[8]. While the regulatory bodies deal with the recent instances of corporate governance failures, it would be interesting to see how liabilities are assigned and enforced.

Regulating Related Party Transactions

The regulation of related party transactions remains a challenge owing to the potential for abuse in the Indian corporate space that consists of numerous closely held companies that are a part of large business groups or controlled by common stakeholders. As such, there have been continuous reforms to further strengthen the existing legal framework including the disclosure regime in relation to related party transactions.

The amendments in the LODR Regulations also tightened the norms further by including all promoter related entities holding 20% or more in the listed entity as related parties, and accordingly ensuring that transactions with these entities will have to be in compliance with Regulation 23 of the LODR Regulations. Disclosure of all transactions with promoter/ promoter group entities (whether related parties or not) holding 10% or more shareholding is also required.

Greater scrutiny by shareholders of certain RPTs is also expected, by virtue of the requirement to obtain shareholder approval, in case of brand/ royalty payments to related parties (exceeding 5% of consolidated turnover of the listed entity), remuneration (above the specified thresholds) payable to executive directors who are promoters or members of promoter group, and to non-executive directors individually. The initial threshold proposed by the regulators was 2%, but it saw a lot of market resistance especially from multi-national companies (as they benefit from global brands, technology, and other product developments).

Down-Streaming Governance

Given that the investors value the entire business structure of a listed company (including subsidiaries, step-down subsidiaries, associates and joint ventures), the LODR Regulations provide for better transparency and governance at levels of downstream investee entities of the listed entity, thereby improving the monitoring of the listed entity at a consolidated level.

With this in mind, the LODR Regulations were amended to reduce the threshold for determination of material subsidiary from 20% to 10% (applicable in all cases other than for appointment of ID on the Board of an unlisted material subsidiary). In addition to the listed entity, the material unlisted Indian subsidiaries are also required to undertake a secretarial audit. Further, the statutory auditor of a listed entity is required to undertake a limited review of the audit of all the entities/ companies whose accounts are to be consolidated with the listed company as per Accounting Standard 21.

Towards Greater Transparency

While a company is subject to extensive disclosures at the time of listing, the LODR Regulations ensure that the quality and accessibility of disclosures by a company post listing enables continuity in parity of information across all stakeholders. This is by way of requiring listed companies to maintain a specific section on their website dedicated to dissemination of basic as well as substantial information regarding the listed entity to investors with continuous updates in

8 For instance various decisions of the National Company Law Tribunal and The National Company Law Appellate Tribunal in Union of India, Ministry of Corporate Affairs v. Gitanjali Gems Ltd. contain observations regarding the duties of the Board in relation to financial matters and their actions upon becoming aware of suspected irregularities.

a timely manner. The LODR Regulations also mandate (i) event based disclosures, such as prior intimations of the Board meetings to be held to consider certain fund raisings, disclosures of material events and information in a time bound manner, (ii) periodic disclosures such as shareholding pattern, report on corporate governance, financial results and disclosures in annual report. The emphasis on timely dissemination of information is clear from the fact that there are timelines prescribed for most disclosures and in fact, outcome of certain Board deliberations is to be disclosed within 30 minutes of Board meetings. The amendment, based on the CG Committee recommendation, requiring 'speaking' resignation by IDs with a specific confirmation that there are no other material reasons for the resignations other than those disclosed, is a ready example of the focus on quality of disclosure under the LODR Regulations. More recently, SEBI has mandated listed companies to make disclousure of any defaults on loans from bank, continuning for 30 days, within 24 hours from such 30th day.

Conclusion

Across the globe, there has been a paradigm shift in assessing performance of companies in view of the move from shareholder model to stakeholder model of governance. As such, the performance assessment no longer remains limited to achievement of financial targets but includes actively assessing and tracking step by step progress in sustainable development and governance (including by way of governance ratings/scorecards). India is a part of this phenomenon and laws relating to good corporate governance practices have come a long way. India has also seen increasing deliberations on governance related issues, both inside and outside the Board rooms. As Indian markets and regulators mature, there is no reason to believe that the governance norms will be diluted and it is more likely that we shall see the regulator proactively plugging the gaps in areas that have been overlooked till now and entities adapting to the revised corporate governance measures.

RECENT CHANGES TO THE DEPOSITORY RECEIPTS REGIME

Introduction

Depository receipts (**DRs**) are foreign currency denominated instruments, issued by a foreign depository, backed by the securities of an issuer which are issued or transferred to the foreign depository and are typically listed on an international exchange. The issue of DRs allows companies to access alternative and larger pools of capital, including industry-specific investor classes that have institutional sectoral expertise, as well as investors with high risk appetite. This, in turn, could provide better valuations for companies as well as benefit shareholders looking for exits. DR issuances also increase visibility of Indian companies in the international markets.

In the early years of liberalisation and up to the time SEBI permitted qualified institutions placement (**QIPs**) in 2006, DR issuances formed a significant and important part of foreign investment into the Indian equity markets.

Initially, the issue of DRs were regulated by the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 (**1993 Scheme**), which was repealed (except for the issue of FCCBs) by the Ministry of Finance, Government of India, by notifying the Depository Receipts Scheme, 2014 in October 2014 (**2014 Scheme**).

The 2014 Scheme widened the scope of depository receipts, allowing both listed and unlisted companies to undertake issuance of DRs and permitted DRs to be issued on the back of securities as defined under the Securities Contracts (Regulation) Act, 1956 (**SCRA**) and

> The listed companies in India will now be able to consider Depository Receipts as a viable option for raising capital

not limited only to equity shares. However, since notification of the 2014 Scheme, there have been very few DR issuances due to a variety of reasons, including regulatory uncertainty with respect to operational guidelines applicable to depositories and custodians in relation to DRs and compliance concerns under the anti-money laundering legislation.

The SEBI has recently introduced a framework for the issuance of DRs by companies listed or to be listed in India (**DR Framework**), by way of its circulars dated October 10, 2019 and November 28, 2019 which provides clarity with respect to certain aspects relating to the issue of DRs. The DR Framework issued by SEBI sets out requirements for DR issuances, in addition to requirements under the Companies Act, 2013 and the rules thereunder, the 2014 Scheme and the foreign exchange regulations.

Salient features of the DR Framework
The DR Framework has provided clarity and incremental conditions than those prescribed under the 2014 Scheme. Certain significant additions are set out below:

- **Eligibility requirements:** The DR Framework provides for customary eligibility requirements for issuers, including that the listed company should be in compliance with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and the listed company and associated persons (such as the promoter) should not trigger regulatory prohibitions such as being debarred from accessing capital markets. Further, promoters or directors of the listed company should not be a promoter or director of any other company that is debarred from accessing the capital market, the issuer or any of its promoters or directors should not be a wilful defaulter and its promoters or directors should not be a fugitive economic offender.

- **Underlying securities:** The DR Framework limits the regulations to the issue of DRs by listed companies and allows listed companies to issue equity shares and debt securities, which are listed in India as underlying for DRs. The 2014 Scheme had permitted DRs to be issued on the back of any "security" as defined under the SCRA. In relation to the list of issuers, which can undertake issue of DRs, companies undertaking a domestic initial public offering (**IPO**) have been permitted to simultaneously set up a DR programme. However, allotment pursuant to such DR issuance can be undertaken only upon receipt of trading approval from the stock exchanges for the IPO.

- **Permissible jurisdictions:** Whilst the 2014 Scheme permitted listing of DRs in any foreign jurisdiction, which is a member of the Financial Action Task Force (FATF) on money laundering and where the regulator of securities of that market is a member of the International Organisation of Securities Commissions and had included a list of 34 jurisdictions, the Central Government (under the anti money laundering legislation) and the SEBI have notified a truncated list of permissible jurisdictions and stock exchanges, respectively, for DR issuances, which include (i) NASDAQ and NYSE in the United States of America, (ii) Tokyo Stock Exchange in Japan, (iii) Korea Exchange Inc. in South Korea, (iv) London Stock Exchange in United Kingdom (excluding British Overseas Territories), (v) Euronext Paris in France, (vi) Frankfurt Stock Exchange in Germany, (vii) Toronto Stock Exchange in Canada and (viii) India International Exchange and NSE International Exchange in International Financial Services Centre in India.

- **Foreign Investment Limits and Minimum Public Shareholding:** Whilst the DR issuances have always been subject to foreign investment limits, the DR Framework requires shareholders to specifically adopt limits up to which DRs can be issued on both primary and secondary basis. Further, the listed company needs to ensure that the maximum number of shares that can be issued/transferred to

the foreign depository, pursuant to the issue of DRs, should not breach the minimum public shareholding norms in India, after excluding the permissible securities held by the depository.

- **Beneficial ownership:** Indian residents and non-resident Indians (**NRIs**) are not permitted to hold DRs or be their beneficial owners and the onus of ensuring compliance has been placed on the permissible holder (including its beneficial owner). By way of a recent amendment to the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (**PMLR Amendment**), the Central Government has clarified the long-standing issue relating to DRs and allowed the identification of beneficial owners to be governed by the norms of the jurisdiction where the DRs will be listed, i.e. a foreign investor can acquire a DR based on the KYC checks it has undergone with the notified international exchange. Earlier, compliance with respect to provisions related to beneficial ownership in respect of DR holders under the under the anti money laundering legislation, had been a cause for concern.

- **Filing of offer document with Indian regulators:** The DR offer document is now required to be filed by an intermediary with the SEBI and the stock exchanges for their

review at the time of initial listing of DRs. Whilst SEBI and the stock exchanges are to provide comments within prescribed timelines, the review time period would need to be factored in the transaction timeline.

- **Restricted DR programmes:** The DR listing is required to meet the highest level of standards for Foreign issuers DR programmes (for example Level III ADR programme on NASDAQ or NYSE),w under the DR Framework and expected to comply with the highest level of disclosure.

- **Voting:** While all DR holders are allowed to vote through the foreign depository, discretion provided to foreign depository under the 2014 Scheme to vote on such matters (irrespective of instructions received from DR holders) has been taken away under the DR Framework. Additionally, management proxies are not permitted under the DR Framework and Foreign depositories must exercise voting rights, if any, only pursuant to instruction from the DR holder.

- **Pricing:** The minimum price for issue or transfer of securities is the price applicable to the corresponding mode of issue to domestic investors (earlier listed companies could price based on QIP pricing i.e., average of weekly high and low prices of the underlying shares for two weeks). Given that the SEBI has prescribed different pricing formula for primary issuances based on the types of offerings (preferential issue, QIP and public offerings), due consideration will be required to identify the price that would apply for a particular DR issuance.

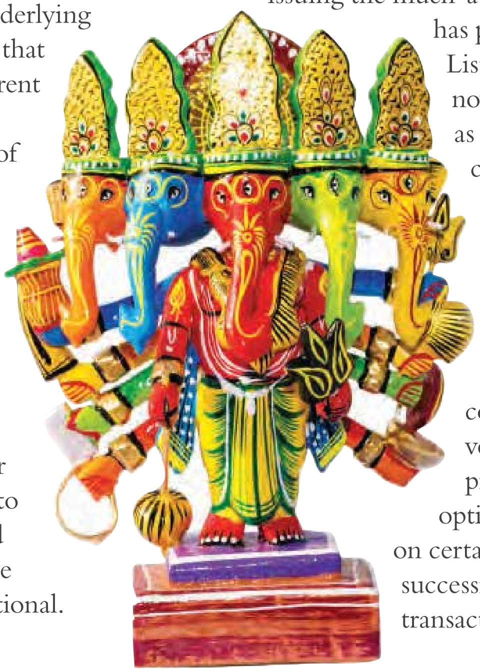
- **Fungibility:** Whilst fungibility is permitted under the DR Framework, subject to the limits set out above, listed companies may need to devise a procedure to make it operational. Further, pricing implications under the DR Framework are required to be considered.

- **Existing DR programmes:** Whilst the DR Framework is applicable only to DR issuances by listed companies after October 10, 2019, existing programmes should consider complying with the terms of the DR Framework such as obtaining shareholders' approval for DR headroom to permit fungibility. Existing programmes must also evaluate their DR voting structure for compliance with the DR Framework, before undertaking further issuances.

- **Obligations of Depository and Custodian:** The DR Framework has prescribed various obligations on the Depository and Custodian, including developing a system for monitoring of aggregate holding of DRs, including ensuring that investment by FPIs through the same investor group do not exceed foreign investment limits, maintaining records in respect of all transactions in the nature of issue and cancellation of depository receipts, for the purpose of monitoring limits.

Conclusion

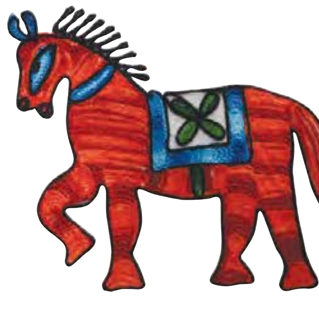
SEBI has taken a step in the right direction by issuing the much-awaited DR Framework and has provided necessary clarity. Listed companies in India will now be able to consider DRs as a viable option for raising capital or to provide an exit to existing shareholders. The simultaneous IPO and DR issuance route provided under the DR Framework would allow unlisted companies, including technology focussed companies, to access specific investor groups outside India and provide a potential structuring option. We expect further clarity on certain issues such as pricing with successful completion of some DR transactions.



LAWS AGAINST INSIDER TRADING IN INDIA

Introduction

It would not be an exaggeration to state that cases involving insider trading (or allegations relating to the same) receive a large proportion of public attention as compared to other matters concerning conduct of securities market participants. Numerous books and movies have been written and produced to show the insidious machinations involved in insider trading, sometimes with a large dose of literary license! Maintaining a level playing field in the securities market is the very essence of laws seeking to prohibit insider trading and regulators seek to ensure uniform dissemination of information to prevent information asymmetry in the market place. Developments in technology, information flow and access to markets have not only enabled evolution of new market structures but also engendered ways in which market manipulation occurs. In response, jurisprudence has also evolved to bolster insider trading laws, along with the methods used for detecting, investigating and carrying out enforcement against insider trading. As an example, the Securities and Exchange Board of India (**SEBI**) order in the matter of *Deep Industries*[1], where the regulator relied on social media connections, specifically, interactions on Facebook, to bring home the charge of 'insider trading', demonstrates how the legal and evidentiary landscape is changing to remain relevant in the current environment.



1 Order of SEBI Whole Time Member in the matter of insider trading in the scrip of Deep Industries Limited dated April 16, 2018.

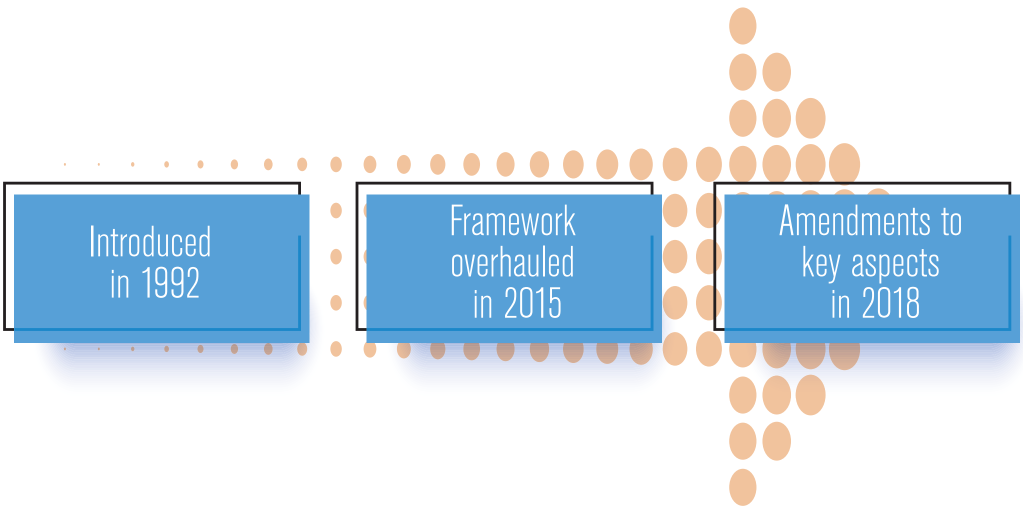
In this article we explore the basic principles of regulations introduced by the Indian securities market regulator, viz., SEBI to prohibit insider trading and the manner of evolution of the legal framework.

Overview of Legal Framework

To ensure information symmetry and integrity of price discovery mechanism in the securities market, the insider trading regime was crystallised by **SEBI** in the form of SEBI (Prohibition of Insider Trading) Regulations, 1992 (**1992 Regulations**). SEBI had to amend the 1992 Regulations multiple times to rectify lacunae and loopholes and after a couple of decades, a need was felt for an overhaul of the entire insider trading laws.

With that intent, a 'high level committee' was constituted by SEBI under the Chairmanship of Justice (Shri.) N.K. Sodhi (**Sodhi Committee**). In 2013, the Sodhi Committee came out with a range of recommendations (being a combination of principles-based and rule – based prescriptive regulations) to modify the legal framework for prohibition of insider trading and to make the regulatory framework more predictable, precise and clear.

This Sodhi Committee report forms a basis for the SEBI (Prohibition of Insider Trading) Regulations, 2015 (**2015 Regulations**) which took effect from May 14, 2015. A noteworthy aspect of the 2015 Regulations is the introduction of legislative notes, which provide an insight into the rationale and purpose and assist in the interpretation of the law.



Subsequently, in August 2017, SEBI constituted the Committee on Fair Market Conduct under the Chairmanship of Shri T.K. Viswanathan (**FMC Committee**) to review the existing legal framework dealing with market abuse to ensure fair market conduct, and to review the surveillance, investigation and enforcement mechanisms of SEBI in order to make them more effective in protecting market integrity and the interest of investors. On the basis of the FMC Committee's report, SEBI has amended the 2015 Regulations, with effect from April 1, 2019 (**2019 Amendment**).

Jurisprudential Underpinnings

The jurisprudential underpinnings of the 1992 and the 2015 Regulations can be traced to the United States, where laws on prohibition of insider trading have evolved over decades primarily through case laws, based on interpretation of Section 10(b) of the Securities Exchange Act, the anti-fraud provision and Rule 10b-5 of the Securities Exchange Commission Rules. While the classical theory of insider trading focussed on the breach of fiduciary obligations owed to a company and its shareholder by a 'corporate insider', various other theories have developed over time, to address issues such as, misappropriation of confidential and material non – public information by persons not directly related to the company.

The concept of 'tipping off', i.e., where an insider passes on price sensitive information to a third party, was also developed by US courts to address circumstances where the actual trade may have been undertaken by a person who is not directly in a position to access the information.

The regulatory framework in India has sought to draw from these principles and learnings, and these concepts have found their way into the 2015 Regulations as well.

Regulatory Framework – Key Concepts

A brief overview of the key concepts under the 2015 Regulations (as amended) have been set out below:

I) Insider:

Any person who is typically expected to have access to unpublished price sensitive information (**UPSI**) and means: (i) a connected person; or (ii) who possesses or has access to UPSI. The term 'connected person' covers any person associated (directly or indirectly) with the company in any capacity, including by reason of frequent communication with its officers, in a fiduciary, employment or contractual capacity, or by virtue of a professional or business relationship with the company, in the 6 month period prior to the concerned trade. The 2015 Regulations also set out a wide list of persons who are deemed to be connected persons, which includes, relatives, holding companies, etc.

II) Unpublished Price Sensitive Information (UPSI):

UPSI means information that is not generally available and which upon becoming generally available is likely to materially affect the price of securities. The 2015 Regulations provide an inclusive list of items that are understood to be UPSI, such as, change in capital structure, declaration of financial results, mergers & acquisitions, etc. It is interesting that the 2019 Amendments create a distinction between UPSI and material information, as understood under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**LODR Regulations**). While a listed company is required to regularly publish, disseminate material information in compliance with the LODR Regulations, the legal framework has now clarified that all such material information may not always be equated with UPSI.

III) Communication of UPSI:

One of the key restrictions imposed by the 2015 Regulations on insiders is the prohibition from communicating, providing or allowing access to UPSI, unless required for legitimate purposes, performance of duties or discharge of legal obligations. Prior to the 2015 Regulations, communication of UPSI, *per se*, was not considered to be an offence. Consequently, the act of "tipping off", i.e., sharing of UPSI with a person without any legitimate reason was not considered to be a violation of the insider trading laws, if there was no actual trading in the securities of the company. In view of the requirement to preserve sanctity of information access and ensuring a level playing field for all market participants, the communication of UPSI constitutes a violation. This restriction is subject to the exception that UPSI may be communicated for a legitimate purpose. While the 2015 Regulations do not define 'legitimate purpose', the illustration added recently (through the 2019 Amendment) indicates that information shared for *bona fide* purpose with advisors, consultants, vendors, etc., in the ordinary course of business would be permissible. Interestingly, this illustration is conspicuously silent on the ability of a listed company to share information with its promoters; this silence assumes greater significance given that the recommendations of the Committee on Corporate Governance (headed by Mr. Uday Kotak) on legitimising information sharing by a listed company with its promoters had not been implemented by SEBI in the past as well. Additionally, the 2015 Regulations also provided a safe harbour for UPSI to be shared by a listed

company with prospective investors as part of the diligence exercise, subject to certain conditions, including the requirement for such information to be made publicly available prior to the transaction being effected. It goes without saying that all the permissible instances of a listed company sharing UPSI with third parties is subject to the recipients ensuring strict confidentiality of the information and complying with the obligations applicable to insiders under the law.

IV) Trading while in possession of UPSI:

The other self - evident restriction imposed by the 2015 Regulations is, of course, the prohibition on an insider from trading while in possession of UPSI. It is interesting to chart the history of this restriction as it originally operated to restrict insiders from trading 'on the basis of' UPSI. In fact, the charging provision of the SEBI Act, 1992 (specifically, Section 15G) continues to use this phrase. However, the earlier wording enabled people charged with insider trading to take the defence that the impugned trades were not motivated by or undertaken 'on the basis of' the UPSI in their possession but for certain other reasons altogether, such as, financial exigencies.

Thus, in order to successfully establish the allegation, SEBI was required to demonstrate intentional use (or misuse) of the UPSI in the possession of the person executing the trade. Since the element of intention is always difficult to establish in cases of this nature, the law itself was amended so as to operate as a restriction on insider trading in securities 'while in possession' of UPSI. Interestingly, the jurisprudence on this issue continues to evolve as the Securities Appellate Tribunal has, in the recent past, upheld defences which demonstrate that the alleged insider did not trade in a manner which could be said to be motivated by the UPSI in their possession.

V) Defences to Insider Trading:

Insider trading is a strict liability offence and the burden of proof rests squarely on the alleged insider to prove that he/she, did not violate the 2015 Regulations. Towards this, the availability and recognition of defences to insider trading is a critical aspect of the legal framework. Post the 2019 Amendment, the 2015 Regulations identify a number of defences that are available to any person charged with insider trading. For instance, such defences are applicable in case of: (a) off – market trades between persons having equal (and legitimate) access to UPSI, (b) trades undertaken for a statutory requirement, (c) trades executed pursuant to a trading plan, etc. The trading plan paradigm was introduced in the 2015 Regulations as a model that could permit perpetual insiders (i.e., persons who continually have access to UPSI) to trade in securities by adhering to a pre-determined, irrevocable and public trading schedule. However, given the stringent compliances associated with it, the trading plan has not found too many takers in the market. Another important defence that has always been embedded in the regulatory framework is the Chinese wall arrangement, i.e., where trading decisions are taken by persons other than those who are in possession of UPSI and arrangements are in place to ensure that no UPSI is made available or accessible to the person making trading decisions. The Chinese wall compliance is the cornerstone of protocols relating to handling of UPSI adopted by market intermediaries and fiduciaries.

VI) Compliance Obligations and Code of Conduct:

Pursuant to the 2019 Amendment, the legal framework now imposes a number of compliance obligations on listed companies, market intermediaries (being entities that are registered with SEBI in any capacity, such as, stock brokers, merchant bankers, investment advisers, etc.) and fiduciaries (being entities that regularly handle UPSI such as, banks, law firms, accountancy firms, etc.). For instance, listed companies are required to formulate various policies, protocols and codes to control the manner in which UPSI is handled and shared by its employees. The 2015 Regulations also provides guidance on how listed companies, intermediaries and fiduciaries should identify 'designated persons', being those people within the organization who are likely to have access to UPSI as part of their functional role. Compliance controls are required to be implemented by listed companies, intermediaries and fiduciaries to monitor the trading of designated persons (and their immediate relatives[2]) and such entities are also required to maintain a database (including PAN and contact details) of all persons with whom UPSI is shared under the permitted exception of legitimate purpose and other identified categories of persons, such as, those with whom the designated persons share a material financial relationship[3].

VII) Informant Mechanism:
Subsequent to the 2019 Amendment, SEBI has recently institutionalized an informant mechanism with effect from December 26, 2019. Through this new hotline, informants can voluntarily and confidentially submit 'original information' relating to an alleged violation (which has to be timely, credible, specific and not known already) to an independent SEBI division designated as the Office of Informant Protection. Upon substantial recovery of the sanctions imposed by SEBI, the informant may even claim a monetary reward for providing such first-hand information, which has been capped to one crore rupees or such higher amount as SEBI may determine.

VIII) Reporting of Violations:
In addition to confidential tipping to SEBI by individuals, SEBI has also standardized the process of reporting violations by istedentities, intermediaries and fiduciaries. A uniform template has been prescribed by SEBI to ensure that all relevant details (in relation to identification of the designated person, the alleged trade and the scrip involved with the action instituted by the organization) are provided while promptly reporting any violation of the code of conduct within the organization has recently institutionalized an informant mechanism with effect from December 26, 2019.

Conclusion

Cases relating to market manipulation and insider trading are typically at the forefront of investigations undertaken by SEBI as part of its enforcement functions. For instance, during the financial year 2017 – 18, almost half the cases taken up by SEBI for investigation pertained to market rigging or insider trading.

The recent 2019 Amendment has not only demonstrated that the regulatory focus on insider trading remains as strong as ever, it has also driven listed companies and market participants to re-evaluate their internal processes, control and protocols to ensure adherence to best practices that prohibit insider trading. The overall impact of these changes and the manner in which they are interpreted in specific cases, remains to be seen. However, there is no doubt that the legal framework will continually evolve as the regulator seeks to keep pace with the market.

2 Immediate relatives is defined in the 2015 Regulations to mean the spouse of a person and parents, children, etc. who are financially dependent on the person or who consult the person for trading decisions.
3 The term "material financial relationship" has been defined in the 2015 Regulations to mean a relationship in which one person is a recipient of any kind of payment such as by way of a loan or gift during the immediately preceding twelve months, equivalent to at least 25% of such payer's annual income but excludes relationships in which the payment is based on arm's length transactions.

CHANGES IN THE MERGER CONTROL REGIME IN INDIA

Introduction

The approval of the Competition Commission of India (**CCI**) in mergers and acquisitions has become a key pre-condition which must be met for all transactions involving parties having assets and turnover valued over specific thresholds. The CCI's pro-active enforcement of the merger control framework in India has increasingly made transacting parties initiate discussions around the CCI's approval at the outset. While the CCI has proven itself to be a business-friendly regulator by not blocking a single transaction since the implementation of the merger control regime in India, it does not shy away from taking action against non-compliance. Parties must ensure that their transaction and the conduct of business pending approval, is in compliance with the provisions of the Competition Act, 2002 (**Act**). Further, in line with the government's policy to improve the ease of doing business in India and to support economic growth, the CCI has introduced the 'Green Channel' route, for spot approval of transactions. This article aims to highlight a few recent and key developments in the Indian merger control framework, which either mark a policy change or provide guidance to parties to enable them to comply with the Act.

Background: Indian Merger Control

In order to ensure that merger and acquisition (**M&A**) transactions do not cause any 'appreciable adverse effect on competition' (**AAEC**) in India, acquisitions (of shares, control, voting rights or assets) or mergers or amalgamations, where the assets and turnover of transacting parties exceed certain jurisdictional thresholds (**Combination**), need

Jurisdictional Thresholds*

De-Minimis Exemption
A ≤ INR 3,500 million in India
T ≤ INR 10,000 million in India

Parties Test (Combined acquirer and target)
Either in India
A > INR 20,000 million
T > INR 60,000 million

OR Worldwide
A > USD 1 billion with at least A > INR 10,000 million in India
T > USD 3 billion with at least T > INR 30,000 million in India

Group Test (Group to which target will belong)
Either in India
A > INR 80,000 million
T > INR 240,000 million

OR Worldwide
A > USD 4 billion with at least A > INR 10,000 million in India
T> USD 12 billion with at least T>INR 30,000 million in India

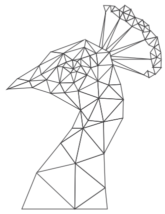
*A – Assets
T – Turnover
All Assets and Turnover Tests are 'or' Tests

to seek the CCI's prior approval in accordance with Sections 5 and 6 of the Act and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (**Combination Regulations**).

The asset and turnover assessment is a three-pronged test, the first of which is based solely on the assets and turnover of the target whereas the second and the third limbs are based on the assets and turnover of the parties and their 'group/s' respectively. A proposed transaction is exempt from notification to the CCI if the assets or turnover of the target in India do not exceed INR 3,500 million or INR 10,000 million, respectively (**De-Minimis Exemption**). If the De-Minimis Exemption is unavailable, the parties may assess if their transaction falls under the categories listed under Schedule I of the Combination Regulations, which ordinarily do not require to be notified as they are presumed not to cause AAEC (**Schedule I Exemptions**). If none of the exemptions are available and the jurisdictional thresholds (the Parties Test and Group Test set out in the chart below) are met, the CCI's approval must be sought.

The Act empowers the CCI to impose a penalty (which may extend to 1% of the total turnover or assets, whichever is higher, of the parties to a Combination) in case of failure to notify a Combination. The Act also contemplates a suspensory regime, i.e., parties cannot consummate the Combination until receipt of the CCI's approval or until 210 days[1] have lapsed from the date of filing of the notification. Pertinently, this standstill obligation imposed on the parties has been recognized as the cornerstone of the merger control regime,[2] and the CCI has frequently penalised parties for failing to adhere to this requirement. The CCI is additionally empowered to "look back" and unwind Combinations that ought to have been notified, for a period of one year from the date on which such Combination has come into effect.[3] However, there is no limitation period on the CCI's powers to initiate proceedings under Section 43A of the Act to impose penalties upon parties for failure to notify the CCI of a Combination.

1 The 210-day period is not absolute and the time taken by the parties to provide additional information, time taken in case the CCI seeks information from third parties or is required to evaluate modifications to the transaction, is excluded from this period.
2 Order under Section 43A of the Act, Hindustan Colas Private Limited, Combination Registration No. C-2015/08/299.
3 Order under Section 43A, DiaSys Diagnostics India Private Limited, Combination Registration No.C-2015/09/313.



Merger Control – Key Changes

Asset Acquisitions

In 2017, a significant change was brought about when the anomaly in case of asset acquisitions was remedied by taking into consideration the value of only the relevant asset/division/undertaking and turnover attributable to such asset /division/ undertaking in order to assess notifiability. The amendment was indicative of the emphasis on the substance of transactions when determining notifiability, rather than the form or structure.[4]

Simultaneously, the CCI has extended the definition of 'asset acquisitions' to include cases of acquisitions of intangible assets.[5] For instance, the CCI has viewed acquisition of trademarks as acquisition of assets. The factors that the CCI requires parties to take into account when determining notification requirements for asset acquisitions is the economic significance of the assets and their potential of generating turnover and constituting a business. The CCI has clarified that a notification would be triggered even if the acquirer has the right to economic benefits that flow from the asset and not necessarily the perpetual ownership of it.[6] Additionally, the value of assets would also include brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered user, homonymous geographical indication, geographical indications, design or layout design or similar other commercial rights.[7]

Trigger Document

The 30-day filing timeline, which required parties to file the notification with the CCI, within 30 days of execution of agreements (in case of an acquisition) or passing of the board resolution (in case of mergers) has been done away with.[8] Parties can now approach the CCI at any time after the execution of the trigger document, provided that the transaction is not effectuated. With this change, parties are no longer burdened with having to make pre-mature filings where the agreements do not detail the terms and conditions of the transaction, or where the filing is data intensive and substantial amount of time would be required for its collation. This is a particularly welcome move for global transactions since earlier parties were forced to notify based on the global agreements, without having executed India-specific documentation.

Inter-connected Transactions

The Combination Regulations mandate that a single notice should be filed for all 'inter-connected' steps of a composite transaction. In case of a failure to do so, the CCI may impose a monetary penalty for non-disclosure of inter-connected steps or invalidate the filing and ask the parties to refile. Given the monetary risks and potential delays in transaction timelines, the question on what constitutes inter-connected transactions gains significance.

As a matter of practice, the CCI has considered transactions to be inter-connected when: (i) the consummation of one of the transaction was dependent upon the consummation of the other;[9](ii) one transaction was undertaken for the purpose of facilitating the other transaction;[10] or (iii) a series of transactions took place between the same parties (or members of each of the parties' respective groups) within a span of 18 to 24 months.[11]

Recently, guidance on 'inter-connected' transactions was also provided by the Supreme Court of India, which was hearing an appeal against the decision of the CCI imposing a penalty for consummating inter-connected steps of a transaction prior to its approval. The Supreme Court[12]upheld the CCI's order and held that:

4 Notification S.O. 988(E), dated 27 March, 2017, by Ministry of Corporate Affairs, Government of India.
5 Order under Section 43A, ITC Limited/Johnson & Johnson, Combination Registration No.C-2017/02/485.
6 Order under Section 43A, Reliance Jio Infocomm Limited, Combination Registration No. C-2017/06/516.
7 Supra note 4. Also see point (c) under Explanation to Section 5 of the Act.
8 Notification S.O. 2039(E), dated 29 June 2017, Ministry of Corporate Affairs, Government of India.
9 Mandala Rose Co-Investment Limited/ Mandala PrimRose Co-investment Limited, Combination Registration No. C-2015/12/356.
10 Denali Holding Inc., Combination Registration No. C-2016/01/370.
11 Piramal Enterprises Limited/Shriram Transport Finance Company, Combination Registration No. C-2015/02/249 ("**Piramal/Shriram**").
12 Competition Commission of India vs. Thomas Cook (India) Ltd. & Anr, Civil Appeal No. 13758 of 2015.

"While it is open for the parties to structure their transactions in a particular way the ***substance of the transactions would be more relevant to assess the effect on competition*** *irrespective of whether such transactions are pursued through one or more step/ transactions.* ***Structuring of transactions cannot be permitted in such a manner so as to avoid compliance with the mandatory provisions of the Act. … Technical interpretation to isolate two different steps of transactions of a composite combination would be against the spirit and provision of the Act."***

Some of the key factors that the Supreme Court considered when determining the inter-connected nature of transactions included proximity in time of the market purchases, simultaneity in execution of the transactions and the facts which suggested that one transaction would not have taken place in the absence of the other. Similarly, in another case, the Supreme Court observed that where acquisitions were part of a long term plan to acquire the target company and were not made 'solely as an investment' or in the 'ordinary course of business', were to be considered as inter-connected in nature.[13] The Supreme Court's decisions further reinforce the jurisprudential focus on substance over form.

Notifiability of Minority Acquisitions

One of the Schedule I Exemptions exempts minority acquisitions of less than 25% shares, if they are made solely as an investment or in the acquirer's ordinary course of business, with a caveat that such transactions should not result in the acquisition of 'control' or confer any special shareholder rights upon the acquirers (**25% Exemption**). Various orders passed by the CCI over the course of the past few years, have interpreted each of these phrases in a broad manner, so as to considerably limit the applicability of the 25% Exemption. One such interpretation that the CCI seems to be increasingly adopting is that where an acquirer and the target are engaged in competing businesses or where their businesses are vertically related, the acquisition "need not necessarily be termed as an acquisition made solely as an investment or in the ordinary course of business".

In case of private equity transactions, while the parties may not be direct competitors, the private equity fund may have interest in portfolio companies which are in the same line of business or vertically linked with the target. The moot issue is whether a threshold should be adopted to avert private equity funds from having to notify every minority non-controlling acquisition in the same sector. Interestingly, last year, the CCI proposed to amend the Combination Regulations to require notification of acquisitions of 5% or more shareholdings, by pooled investment vehicles (**PIV**), where the target competes with or operates in a vertically linked market, as that of an existing investment of the PIV. This was not restricted to 'controlled' investments of the PIV. While the CCI ultimately did not incorporate this amendment and has reviewed cases where the acquisition was for less than 5% shareholding,[14] it provided an insight into the CCI's thoughts. Given the murky waters and in the absence of clear precedent, the applicability of the 25% Exemption is likely to be further restricted.

Definition of 'Control'

The interpretation of the terms 'control' and 'group' form one of the cornerstones of the Indian merger control framework. This is on account of the fact that several of the Schedule I Exemptions pivot around these terms. The definition of 'group' itself has 3 limbs, one of which is subjective in nature and qualifies entities as group entities, if 'control' exists.

The concept of 'control' under the Act is of a lower threshold than that provided under other statutes. In terms of jurisprudence, it has been one of the most evolving concepts under the Act. The CCI recently provided further guidance on this

13 SCM Soilfert Ltd. & Anr. vs. Competition Commission of India, Civil Appeal No(s). 10678 of 2016.

14 Amazon.com NV Investment Holdings LLC/ Quess Corp Limited (Combination Registration No. C-2019/08/680) and Jomei Investments Limited/ Aditya Birla Capital Limited (Combination Registration No. C-2019/09/686).

in its order in *UltraTech Cement/Jaiprakash Associates*[15] (**UltraTech Case**). The CCI held that there were different degrees of control in competition law. The first degree of control identified by the CCI is that of "material influence", which constitutes the lowest level of control and gives an enterprise the ability to influence affairs and management of the other enterprise. The second degree of control identified by the CCI is that of de facto control which implies a situation where an enterprise holds less than majority of the voting rights, but in practice controls over more than half of the votes actually cast at a meeting. The third degree of control identified by the CCI amounts to de jure or 'controlling interest' which exists where an entity has a shareholding conferring more than 50% of the voting rights. The CCI's decision in the UltraTech Case requires that parties undertake a nuanced review of "commercial realities" to ascertain when the CCI's approval is required. Moreover, given that the information that is to be provided to the CCI in a notification also depends on the business activities of the parties' groups' activities, the identification of group and group entities is of substantial relevance.

In other cases, the CCI has considered the acquisition of veto rights for approval of business plan/annual operating plan/ budget, commencement of a new line of business or to set up operations in new cities, discontinuation of an existing business, appointment of key managerial personnel including key terms of employment, influencing material terms of employee benefit plans and strategic business decisions, as acquisition of right amounting to control for the purposes of Indian competition law.[16]

Latest developments

Introduction of Green Channel Route

The CCI has amended certain key aspects of the Combination Regulations, by its notification dated 13 August 2019.[17] In one of the most significant amendments to the merger control regime in India, the CCI has introduced the concept of a Green Channel approval route (**Green Channel**), which will allow parties to receive an on-spot approval from the CCI, instead of waiting for the 30 working-day period. It is pertinent to note that the Green Channel is one of the recommendations of the Competition Law Review Committee, which was set up to review the competition law framework in India.

The Form I (i.e., the simple form) has also been revised to present a more comprehensive picture of possible effects of the proposed combination and to simplify the filing for Green Channel notifications. The Green Channel will apply to only those transactions where the acquirer (and the acquirer group) has no existing interests in companies:

(i) that may be seen as competitors of the target group's business; or
(ii) that operate in markets with vertical linkages to the target group's business; or
(iii) that have complementary linkages to the target group's business.

Eligible parties may also choose the ordinary route to approach the CCI and wait for the CCI's approval. If they opt for the Green Channel, they would receive a deemed approval immediately upon notifying the CCI and upon receipt of the acknowledgement.

However, if the CCI finds that a transaction did not qualify for the Green Channel and/or the declaration filed along with it was incorrect, the notification and the approval would become void ab initio and it is likely that the CCI will pursue proceedings for 'gun jumping' under Section 43A of the Act and possibly under Section 44, for material non-disclosure. The CCI will allow the parties an opportunity to be heard before it arrives at a finding in this regard.

The parties opting for the Green Channel will also benefit from simpler disclosure and data requirements under the Form I. For instance, there is no requirement of providing responses

15 Order under Section 44, Combination Registration No. C-2015/02/246.
16 SPE Holding-MSM India (C-2012/06/63, Order dated 9 August 2012) and Century Tokyo-Tata Capital (C-2012/09/78, Order dated 4 October 2012).
17 Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Amendment Regulations, 2019, dated 13 August, 2019.

to the ‘Top 5 Questions’ (customers, competitors and suppliers) or market related information such as market size and market shares. The latest case to be notified to the CCI through the Green Channel route is that of ROC *Star Investment Trust/ Star Health and Allied Insurance Company Limited (C-2020/1/716)*.

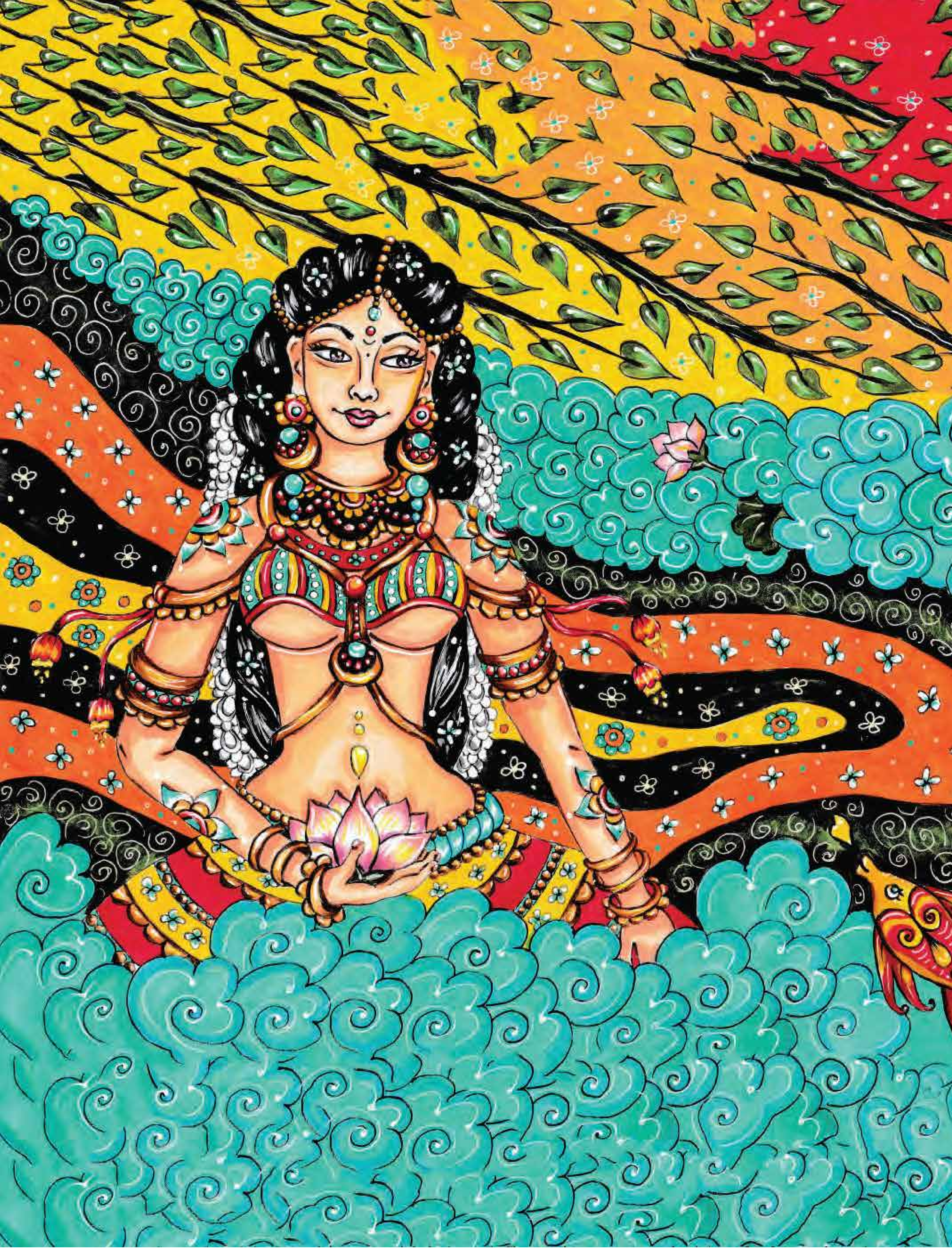
Increase in the filing fees for Form-I and Form-II

In October 2019, the CCI has increased the fees for filing Form I from INR 1.5 million to INR 2 million and the fees for filing Form II from INR 5 million to INR 6.5 million.[18]

Conclusion

The CCI has come a long way in identifying the core concerns that arise in M&A transactions. However, in the absence of definitive guidelines and the evolving nature of the jurisprudence, parties are increasingly seeking the CCI’s approval out of abundant caution. The need of the hour is for the CCI to bring about a degree of certainty in the letter of law, to further the overall objective of enhancing the ease of doing business in India.

18 Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Second Amendment Regulations, 2019, effective from 30 October, 2019.



CODE ON WAGES, 2019 RECEIVES PRESIDENT'S ASSENT

The Code on Wages, 2019 (**Wages Code**) is one of the 4 (four) labour codes that aims to consolidate and simplify the complex labour law regime in India. The Wages Code subsumes the following 4 (four) existing central legislations (i) Minimum Wages Act, 1948 (**MWA**); (ii) Payment of Wages Act, 1936 (**PWA**); (iii) Payment of Bonus Act, 1965; and (iv) Equal Remuneration Act, 1976 (**ERA**). The objective of the Wages Code is to ensure ease of compliance for employers by harmonising and consolidating the provisions of the aforesaid legislations under a single code. Though the Wages Code has received the President's assent on August 8, 2019, it will be brought into force after the appointed date for its implementation is notified by the Central Government. It may be noted that the Governmentis empowered to bring into force the various provisions of the Wages Code in a staggered manner.

Key aspects of the Wages Code

(a) **Uniform definition of the term 'wages':** To ensure consistency in applicability of the aforementioned legislations, the Wages Code provides for a uniform definition of wages, unlike the current framework wherein each of the abovementioned legislations has a separate definition for the term 'wages', leading to certain remuneration components being considered as wages under some of these legislation, but not under others. The Wages Code defines wages to include all remuneration that can be expressed in monetary terms and lists down specific exclusions, such as house rent allowance, conveyance allowance, bonus paid in accordance with the law, gratuity, terminal benefits etc. In this regard, the Wages Code introduces a unique concept under which if the aggregate value of the Exclusions exceeds the prescribed threshold, some of these Exclusions will considered as wages. This may have ramifications in the manner in which salary, especially for top managerial employees, is structured.

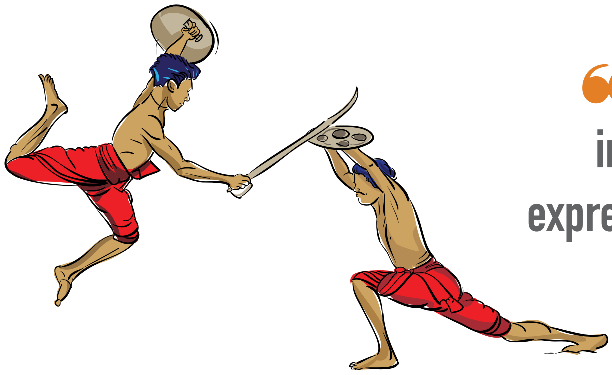
(b) **Broad definition of the term 'employer':** The Wages Code provides a broad definition of the term 'employer', and includes contractors. Accordingly, while a contractor would, primarily, be responsible for all compliances relating to its employees, deployed as contract labour at various establishments should the contractor default in any manner, the contract workers have been given the option to proceed against the principal employer to enforce their rights.

(c) **Broad definition of the term 'employee':** The Wages Code broadens the definition of the term 'employee' to also include persons employed at supervisory and managerial levels.Therefore, the service conditions of senior level employees will henceforth be regulated by the provisions of the Wages Code. Given that the Wages Code regulates deductions made to an employee's salary, this will also impact the salary structuring of such employees, especially with regard to their deferred compensation and clawback provisions.

(d) **Prohibits gender discrimination:** The ERA ensures pay parity between male and female employees only. The Wages Code, however, recognises the third gender and provides for pay parity for all genders. The Wages Code also provides that experience of an employee maybe considered while determining pay parity and other conditions of service. Therefore, the Wages Code recognises that experience and expertise, too, could be a reasonable differentiator when answering questions as to whether an employer is involved in any discriminatory practices.

(e) **Floor Wage:** The MWA applies only to specified employments and certain categories of employees therein. The Wages Code and the minimum wages related provisions would apply to all types of employment/industries and employees. Under the Wages Code, the Central Government is empowered to fix the national minimum wages (**Floor Wage**) and once it is done, the concerned government cannot fix a minimum wage lower than the Floor Wage.

(f) **Focus on compliance and not on penalising:** The emphasis of Wages Code is on compliance. It provides the organisation/



> The Wages Code defines wages to include all remuneration that can be expressed in monetary terms and lists down specific exclusions

employer the opportunity to rectify non-compliances. Accordingly, the role of the inspector, under the existing legislations, has been changed to inspector-cum-facilitator, who will be responsible for guiding and advising the employers and workers to ensure compliance, with the provisions of the Wages Code. Another welcome measure introduced by the Wages Code is that it allows compounding of an offence under certain conditions.

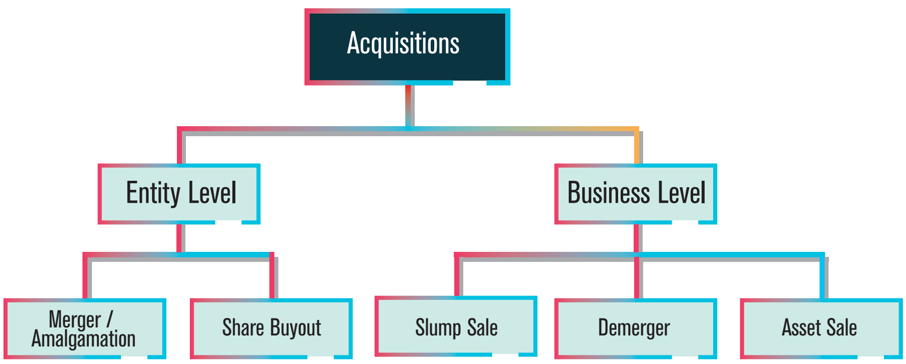
The Wages Code, therefore, streamlines the legislations relating to wages and conforms with the Ease of Doing Business concept by providing a far more simple compliance framework. The Preliminary Draft Rules for the Code on Wages, 2019 (**Wage Rules**) were published on the website of the Ministry of Labour on November 1, 2019, to implement the provisions of the Wages Code and also, to repeal and subsume the existing Central rules under the abovementioned legislations. However, the Wages Rules are yet to be finalised and the Ministry of Labour has invited inputs, comments and suggestions from the public.

TAXATION OF CROSS BORDER MERGERS & ACQUISITIONS IN INDIA

With the revision of tax treaties entered into between India and Mauritius, Singapore and Cyprus the residence based taxation of capital gains arising to foreign investors from transfer of shares of Indian companies, is now replaced with 'source' based taxation. Consequently, foreign investors are now generally subject to Indian capital gains tax in respect of gains realised from transfer of shares of Indian companies, if they are acquired after March 31, 2017.

Merger & Acquisition and taxation aspects

There are a number of ways of carrying out M&A activities, typical of which would fall in the following categories or a variant of them:



These can be within India, i.e. both the target and the acquirer being in India, or cross border, where either the acquirer or the target or both are situated outside India. In such a situation, it becomes critical for the foreign entity to be aware of the high level tax nuances under the Indian law, which could have tax implications and may increase the cost of acquisition of the Indian target or a parent of an Indian company.

"GAAR essentially codifies the doctrine of 'substance over form' to deter tax avoidance. The IT Act does contain inherent checks and balances to avoid frivolous exercise of powers under GAAR"

Before we move to consider the high level tax implications for the transferor of the business or assets in each of the above cases, it is important to discuss one very important anti abuse provision under the Indian Income Tax Act, 1961 (**IT Act**). This anti abuse provision is triggered when any person (including a non-resident) receives a 'property' from any person at a consideration which is less than the fair market value (**FMV**) of the 'property'. The difference between the FMV and the consideration paid is treated as income from other sources in the hands of the recipient of 'property'. Such other income is taxed at the highest rate applicable, which would be 30% in case of a resident and 40% in case of a non-resident company. 'Property' for this purpose is specifically defined and includes shares, financial assets, land, buildings etc. but does not include 'business undertaking' as one of the listed items. Thus, this provision should not be attracted where a person receives 'business undertaking' through a business transfer agreement. There are detailed rules on determination of the FMV for each type of property. In view of this provision, while undertaking M&A activities in India, it is very important to ensure that these negative tax implications are not attracted.

"Similar to the anti-abuse provision discussed above, a corresponding provision is also applicable on the transferor of unquoted shares. A transferor of unquoted equity shares is subject to capital gains tax based on adopting the FMV as sale consideration, where the sale consideration is less than the FMV. It is pertinent to note that to facilitate the transferor in case of genuine transactions certain exemptions would be available to specified class of persons, which is yet to be notified. It is expected that these exemptions would, inter-alia, include situations where shares of companies undergoing insolvency proceedings under the Insolvency and Bankruptcy Code are transferred."

Merger

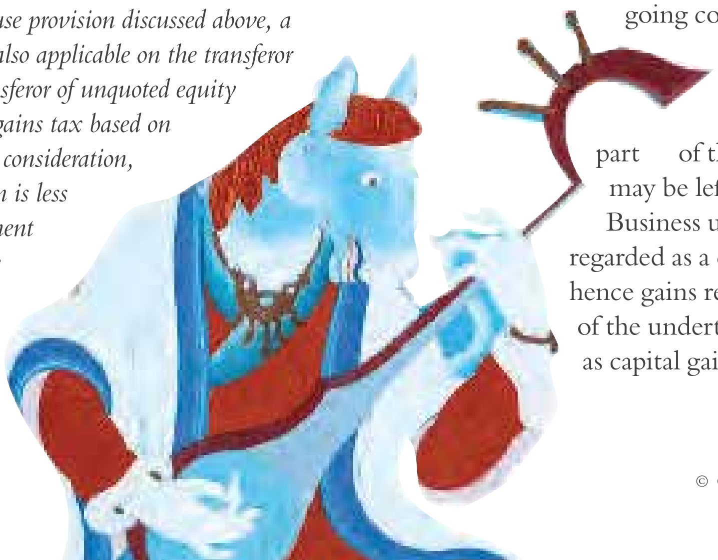
Under the IT Act, a court/tribunal approved merger is not regarded as transfer for capital gains tax purposes provided it satisfies certain conditions. Consequently, such transfer of assets does not result in any tax in the hands of transferor company or its shareholders. If the conditions are not satisfied then the transaction would be taxable.

Share Buyout

Seller would recognise capital gains as the difference between sale consideration and cost basis. Capital gains tax at the rate applicable to short term or long term gains would be levied on the transferor depending on the period of holding of the shares. Capital gains is to be computed in accordance with the prescribed rules. A non-resident is also required to pay Indian capital gains tax. In the case of a non-resident seller, the buyer of shares is obligated under Indian law to withhold appropriate tax, deposit the same with the tax department and carry out related compliances.

Slump Sale

Sale of business undertaking for a lump sum consideration without attributing individual values to the different components of the items of the balance sheets is regarded as a 'slump sale'. All assets and liabilities of the business must be transferred for it to run as a going concern. Unrelated assets or liabilities of the company – not part of the undertaking – may be left behind. Business undertaking is regarded as a capital asset and hence gains realised on sale of the undertaking are taxed as capital gains – long or



short term. There are special provisions for computation of these gains. The net worth of the undertaking is taken to be its cost basis for computing capital gains. Care needs to be taken to ensure that the undertaking qualifies as such under the definition provided in the IT Act.This mode offers operational flexibility since the acquirer can record the assets at FMV or a value that is justifiable for him and he may also recognise acquisition of goodwill, which can be amortised as per rules.

Demerger

This is essentially hiving off of an undertaking generally carried out through a court approved scheme. For such a demerger to qualify as tax neutral, conditions need to be satisfied and cash can be paid to no more than 25% in value of the shareholders of the demerging company. *"Another condition for a demerger to qualify as tax-neutral, is that the resulting company is required to record the acquisition of assets and liabilities at values appearing in the books of the demerged company prior to demerger. To enable transfer of assets and liabilities at values different from book value, it has been clarified that the tax-neutral status would be maintained even if assets and liabilities were transferred at value different from book value, as long as resulting company records such assets and liabilities in compliance with the applicable Indian Accounting Standards."* This may be a preferred route in certain circumstances since the transferor company would not be taxed on this transfer and even the shareholders may not pay any tax if this is structured appropriately.

Asset Sale

In this case, each asset being acquired is valued and paid for separately. There may be capital gains on transfer of such assets which are computed and paid by the transferor. Since the transferor would be an Indian enterprise, the acquirer would not have withholding tax obligation in relation to capital gains tax of the transferor, except in case of acquisition of land. Depreciable assets forming part of a block of assets may result in short term capital gain or loss, depending on whether the price received is more or less than the net value after deducting related depreciation.

It is opportune to discuss the tax aspects of cross border mergers now.

Inbound Merger

In case of cross border merger, where a foreign company merges with an Indian company, the benefit of tax neutrality on such merger under IT Act should be available to the transferor company. However, for the transferor company and its shareholders to avail such exemption, the following conditions laid down in the IT Act would need to be satisfied:

a. All properties / liabilities of the merging company should become the properties / liabilities of the merged company;

b. Shareholders holding at least 75% in value of the shares in the merging company (excluding shares already held therein before amalgamation or its subsidiaries or nominees) should become shareholders of the merged company.

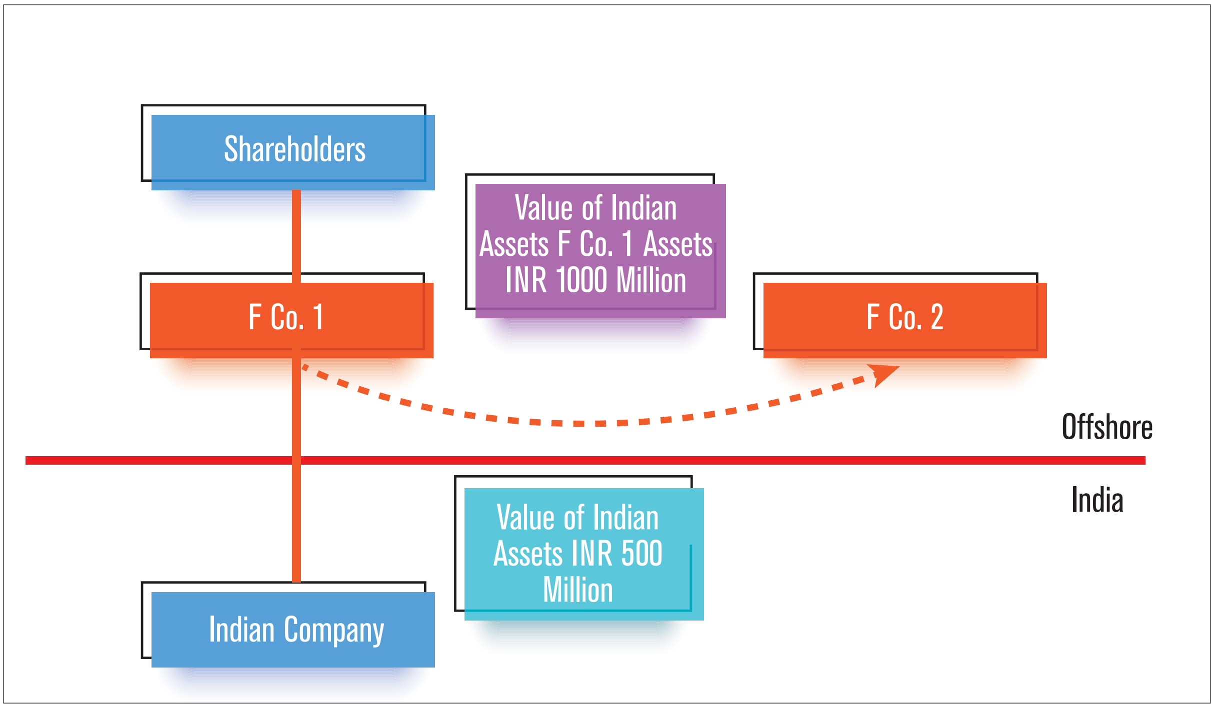
Offshore merger

When, as a result of merger of two foreign companies, shares directly held by the mergingcompany in an Indian company are also transferred to the merged company. This transfer would not be subject to Indian capital gains tax under the IT Act in the hands of the merging company provided certain conditions are satisfied. Such merger should not be subject to tax in the country where the merging/ transferor company is incorporated and at least 25% shareholders in value of the merging foreign company remain the shareholders of the merged/surviving foreign company.

The above described transaction is depicted pictorially below.

> "It would be advisable to seek a comprehensive advice on the transaction as whole, ideally during the planning stages itself, to avoid any surprises from an Indian tax perspective"

As a result of this offshore merger, the shareholder of the merging company F Co1 is transferring his shares in F Co1 to F Co 2. While the merger itself, as discussed above, would not be taxable in India in the hands of F Co1 if conditions are satisfied, the shareholders of F Co1 may get caught in the provision of Vodafone Tax, since there is no specific exemption in the IT Act in such cases. Thus, the shareholder may be subject to tax in India in respect of the transfer of shares in F Co1 if the conditions for attracting Vodafone Tax as discussed below, are satisfied. In such



a situation, valuation reports need to be procured to assess the situation and it may be possible to plan the transaction to steer clear of this uncertainty.

Global M&A involving an underlying Indian asset (Vodafone Tax)

In 2012, a retrospective clarification was brought in the IT Act, as a result of which transfer of shares of foreign company or entity by a non-resident to another non-resident was also brought within the Indian tax net, if such a transfer fell within the provision set out below:

If the share or interest in a foreign company or entity registered or incorporated outside India derives, directly or indirectly, its value substantially from assets located in India then such share or interest of the foreign entity would be deemed to be situated in India. Hence, gains derived from transfer of such entities would attract gains derived from the transfer thereof would attract Indian capital gains tax. This is known as 'Vodafone Tax' since it was introduced pursuant to the Hutchison-Vodafone telecom transaction, which the Indian tax department contended was taxable in India. The Supreme Court of India had ruled in favour of the taxpayer noting that the shares transferred were not assets situated in India and hence Indian tax was not attracted. As per the current law, a foreign share or interest is deemed to derive its value substantially from assets located in India if the value of such assets exceeds INR 100 Million and represents at least 50% of all assets owned by the offshore company or the entity. It is pertinent to note that a valuation report needs to be procured for this determination as on the 'specified date' in accordance with the prescribed valuation methodology. Notably, the provisions of the IT Act provide an exemption from this tax to certain small shareholders, investors in Foreign Portfolio Investors (**FPI**)/ Foreign Institutional Investors etc.

In view of the above, in case of a global restructuring being undertaken, it is important to identify what Indian assets are being indirectly transferred and whether Indian capital gains tax is attracted.

In this context, it is important to note that the majority of the Indian tax treaties provide for such gains to be taxed only in the country of residence of the shareholders. It would, therefore, be very important to examine the jurisdictions of those shareholders and their eligibility to claim the benefit of the tax treaty between their country of residence and India. This evaluation in case of global restructuring should be done early in the day.

Availability of Operating Losses to the Acquirer

It is also important to note that under the IT Act, the acquirer company in case of merger or acquisition of shares of a target company or a business transfer may not be able to benefit from the brought forward tax losses of the target. The IT Act restricts carry forward of tax losses to the acquirer and lays down conditions in this regard. It is, therefore, important to evaluate this situation and position while considering the acquisition structure.

Outbound Merger

Unlike inbound mergers, in case of an Indian company merging with a foreign company, the benefit of tax neutrality under the IT Act is not available as the merged company would not be an Indian company. Consequently, any transfer of capital assets from an Indian company to the foreign company would attract capital gains tax in the hands of the transferor/merging Indian company. The shareholders receiving the shares of the foreign merged company may also be subject to tax in India in absence of any extant provision in the IT Act making this taxable in the hands of the shareholders in case of outbound merger. The shareholder of the merging company may also need to consider the anti-abuse provision under which it should be ensured that the FMV

of the shares received of merged company should not be more than the value of shares of merging company surrendered.

Another aspect that needs to be considered in such cases is the risk of creation of place of effective management (**POEM**) of the foreign company in India. POEM has been defined under the IT Act to mean the place where key managerial and commercial decisions of a company are undertaken. In the event the PEOM of the foreign company is determined to be situated in India either by the Indian tax authorities on their own or pursuant to a mutual agreement procedure under Article 4 of the Multilateral Instrument (**MLI**) under BEPS Action Plan 15, the foreign merged company would be considered a company resident in India and would be subject to tax on its global income in India. The tests laid down for POEM are different for companies with 'active' business income and 'passive' income earning companies.

General Anti Avoidance Rules (GAAR)

GAAR became operational in India from 1 April, 2017. While undertaking a structure and transaction, it is important to consider whether, though tax efficient, the same falls foul of GAAR. These provisions empower the tax authorities to declare an arrangement, or transaction as an impermissible avoidance arrangement (**IAA**) if the main purpose of the arrangement is to obtain a tax benefit and which also satisfies at least one of the following four tests:

(1) creates rights and obligations, which are not normally created between parties dealing at arm's length;
(2) results in misuse or abuse of provisions of the IT Act;
(3) lacks commercial substance or is deemed to lack commercial substance in whole or in part; or
(4) is carried out in a manner which is normally not employed for *bona fide* purpose.

The consequences of a transaction or an arrangement being declared as an IAA are many and far reaching and could include:

- Denial of treaty benefits;
- Disregarding, combining or re-characterizing steps in the transactions;
- Revising the place of residence of any party or situs of an asset;
- Looking through corporate structure;
- Re-characterizing equity or debt or accrual of receipts or expenditure, etc.

GAAR essentially codifies the doctrine of 'substance over form' to deter tax avoidance. The IT Act does contain inherent checks and balances to avoid frivolous exercise of powers under GAAR. The Assessing Officer would need to seek approval of the Principal Commissioner before proceeding to initiate action. One needs to be mindful of the fact that upon invocation of the proceedings to declare an arrangement as an IAA, the taxpayer would need to prove before the Principal Commissioner that the main purpose is not of obtaining tax benefit. Thereafter, the Principal Commissioner would be required to issue appropriate order. If such order is against the taxpayer, the Principal Commissioner would need to make reference to Approving Panel which shall issue appropriate directions after hearing both the taxpayer and the Assessing Officer.

Conclusion

In view of the myriad consequences under GAAR and the risk of the denial of tax treaty benefits, it is vital that the transactions and arrangements including any structuring thereof pass the smell test under GAAR. It is also important that a proper evaluation of pros and cons and commercial justification for the structuring of the transaction is carried out, to avoid the rigours of GAAR. Further, the bilateral tax treaty network is also undergoing change, in light of MLI and various tax treaties which have been renegotiated, requiring careful consideration of the impact of the applicable tax treaty. In global deals involving Indian assets, one would need to undertake a specific exercise to identify Indian tax issues relating to aspects such as adjustment of the sale consideration outside India, taxability of earn out payments or deferred consideration, applicability of transfer pricing, Indian withholding tax obligations etc. It would be advisable to seek a comprehensive advice on the transaction as whole, ideally during the planning stages itself, to avoid any surprises from an Indian tax perspective.

THE PERSONAL DATA PROTECTION BILL, 2019: AN UPDATE ON DEVELOPMENTS

Since August 2017, a series of increasingly important legislative and judicial developments have taken place in India in the field of privacy, data protection and information technology.

The Privacy Judgements

Multiple[1] challenges to India's proposed unique biometric identity system "Aadhaar"[2] culminated in August 2017, before a nine judge constitutional bench of the Supreme Court of India (**Supreme Court**).

In *Justice K.S. Puttaswamy (Retd.) & Anr. v. Union of India & Ors.*[3] (**Right to Privacy Judgement**), the Supreme Court ruled that the right to privacy is a fundamental right implicit within the scope of Article 21 of the Constitution of India and affirmed that informational privacy was an inherent part of the right to privacy.

The Right to Privacy Judgement laid down the three-part test of legality, legitimate aim and proportionality and held that any restraint on the right to privacy would have to satisfy this test. Broadly, this test requires (a) the existence of a law which provides for the said restraint. This is based on the principle that no person can be deprived of his personal liberty except in accordance with procedure established by law; (b) there must a legitimate aim, in pursuance of which the

1 The New Indian Express, Aadhaar Challenge: The bunch of people who moved SC against the biometric card project (26 September, 2018) available at http://www.newindianexpress.com/nation/2018/sep/26/aadhaar-challenge-the-bunch-of-people-who-moved-sc-against-the-biometric-card-project-1877052.html.
2 Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016.
3 Justice K S Puttaswamy (Retd.) & Anr. v. Union of India & Ors. (2017) 14 Scale 375.

fundamental right has been restricted; and (c) the restriction proposed by law should be proportional to the object and needs sought to be fulfilled by the law.

The application of the above constitutional principles to data protection were enumerated in September 2018 by the Supreme Court in its judgement on the Aadhaar regime (**Aadhaar Judgement**)[4] where it applied this three-part test to strike down several provisions of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016.

In doing so, it expanded upon the application of the third leg of the test, i.e. proportionality, to privacy by ruling that: (a) there must be a legitimate goal which justifies the restriction of the right to privacy; (b) there must be a suitable means of furthering the goal; (c) there must not be any equally effective alternative that is less restrictive; and (d) there must not be a disproportionate impact on the right holder.[5] The Supreme Court also recognised data protection principles such as consent, purpose and storage limitation, data minimisation, substantive and procedural fairness and safeguards, transparency and data security.[6]

The Personal Data Protection Bill, 2019

In the aftermath of the Privacy Judgement, in July 2017, the Government of India constituted a Committee of Experts under the Chairmanship of Justice B.N. Srikrishna (Retd.) (**Committee of Experts**) to (a) study various issues related to data protection in India; (b) make specific suggestions regarding the principles to be considered for data protection in India by the Central Government; and (c) suggest a draft data protection bill.[7]

In July 2018, the Committee of Experts submitted a draft Personal Data Protection Bill, 2018 and its corresponding report to the Government of India for consideration. The report relied on the Right to Privacy Judgement to form the normative basis for its proposed data protection framework.

In December 2019, the Personal Data Protection Bill, 2019 (**PDP Bill**) was introduced into the Lok Sabha and sent to a joint parliamentary committee for their inputs.

While the PDP Bill is based, in large part, on the proposed draft of the Personal Data Protection Bill, 2018, it also includes several modifications and changes in scope and intent.

Definition and Scope

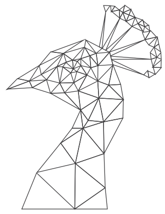
The PDP Bill governs all processing (which includes, inter alia, collection, storage, organisation, structuring, adaptation, transmission, disclosure, or even erasure) of personal data.

Personal data is data, whether online or offline, relating to a natural person, who is directly or indirectly identifiable from such data, having regard to any feature of the identity of such person, or a combination of such features with each other, or other information.[8]

The PDP Bill will govern all processing of personal data: (a) within India; (b) by Indian entities, authorities or persons; and (c) outside India, if such processing is in connection with business, or the systematic offering of goods or services to persons, or their profiling within India, or the profiling of persons in India.

A subset of Personal Data, namely, "personal data revealing, related to, or constituting, as may be applicable – *(i) financial data; (ii) health data; (iii) official identifier; (iv) sex life; (v) sexual orientation; (vi) biometric data; (vii) genetic data; (viii) transgender status; (ix) intersex status; (x) caste or tribe; (xi) religious or political belief or affiliation; or (xii) any other category of data specified by the Authority under Section 22"* is

4 Justice K S Puttaswamy (Retd.) & Anr. v. Union of India & Ors. (2018) 4 SCC 651.
5 Aadhaar Judgement, Sikri, J. at paragraph 261.
6 Aadhaar Judgement, Sikri, J. at paragraph 187.
7 MEITY Office Memorandum, Constitution of a committee of experts to deliberate on a data protection framework for India (July 31, 2017) available at https://www.meity.gov.in/writereaddata/files/MeitY_constitution_Expert_Committee_31.07.2017.pdf .
8 Section 3(28), PDP Bill.



classified as Sensitive Personal Data.[9] More onerous and granular requirements apply to the processing of Sensitive Personal Data under the Bill.

Data Fiduciaries, Significant Data Fiduciaries and Social Media Intermediaries

The PDP Bill provides for a fiduciary relationship between entities which collect and process personal data (the **Data Fiduciaries**[10]) and the individuals whose personal data is being processed (the **Data Principals**[11]). Consequently, Data Fiduciaries are required to process data in a fair and reasonable manner that ensure the privacy of the Data Principal[12] for a valid purpose (dealt with below) and to ensure that such data is complete, accurate, not misleading, and has been updated having regard to the purpose for which it is processed.[13]

Data Fiduciaries can be classified as Significant Data Fiduciaries by the Data Protection Authority to be constituted under the PDP Bill on the basis of various factors including the volume or sensitivity of the data they process, the risk of harm associated therewith, or the use of innovative and new technology for processing

Significant Data Fiduciaries are subject to privacy audits, impact assessments, more stringent compliance requirements and higher levels of liability. A specific class of social media intermediaries[14] which have more than a specified number of users, and whose actions are likely to impact electoral democracy, security of the state, public order, sovereignty or integrity of India will also be classified as Significant Data Fiduciaries.[15] All such notified Social Media Intermediaries are required to enable users who register for, or use their services from India an option of verifying their accounts, after which such accounts will be indicated as verified to all users.[16]

Consent

The PDP Bill requires that Personal Data be processed for a purpose consented to by the Data Principal. Processing is also permitted for purposes reasonably expected by the Data Principal to be incidental to, or connected with, the purpose consented to.

Consent is required to be obtained after providing a clear, concise and easily comprehensible consent notice satisfying certain criteria, and is required to be free, informed, specific, clear and capable of being withdrawn.[17]

Additionally, consent for the processing of Sensitive Personal Data is required to be explicit, and granular.[18]

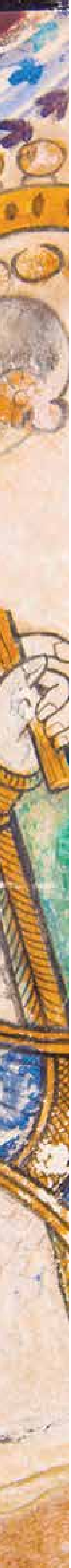
Data Fiduciaries will be required to discharge the burden of proving that they have obtained valid consents, and cannot condition the performance of any services or provision of any goods, on the processing of Personal Data which is not necessary for such performance or provision.[19]

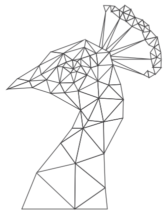
Grounds for processing

Personal Data may be processed without consent where such processing is necessary on certain grounds including: under any law in force; functions of the State, authorised by law, for certain purposes such as the provision of services, benefits, licence, permit, etc., compliance with orders of Indian Courts, responding to medical emergencies, providing medical treatment under certain circumstances and disaster relief.

Processing is also permitted for the purposes of recruitment or termination of employment, provision of services to employees, verifying attendance or other activities relating to assessment of performance of employees. Such processing

9 Section 3(36), PDP Bill..
10 Section 3(13), PDP Bill. Data Fiduciary means any person, including the State, a company, any juristic entity or any individual who alone or in conjunction with others determines the purpose and means of processing of personal data.
11 Section 3(14), PDP Bill. A Data Principal means the natural person to whom the personal data relates.
12 Section 5, PDP Bill.
13 Section 8(1), PDP Bill.
14 Section 26(4), PDP Bill. These are entities which primarily or solely connect users enabling them to create, modify, upload, share, disseminate or access information. Search engines, e-commerce entities, internet service providers, email and storage services, and online encyclopaedias are expressly excluded from this definition.
15 Section 26(4), PDP Bill.
16 Section 28 (3) and 28(4), PDP Bill.
17 Section 11, PDP Bill.
18 Section 11(3), PDP Bill.
19 Section 11(4) and 11(5), PDP Bill.





can only be done where consent is not appropriate in view of the employment relationship between the principal and fiduciary or would require disproportionate effort to obtain.

In addition, other reasonable purposes for processing may be specified as grounds for processing by the Data Protection Authority including for mergers and acquisitions, credit scoring, fraud prevention, debt recovery, processing publicly available information, and the operation of search engines.

Data Fiduciaries can only collect personal data to the extent required and necessary for the purposes of processing,[20] and thereafter can only store such data for as long as is necessary to satisfy the purpose for which it is being processed, the period required under applicable law or for a longer period where explicit consent is obtained from the Data Principal for such retention.[21] It is unclear whether such retention under consent will override the purpose requirement under Section 4 and 5 of the PDP Bill.

Data Fiduciaries are also required to ensure that the personal data collected is accurate and updated.[22]

Data Fiduciaries are also required to implement privacy by design policies to ensure that their managerial, organisational and business practices are designed in a manner as to anticipate, identify and avoid harm to the Data Principal.[23] Further, subject to regulations, the Data Fiduciary may submit such privacy by design policies to the Data Protection Authority for certification. Upon certification, the Data Fiduciary is required to publish the policy on its website.

Data Fiduciaries are required to maintain transparency regarding their general practices related to processing personal data[24] by making available to Data Principals the categories of personal data which they collect and the purpose of such collection and processing which may result in significant harm, data trust scores, and where processing is undertaken by automated means, certain personal data in machine readable form.[25] Data fiduciaries are also required to implement appropriate security measures to safeguard personal data.[26]

Erasure

The PDP Bill provides a direct right to seek erasure of irrelevant personal data.[27] This may require Data Fiduciaries to develop robust erasure mechanisms. Additionally, there is also a 'right to be forgotten' mechanism to restrict or prevent the continuing disclosure of personal data by a Data Fiduciary after adjudication.[28]

Regulatory Sandbox

The PDP Bill provides for a regulatory sandbox (between 12 (twelve) and 36 (thirty six) months in duration), pursuant to which entities can apply for exemptions from purpose, storage and consent requirements under the PDP Bill.[29] The intent is to create an eco-system which encourages the development of new technologies in the nature of artificial intelligence and machine learning.

Data Localisation

The PDP Bill mandates that all sensitive personal data continue to be stored in India, but may be transferred outside India for processing.[30] Such transfer is permitted upon satisfaction of requirements after obtaining explicit consent from the Data Principal and pursuant to intra group schemes or contracts which meet certain criteria. Cross-border transfers are also permitted with explicit consent to countries or entities permitted by the Central Government based on specified criteria.[31]

20 Section 6, PDP Bill.
21 Section 9, PDP Bill.
22 Section 8, PDP Bill.
23 Section 22, PDP Bill.
24 Section 23, PDP Bill.
25 Section 19, PDP Bill.
26 Section 24, PDP Bill.
27 Section 18, PDP Bill.
28 Section 20(2), PDP Bill.
29 Section 40, Bill.
30 Section 22, PDP Bill.
31 Section 34, PDP Bill.

Further, the PDP Bill provides for the creation of a narrow category of critical personal data to be assessed and notified by the Central Government. This category of data cannot be transferred outside India.[32]

Other Localisation Norms

While the above "soft" localisation is yet to be legislated, a far more extensive and tangible sector specific data localisation regime has been in place in India since April, 2018.

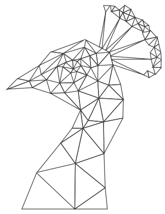
The Reserve Bank of India (**RBI**) vide notification dated April 6, 2018, directed all system providers to store data relating to payment systems[33] only in India[34]. A limited exception has been carved out wherein data which relates to the foreign leg of a transaction is permitted to be stored abroad as well.[35] The FAQs also specify that there is no restriction on processing of payment data outside India but such data must be stored only in India within 24 (twenty four) hours of the processing being complete. Separately, a system audit report (**SAR**) conducted by CERT-IN certified auditors which is duly approved by the board of the system provider, must be submitted to the RBI.[36]

E-Commerce Policy

A broader reflection of the above trend can be seen in a revised draft of the E-Commerce Policy (**Policy**), which was released on February 23, 2019.[37] In order to enable the use of "India's Data for India's Development", the Policy has aimed to create clearly defined restrictions on the ability of entities to share certain types of data outside India.

The Policy, after stating that data which is generated in India is a 'national asset',[38] seeks to restrict cross-border transfer of data generated from sources such as inter alia

32 Section 33(2), PDP Bill.
33 Section 2(1)(i), Payments and Settlement Systems Act, 2007.
34 RBI Notification on Storage of Payment System Data dated April 06, 2018.
35 Ibid.
36 Ibid.
37 Department for Promotion of Industry and Internal Trade, Draft National E-Commerce Policy available at https://dipp.gov.in/sites/default/files/DraftNational_e-commerce_Policy_23February2019.pdf..
38 Id at page 14.



social media networks, public Internet of Things (**IoT**) devices, search engines and e-commerce companies. [39]

Further, the Policy proposes additional restrictions on entities that collect or process any 'Sensitive Data'[40] in India and store it abroad. These entities must ensure that such data will (a) not be made available to business entities outside India or other third parties, for any purposes, even with customer consent; (b) not be made available to a foreign government, without prior permission of Indian authorities; and (c) immediately be made available to Indian authorities upon request.

Separately, it should also be noted that Section 2(B) of the PDP Bill provides that it is not applicable to the processing of anonymised data other than the anonymised personal data referred to in Section 91.

Section 91 of the PDP Bill proposed to vest power with the Central Government to compel any Data Fiduciary or processor to provide any anonymised personal data or other non-personal data that enables better targeting of delivery of services or formulation of evidence-based policies.[41]

The Ministry of Electronics and Information Technology has constituted a Committee of Experts under the Chairmanship of Kris Gopalakrishnan on September 13, 2019 to (a) study various issues relating to non-personal data; (b) deliberate on a data governance framework; and (c) make specific suggestions regarding the regulation of non-personal data. An indicative timeline for the release of the report is yet to be notified.

Telecom Law

The Unified License Agreement proscribes the transfer of (a) any accounting information relating to the subscriber, except for international roaming/billing details and any statutorily required disclosure of financial nature; and (b) user information other than those pertaining to foreign subscribers using Indian operator's network while roaming, and International Private Leased Circuit subscribers to any person/place outside India.

Insurance Law

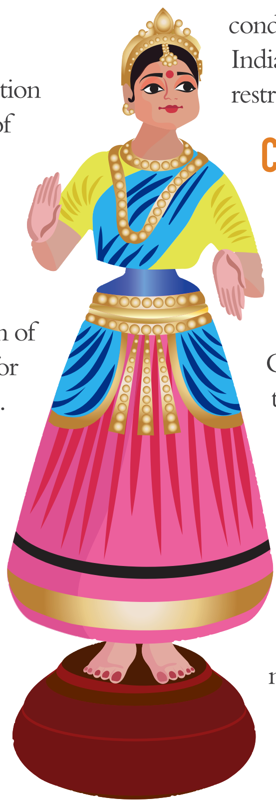
The IRDAI (Outsourcing of Activities by Indian Insurers) Regulations, 2017 mandates that all original policy holder records must be maintained in India.

Companies Law

The Companies Act, 2013 read with the Companies (Accounts) Rules, 2014 mandates the storage of back-up copies of the company's books of account and other books and papers in servers which are physically located in India.

Draft E-Pharma Regulation

The draft amendment to the Drugs and Cosmetics Rules, 1945 (**DC Rules Amendment**) has proposed to mandate the localisation of data that is generated while conducting business through an e-pharmacy portal in India. Further, the DC Rules Amendment seeks to restrict the transfer of such data outside the country.



Conclusion

The PDP Bill has been referred to a Joint Parliamentary Committee (**Committee**) for further evaluation. The terms of reference to the Committee specify that the Committee is required to submit its report in the last week of the 2020 Budget Session of the Parliament.

Further, media reports indicate that the Committee intends to undertake wider consultation with stakeholders before it submits its report. This may forebode further changes in the Bill before its enactment.

Businesses would be well-advised to align their operations and processes with the data protection imperatives in order to prepare for the forthcoming legislation.

39 Id at page 16.
40 Sensitive Data has not been clearly defined in the Policy.
41 Section 91, PDP Bill.

THE JOURNEY OF INNOVATION AT LAW FIRMS

"If you want something new, you have to stop doing something old"

[- **Peter Drucker**]

Introduction

Everyone has been mesmerized by the words "Innovation", "New technologies", "AI & Blockchain". Innovation is imperative in current times and often when we hear discussions on innovation, it is primarily resonated with technology. This is indeed not true, and adoption of technology is in fact just one aspect of innovation. Legal innovation and legal technology continue to be read together, even though they are not the same thing. You can innovate using legal technology and you can also innovate without it. Innovation is more about opening our mind, changing our behavior, honing our skills and mindset. In this context, Scott Anthony of Innosight Consulting who, together with his colleague, Professor Clayton Christensen of Harvard, has researched innovation for decades, defines 'innovation' as "doing something different with impact[1]".

Innovation is becoming increasingly relevant for Law firms. The focus of Law firms is now moving from making that one big disruptive change to making hundreds of small incremental changes. Firms are identifying the factors pushing for innovation, which could be internal i.e. to generate higher revenue or provide a better work life balance to the lawyers, or external, including where the clients ask for a faster turnaround time or highly competitive pricing. Innovation, put simply,

1 See https://www.lawgazette.co.uk/practice/how-to-be-innovative/5041688.article.

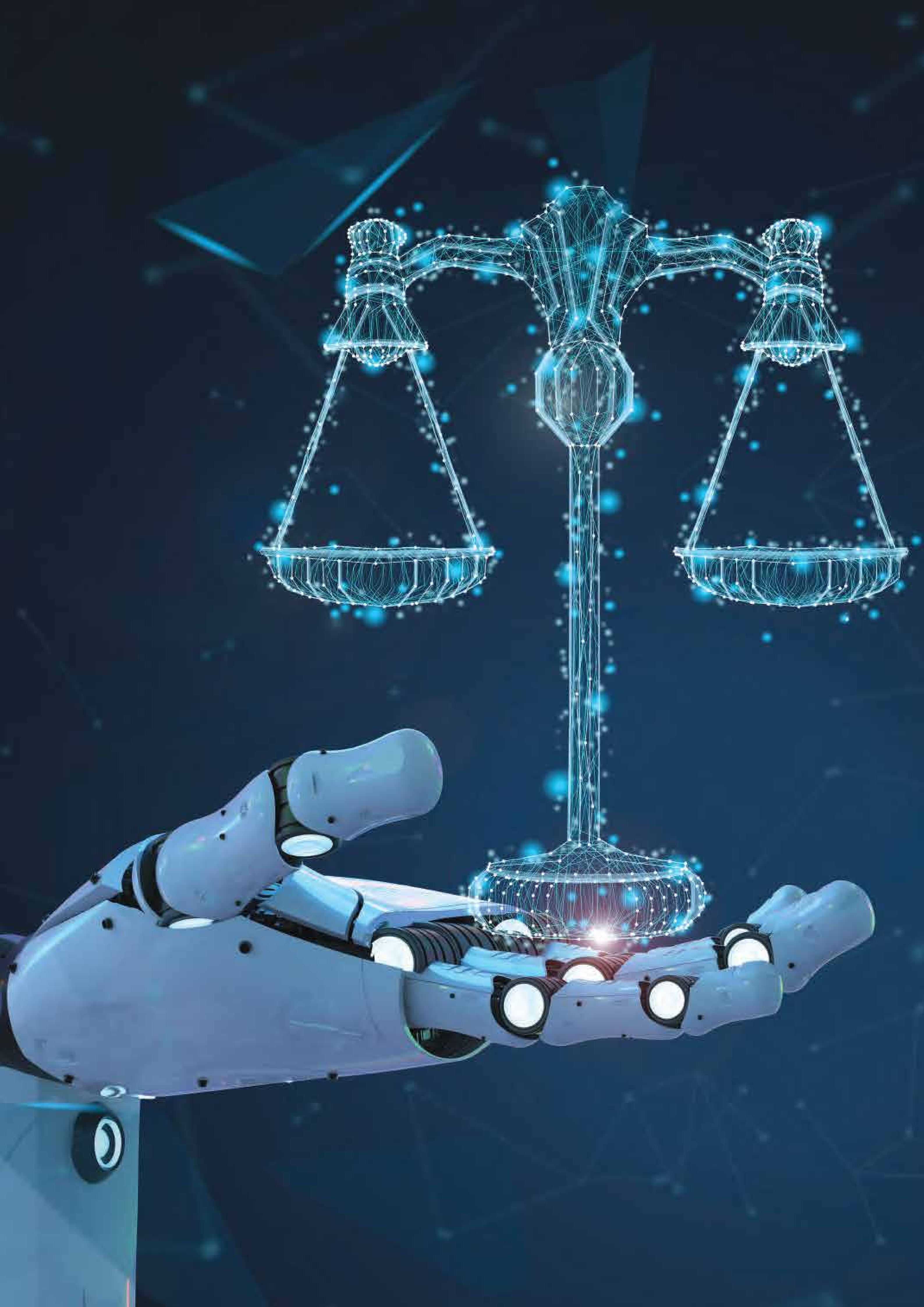
is using new ideas to create more effective processes, more dynamic products or better ways to deliver the current services. Law firms are slowly realising the need for innovation and in certain instances, feeling the brunt of the changing face of the legal industry. Law firms are also moving away from short-term innovation goals aimed at adding immediate financial value towards long term strategies that drive the culture of innovation and add value to the firm. It is easy to talk about change but it is difficult to make the change happen. Accordingly, to drive the innovation process in a useful manner, it is imperative to understand the internal requirements, the needs of the clients, and to ensure that such requirements are well understood and appreciated by lawyers at every level in the firm. Innovation should be both top-down and bottom-up.

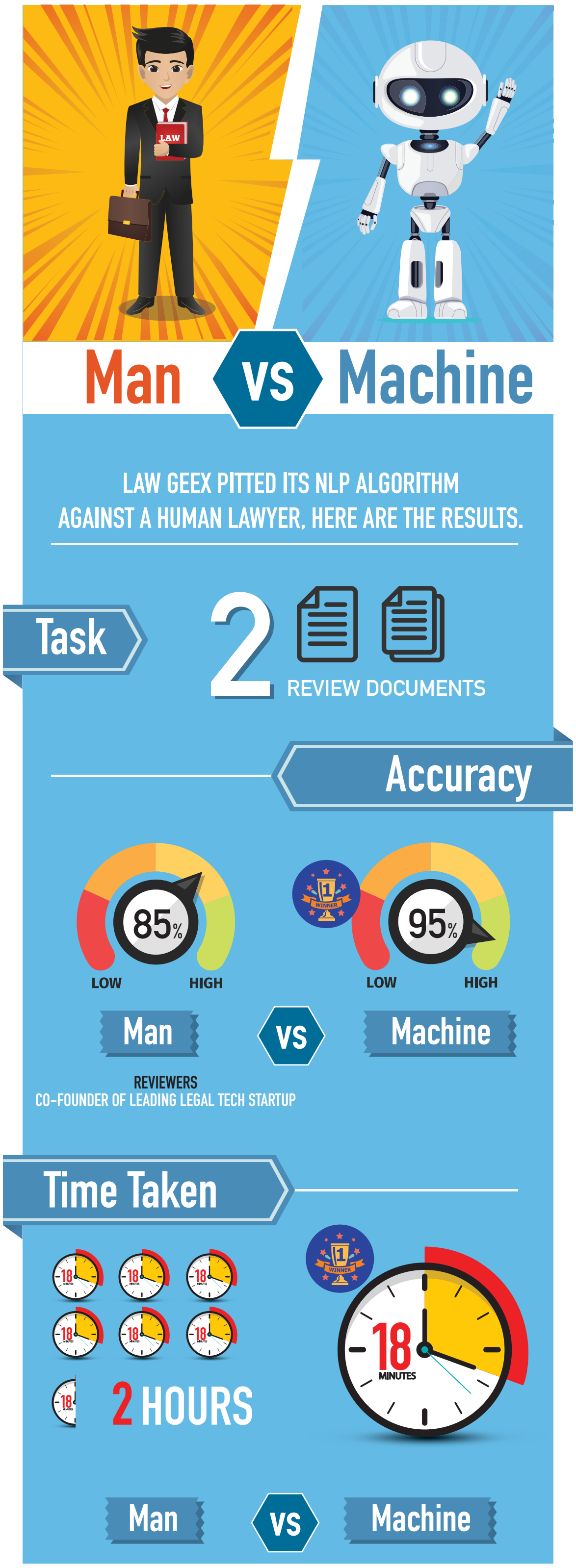
Why Innovate?

The question that often arises is 'why innovate?' When it is time to change, you must. The legal industry is undergoing transformation, and all for the good – good for the clients, good for the lawyers and good for the industry as a whole. Some of the current innovative practices introduced in the Indian legal scenario are:

(a) offering innovative pricing models;
(b) better efficiency and accuracy, using emerging and successful technologies;
(c) improved utilization of resources;
(d) bespoke services for end to end delivery;
(e) launching alternative legal services;
(f) process manuals
(g) standardization; and
(h) driving the culture of Innovation

“The question that often arises is 'why innovate?' When it is time to change, you must. The legal industry is undergoing transformation, and all for the good – good for the clients, good for the lawyers and good for the industry as a whole.”





Offering Innovative Pricing Models

Growth is essential for any successful business. The Indian Law firms are at a phase where most of them are facing rising costs, pricing pressure and the need for investment in staff, resources and service delivery. They are finding that growth and scale is not as easy to achieve as it was earlier. With the growing propensity amongst corporates to have in-house legal teams and the adoption of technologies by them, it is becoming necessary for Law firms to change how they price their services. Clients are expecting Law firms to evolve in this respect, both pre-emptively and in response to a changing global landscape. In response to clients' demands for greater predictability and desire to control legal costs more effectively, more Law firms are moving away from conventional pricing methods and devising non-hourly billing strategies.

Clients now prefer innovative pricing models, such as a fixed transaction fee, per unit billing or a combination of different pricing methods, which predict the legal spend in advance. This has led the Law firms to innovate their processes and cut down turnaround time. Today clients understand that alternative fee arrangements are value based and transparent, and Law firms have accepted that alternative pricing models are the new norm.

Better Efficiency and Accuracy using Emerging and Successful Technologies

Various studies have shown that using technology can help in improving efficiency and accuracy of lawyers. In continuation of its "man vs. machine" competition, Law Geex pitted its NLP algorithm against a human lawyer. The lawyer, who is a co-founder of a leading legal tech startup took over an hour to review the two documents which he did with 85% and 83% accuracy. 'LawGeex bested the human lawyer by spending just 18 minutes reviewing and achieved 95% accuracy on two contracts. Previously, a similar challenge was conducted by Law Geex in which 20 US trained lawyers were pitted against their artificial intelligence (AI) tool to evaluate legal contracts showed dramatic

2 See https://www.artificiallawyer.com/2019/04/23/lawgeex-beats-human-lawyer-round-two-feat-vice-news-dealwip/

results. In the experiment the lawyers spent an average of 92 minutes to review five non-disclosure agreements with an 85% accuracy while the AI tool reviewed and marked the relevant clauses in merely 26 seconds with an astounding 95% accuracy[3]. We have witnessed similar results while testing Kira, in-house, at 'Cyril Amarchand Mangaldas'.

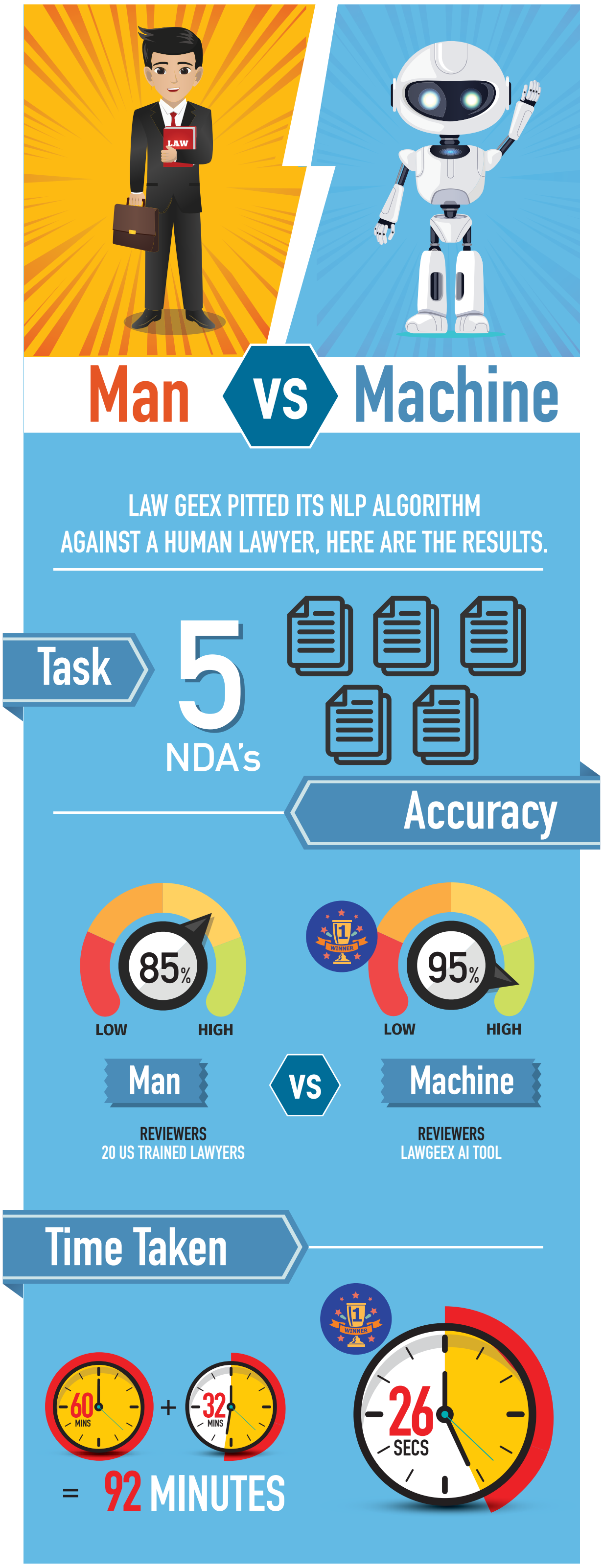
The attorneys in the Law firms are now embracing technology and innovation and preferring to spend most of their time on legal advisory and business development tasks and lesser time on the tasks that can be automated. AI systems, such as contract analysis or new research systems, reduce the time spent on routine legal tasks to provide better value, productivity and efficiency.

Law firms are turning to technology to help identify and exploit potentially short-lived windows of opportunity. At the same time, focus is shifting to the role of technology in monitoring and making-sense of the evolving landscape. Technology is now at the centre of new operating models, with a particular emphasis on the use of AI and chat-bots to automate tasks previously performed by skilled workers. Technology has a multiplier effect, allowing more to be done with fewer people.

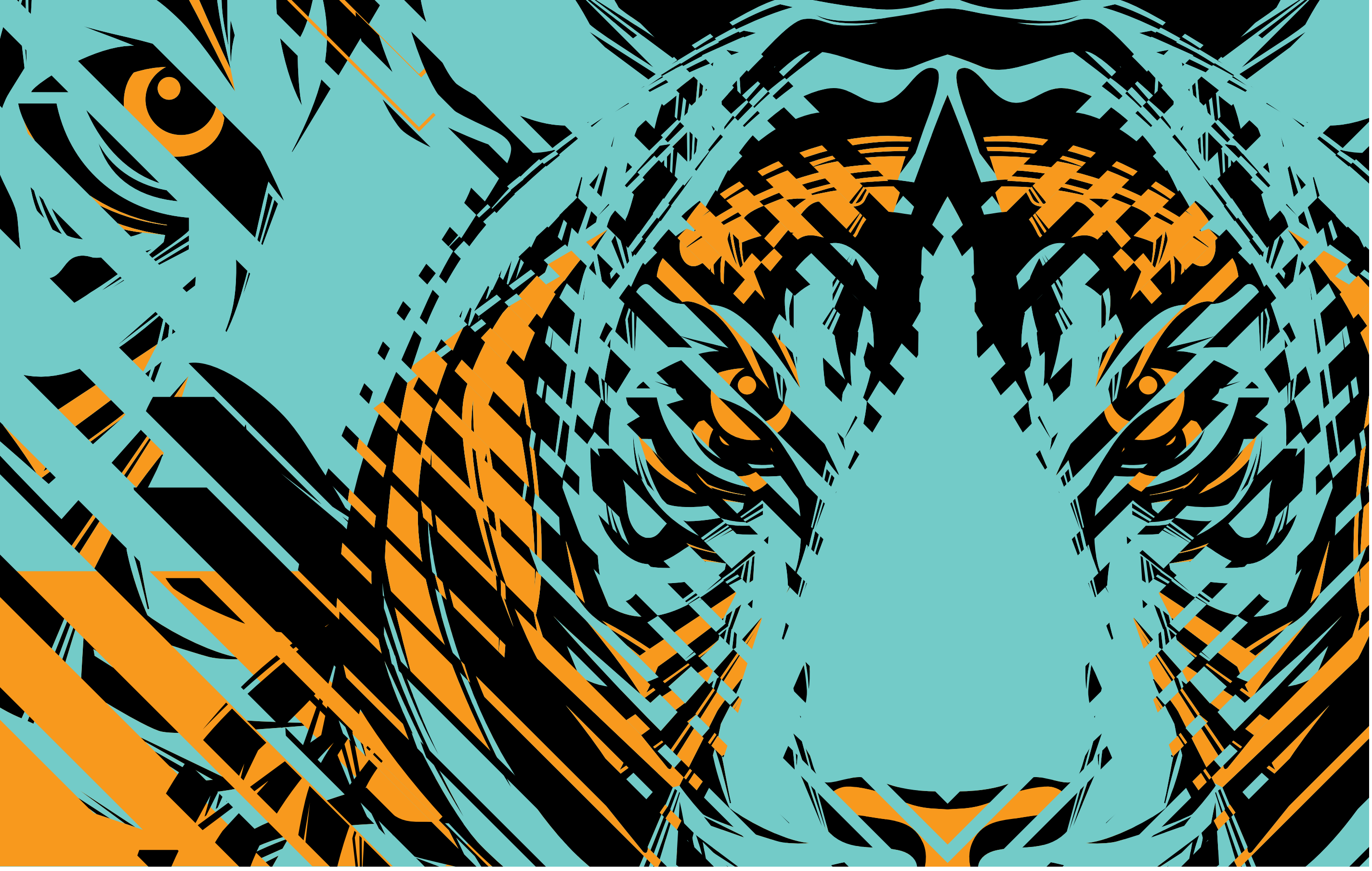
There are popular technologies that are being used for various services. E-discovery is the most mature market with Relativity, Ringtail and the likes that enable faster turnaround time and also remove duplicates. 'Technology assisted review' is becoming highly popular with these review tools.

There is an increase in the usage of contract extraction tools that are helping with contract analysis and due diligence. These tools reduce the need for attorneys to do basic level work and instead be assigned for higher value tasks. These tools are also being used for risk analysis.

A Number of firms have started using AI based legal research and legislative tracking tools. The use of these tools helps firms save numerous hours spent on legal research manually and provides the firms with greater and more efficient manpower utilization.



3 See https://www.lawgeex.com/AIvsLawyer/



> Law firms are looking beyond the doers and are now focusing on the thinkers, creators and inspirers.

Firms are now looking at experimenting with the development of online products on open platforms aimed at specific sectors (e.g. banking & finance, private client) where they are combining their legal knowledge into online subscription products that give clients access to automated document creation or knowledge (e.g. compliance tracking, estate management, etc.)

As a part of the innovation drive, firms that initially offered only 'compliance manuals' are now taking a leap forward by either integrating third party compliance management software or developing a compliance management suite, in-house, to meet the end-to-end needs of the clients.

Improved Utilization of Resources

The process of breaking down services, identifying the right resource for the right task, effort estimation including quality control has enabled Law firms to utilize their resources optimally and cross-train their teams to work in different practice groups on need basis. This ensures low bench/idle time, higher productivity and utilization, which widens the scope of individual learning and results in happier lawyers.

In-house Alternative Legal Service Providers

Legal services are no longer being provided by law-firms and lawyers alone. The 'big four' and the 'alternative legal service providers' (ALSP) have emerged strongly in the recent years and have been giving Law firms and in-house teams tough competition on routine, repeatable and voluminous work. The growth in outsourcing units is also seen as a major threat to Law firms, especially for perceived non-intellectual tasks.

Global firms have launched their own ALSPs and are succeeding in their business because clients still trust such Law firms with all their work. If a Law firm can be a one stop shop, clients would not prefer to explore multiple vendors. One of the reasons why clients look for other service providers is because a Law firm has not evolved enough and cannot provide certain service offerings. This is being addressed by introducing a new practice that is focused on non-advisory repeatable voluminous work that is best delivered with the right combination of people, process and technology. A consulting solution approach is being created for corporate clients that includes deconstructing and re-engineering legal processes, preparing and delivering new operating models, defining service levels, metrics and governance processes.

Bespoke Services for End-to-End Delivery

Over the years, more specialized services have evolved globally to meet the needs of the clients. Even clients and their needs have evolved. The Indian Law firms are following the global trend. For instance, Law firms are now providing bespoke services for start-ups that take them from seed funding to the filing of an 'initial public offering' at competitive prices.

Firms have also started utilizing 'contract lifecycle management' and 'regulatory compliance' tools which ensure that the attorneys spend less time on managing contracts, tracking renewal dates, filing compliances etc. Instead, now the attorneys can spend more time on advisory and drafting activities. This automation has led to an increase in efficiency and a decline in missed deadlines.

Process Manuals

Everything in life is an act of processes, from the time one wakes up till the bedtime. It is important to put all processes in places from conflict check to the close of the matter and returning/deleting clients' confidential information, etc. Law firms are not only creating manuals for each practice group but also for the functioning of the firm as a whole.

Standardization

For Law firms to work more effectively and be profitable, it is important to learn the art of standardization against global benchmarks. Standardization of documents across the Law firm would not only save time but will also help in the adoption of technology. It is important for Law firms to innovate and have standard drafts of all documents to be shared across the firm and across practice groups. This increases efficiency and also the profitability.

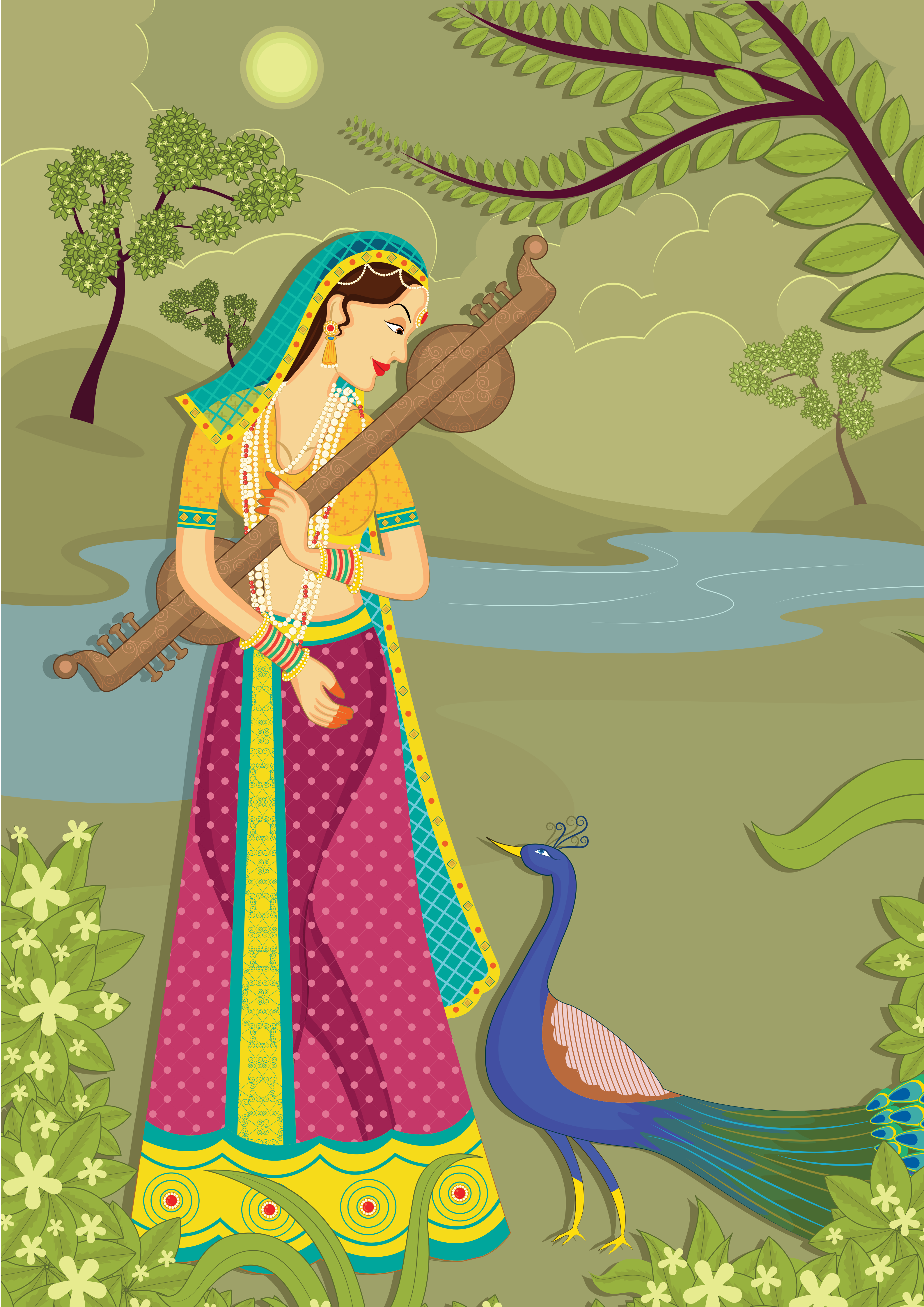
Driving the culture of Innovation

To make innovation sustainable and to engrain it in the DNA of the firm, Law firms are now hiring dedicated Innovation teams led by specialists who create and drive the culture of Innovation. Firms are moving towards the concept of "Kaizen" where every stakeholder is a part of the innovation journey. This is being made possible by crowdsourcing innovative ideas and suggestions on process improvements. They are now looking at their employees as Intrapreuners which in turn encourages and empowers them to be a part of the change. Intrapreunership is a bottom-up approach and helps to develop radical innovations in-house. Innovation weeks are being observed and each idea submitted is assessed and the relevant ones are implemented. The innovation week encourages people to think, create and participate. The ideators are mostly recognized and rewarded.

Law firms across the world are launching legal tech incubators & accelerators to foster creativity and talent. These incubators provide physical working space, mentoring, intellectual capital and access to a marketplace. By launching incubators, firms are moving their focus from people to products and processes. The aim of the incubators is to encourage legal tech developers to develop more suitable products, to give Law firms a direct access to some of the brightest minds and for firms to identify prospective technologies and business practices. Law firms are looking beyond the doers and are now focusing on the thinkers, creators and inspirers.

Conclusion

Law firms are driving innovation consciously. They are investing in the growth of their people, identifying products that can improve work-life balance and designing processes to standardize practices. Firms are also having year-to-year innovation plans that are reviewed and measured periodically for effectiveness. Firms are moving focus from problem solving to value creation and are now thinking about problems differently. They perceive the problems as opportunities to create new value. We now believe that when everyone else is facing in one direction, deliberately looking in another direction is the way forward.



DO FOREIGN SEATED ARBITRATIONS RESULT IN FOREIGN AWARDS?

Introduction

The concept of the 'seat' of arbitration implies not just the geographical location, but the legal jurisdiction to which the arbitration is tied . The seat will normally determine the curial law (*lex arbitri*), which the arbitration follows, and the courts will have jurisdiction and a supervisory role over the conduct of the arbitration. It is to be noted that Part I of the Arbitration and Conciliation Act, 1996 (**Act**), contains detailed provisions relating to the procedure of arbitration, as also challenges and enforcement of an award, and is stated to apply to arbitrations that take place within India. Part II contains provisions only in relation to referring parties to foreign arbitration (i.e. foreign seat), and enforcement of a foreign award.

The Act does not use the word 'seat', but instead refers to the 'place' of arbitration, although the concept and consequences of a seat were specifically recognised in the seven-judge bench decision of the Supreme Court in Bharat Aluminium Company v. Kaiser Aluminium Technical Services[1](**BALCO**). In 2014, the Law Commission of India proposed amendments to the Act that would clarify the difference between a (legal) seat and a (mere) venue for arbitration; however, this amendment was not brought into effect when the Act was amended in 2015. Nevertheless, the concept is accepted, recognised and applied by courts across India. Recently, the Supreme Court shed some light on ambiguity over the seat of an arbitration. It noted that where an

1 [2012] 9 SCC 552.

arbitration agreement referred to a 'venue' (but made no reference to 'seat' or 'place'), it did not automatically make such identified venue the seat of the arbitration. In such cases, a number of factors would have to be considered, such as, the cause of action, location of parties and witnesses, etc., to determine which place has the "closest connection" with the agreement. Such a place would then be identified as the 'seat' of arbitration.[2]

In BALCO, the Supreme Court ruled that the consequence of a foreign seat amounted to an exclusion of the provisions of Part I of the Act and the jurisdiction of Indian courts. Part I and the requisite arbitration procedure – critically the ability to challenge an arbitral award, would apply only when India were the seat. Resultantly, it was (happily) ruled that it was not open to parties to challenge foreign awards before Indian courts (something that an earlier Supreme Court decision in Venture Global Engineering v. Satyam Computer Services Ltd.[3], had ruled could be done).

What is a Foreign Award?

The obvious answer is, a foreign award is an award culminating out of arbitration proceedings taking place in a foreign seat (rather than mere venue). Pursuant to the ruling in BALCO and the subsequent amendments to the Act in 2015, a foreign award can be challenged only at the courts of the seat; enforcement could be sought from an Indian court (which could be opposed), and the award would be enforced, subject to meeting the conditions set out in Part II of the Act.

Are All Foreign Awards Enforceable in India?

There are various conditions that are required to be met before an award is recognised as a foreign award and enforced as such under the Act.

(a) **Condition 1:** A foreign award must arise out of an arbitration relating to disputes arising out of legal relationships, which are considered as 'commercial' under Indian law. As the Supreme Court noted in R.M. Investment & Trading Co. v. Boeing Co.[4], the term 'commercial' should be construed broadly as "having regard to the manifold activities which are an integral part of international trade today".

That said, if the dispute covered and the award rendered by the tribunal in the arbitration is not 'commercial' in nature, such an award may not be enforceable under the Act.

(b) **Condition 2:** The award must be in pursuance of an agreement in writing, for arbitration to which the New York Convention (or the Geneva Convention), applies. The New York Convention has been entered into by about 148 contracting states, to recognise and enforce arbitration awards made in other contracting states, i.e. foreign awards. Additionally and crucially, this condition is not met just by virtue of the award being passed in a jurisdiction or country, which is a signatory to the Conventions. Such signatory territory must also be notified by the Central Government for the purposes of recognition and enforcement in India.

As such, an award passed in a jurisdiction that is not a signatory to the New York Convention (or the Geneva Convention); or, though passed in a signatory country, not notified by the Central Government, would not be amenable for enforcement under the Act. The Supreme Court had noted this lacuna in its judgement in Bhatia International v. Bulk Trading SA[5] to therefore suggest that such awards could then be enforced under Part I of the Act, but as aforesaid, this judgement was overruled

2 Union of India v. Hardy Exploration and Production (India) Inc, AIR 2018 SC 4871.
3 (2008) 4 SCC 190.
4 1994 SCC (4) 541.
5 (2002) 4 SCC 105.

in BALCO, where it was clarified that Part I would not apply and that Indian courts would not have jurisdiction over any foreign arbitration (or award). It should be noted in this regard, that of the approximately 148 countries that are signatories to the New York Convention, India has notified only about 50 countries.

(c) <u>**Condition 3**</u>**:** The award should not fall foul of other conditions based on which enforcement would be granted. For instance, it should not be passed in relation to disputes which are not amenable to arbitration under Indian law (for example, testamentary matters, criminal offences, cases of oppression and mismanagement of companies, etc.), or where a party was not given proper notice of arbitration or was unable to present its case and of course, if the award is contrary to the public policy of India. Notwithstanding that an award has become final in its jurisdiction, even by way of a challenge to such award having been heard and rejected, it may not meet the test of enforceability under the provisions of the Act so as to enable its enforcement in India. To clarify, this is not an easy condition to meet and a majority of foreign awards that meet the first two conditions are enforced.

In a recent decision, enforcement of a foreign award was refused on the ground that the submissions of one party were entirely ignored (thereby breaching natural justice and being against public policy), and for allowing consolidation of two distinct claims arising from two distinct contracts by lifting the corporate veil, but without giving any reasons.[6]

(d) <u>**Condition 4**</u>**:** It is debatable whether there is another condition for enforcement of a foreign award – can two or more Indian parties choose a foreign seat? Would such an award be a foreign award? Would it be enforceable?

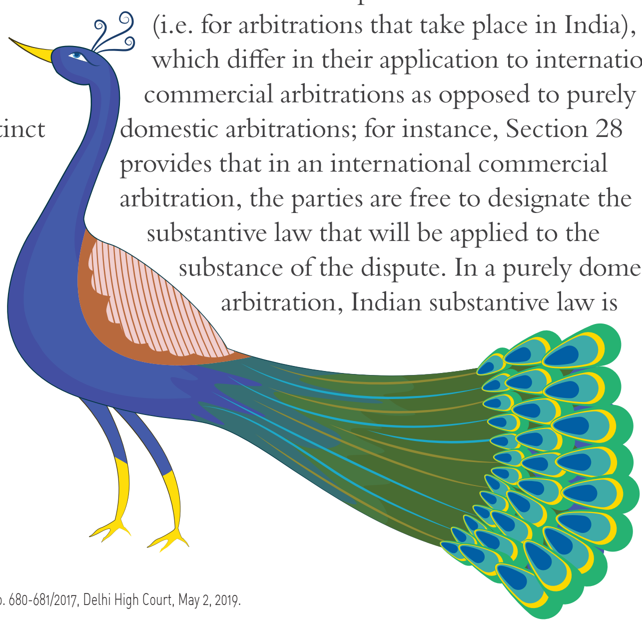
Can Two Indian Parties have a Foreign-seated Arbitration?

There are two factors at play here; the first being the respect for party autonomy, something that is an intrinsic and fundamental characteristic of arbitration; and the second is a larger policy question in relation to Indian parties being permitted to derogate from Indian law and Indian court jurisdiction in relation to a matter where there is no cross-border element.

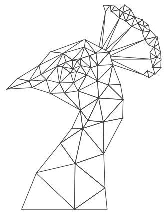
There is nothing in the Act that specifically precludes two Indian parties from choosing a foreign seat of arbitration. Where a preclusion was intended, it has been included; for instance, in an arbitration taking place in India between Indian parties, the arbitral tribunal is required to decide the dispute in accordance with Indian substantive law. The primary characteristic that distinguishes a domestic award from a foreign award is the seat i.e. a foreign seat (in a notified Convention country), gives rise to a foreign award. Part II which deals with foreign awards treats as irrelevant, the nationalities of the parties involved in the arbitration. The nationality of the parties is relevant only of the Act to consider whether an arbitration is an 'international commercial arbitration', as opposed to an arbitration solely between Indian persons.

Yes, they can!

There are certain provisions in Part I of the Act (i.e. for arbitrations that take place in India), which differ in their application to international commercial arbitrations as opposed to purely domestic arbitrations; for instance, Section 28 provides that in an international commercial arbitration, the parties are free to designate the substantive law that will be applied to the substance of the dispute. In a purely domestic arbitration, Indian substantive law is



6 Campos Brothers Farms v. Matrubhumi Supply Chain Ltd. , O.M.P.(EFA)(COMM.) 1/2017 & IA No. 680-681/2017, Delhi High Court, May 2, 2019.



required to be applied and no derogation is permitted therefrom. Given that these provisions are contained in and apply only to Part I, which is stated to apply "where the place (meaning seat), of arbitration is in India", and that Section 28 applies to cases "(w)here the place of arbitration is situated in India", it can be argued that as there is no specific prohibition in the Act against Indian nationals choosing a foreign seat, such choice of a foreign seat is permitted.

Taking it a step further, if the arbitration is in a foreign seat, Part I would not apply and similarly, the embargo against a foreign substantive law should also not apply even if the arbitration is between purely Indian parties. The question then arises, whether the law could be intended to mandate that Indian parties cannot contract out of Indian substantive law only when the arbitration is seated in India, but would be entitled to do so should they choose a foreign seat. Considering the closest connection test in the application of a substantive law, there is considerable jurisprudence to suggest that where the parties are Indian and the performance of the contract is in India, logic dictates and the closest connection test would mandate that Indian law is appropriate as a substantive law and should be applied.

Two High Courts in India -- viz. the Madhya Pradesh High Court in Sasan Power Ltd. v. North American Coal Corp[7] (Sasan Power) and the Delhi High Court in GMR Energy Ltd. v. Doosan Power Systems[8] have ruled that there is no bar under the Act and that nothing prevents two Indian parties from choosing a foreign seat. Sasan Power went up to the Supreme Court in appeal, but on the basis of a finding that the matter at hand was an international commercial arbitration (and that therefore a foreign seat was expressly permitted), the Supreme Court did not decide the issue.[9]

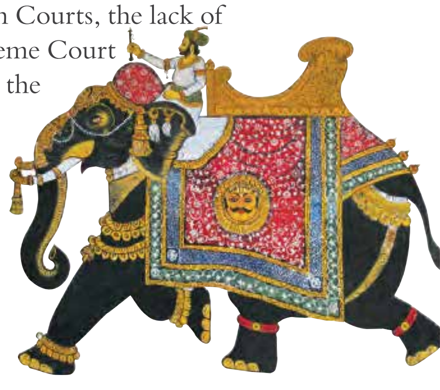
No, they cannot!

Reliance is often placed upon Section 28 of the Indian Contract Act, 1872, which makes void, any agreement in restraint of legal proceedings. It has been argued that any provision in a contract, which restrains an Indian person from enforcing his rights through usual legal proceedings under law, by ousting the jurisdiction of Indian Courts is void. On the basis that a foreign seat means a foreign curial law and foreign court jurisdictions over the arbitration (save for international commercial arbitrations which are exceptions), two Indian nationals cannot oust the jurisdiction of Indian courts and thus cannot choose a foreign seat. This argument needs to be further developed and considered by courts in as much as the Section specifically carves out an exception in respect of an arbitration agreement. Section 28 of the Act, explained above, is most often used to argue that a foreign seat cannot be availed of in a purely domestic arbitration.

The case of TDM Infrastructure Pvt. Ltd. v. UE Development[10] (TDM Infrastructure) makes the point that when both parties are companies incorporated in India, the arbitration will be a domestic arbitration and that accordingly, parties cannot derogate from Indian law. Notably, the Supreme Court in TDM Infrastructure, however, did not examine the issue of whether a foreign seated arbitration between two domestic parties was permissible at all. On the basis of TDM Infrastructure and Section 28 of the Act, the Bombay High Court in Addhar Mercantile P. Ltd. v. Shree Jagadamba Agrico[11] held that two Indian parties could not contract out of Indian substantive law as that would be contrary to the public policy of India, and then (slightly tangentially), held that therefore, India be mandated as the seat of arbitration.

We repeat – Condition 4?

The answer is not fully clear in view of the conflicting decisions of High Courts, the lack of a clear ruling from the Supreme Court and the lack of clarity under the



7 First Appeal No. 310 of 2015, Madhya Pradesh High Court.
8 2017 SCC Online Del 11625.
9 (2016) 10 SCC 813.
10 (2008) 14 SCC 271.
11 2015 SCC Online Bom 7752.

Act. Certainly there is a risk in two Indian parties choosing a foreign seat, i.e. the risk of the eventual award being held contrary to Indian public policy.

Any clarity under Arbitration and Conciliation (Amendment) Act, 2019?

The Arbitration and Conciliation (Amendment) Act, 2019 has brought significant amendments to Part II of the Act. The intervention by a judicial authority under Section 45 of the Act has been restricted to situations wherein the judicial authority prima facie finds that the arbitration agreement is null or void, inoperative or incapable of performance. Further, Section 50 of the Act has been amended to provide that the right to appeal from an order refusing to enforce a foreign award as the same would lie notwithstanding anything contained in any other law. However, the lack of clarity still persists.

Conclusion

All arbitral awards passed outside of India are foreign awards. However, they are not 'Foreign Awards', as defined under the Act for the purposes of being enforceable in India. In order for an award to be enforced in India, abovementioned conditions one, two and three, are statutorily required to be met. Condition four is still debatable in view of the conflicting views of the High Courts, but international practice would normally posit that a foreign seated arbitration between domestic parties should be permissible.

LIBERALISATION
OF THE MANAGERIAL REMUNERATION REGIME IN INDIA

*The provisions of Section 67 of the Companies (Amendment) Act 2017 (**Amendment Act**), which came into force on September 12, 2018, and the separate notification issued by the Ministry of Corporate Affairs on September 12, 2018 (**Notification**) extend autonomy for public companies in connection with payment of remuneration to their management. This Article seeks to broadly summarise the framework for managerial remuneration pursuant to the provisions of Section 197 of, and Schedule V to, the Companies Act, 2013 (**Act**), as modified by the Amendment Act and the Notification. Different provisions are applicable in the Act, to companies that have adequate profits, and to those that have made losses or have inadequate profits.*

For simplicity, we will first consider the provisions on payment of managerial remuneration, in the case of a company which has adequate profits.

◈ Company having adequate profits

Liberalisation of Total Managerial Remuneration

As per the Act, the total remuneration which a public company having adequate profits is permitted to pay its directors, executive and non-executive, in any financial year, cannot exceed eleven per cent of the net profits of the company for that financial year; however, the limit can be exceeded if the company complies with the provisions laid down in the Act for this purpose. Prior to the notification of the Amendment Act, companies wishing to exceed this 11% limit, were required to obtain approval of the Central Government, in addition to approval from their shareholders at a general meeting. Pursuant to the amendment, companies can now pay remuneration in excess of this 11% overall limit after simply obtaining approval from their shareholders at a general meeting. In the absence of any requirement that such approval be by way of a special resolution, it appears that the approval may be by way of an ordinary resolution.

This provision applies to remuneration payable to all directors of a public company and does not distinguish between promoter and non-promoter directors or independent and non-independent directors. A company can, upon receipt of the approval of its shareholders to do so, and upon compliance of all the other provisions of the Act and other relevant legislation, exceed this 11% limit to any extent.

Liberalisation of Sub-limits on Managerial Remuneration

The Act also imposes certain further limits, within the overall limit of 11%, (when no approval to exceed it is obtained) on payment of remuneration by public companies to individual directors or managers or classes of directors, which limits can again be surpassed with the approval of shareholders of the company at a general meeting. However, this approval of the shareholders is now required to be by way of a special resolution.

Without such approval –

a) the remuneration payable to any one managing director or whole-time director or manager of a public company cannot exceed 5% of the net profits of the company; and if there is more than one such director, the remuneration to all such directors and manager taken together cannot exceed 10% of the net profits of the company;
b) a public company which has a managing or whole-time director or manager, can pay remuneration to its directors who are neither managing directors nor whole-time directors not exceeding 1% of the net profits of the company; otherwise, it can pay remuneration to its directors who are neither managing directors nor whole-time directors not exceeding 3% of the net profits of the company.

If the shareholders pass a special resolution permitting payment of remuneration beyond these sub-limits, the company is entitled to pay its directors such higher remuneration as specified in the special resolution but it will still be bound by the overall limit (i.e. 11%), unless the shareholders also pass a resolution for exceeding the overall limit.

◊ Company having losses or inadequate profits

Payment of Managerial Remuneration to Executive Directors

The procedure for payment of managerial remuneration to executive directors in cases of companies having losses or inadequate profits has also been simplified by the Notification. Previously, a company having losses or inadequate profits could, without Central Government approval, pay managerial remuneration as per the table below, and the limits in the said table could be doubled if shareholders passed a special resolution (in either case, to be pro-rated for a period less than a year). Now the Act allows payment of managerial remuneration in excess of the limits in the table below, up to whatever amount that the shareholders may by a special resolution, decide. Again, the remuneration is to be pro-rated for a period less than a year.

Where the effective capital[1] is	Limit of yearly remuneration payable shall not exceed (Rupees)
(i) Negative or less than 5 crores	60 lakhs
(ii) 5 crores and above but less than 100 crores	84 lakhs
(iii) 100 crores and above but less than 250 crores	120 lakhs
(iv) 250 crores and above of Rs. 250 crores of the effective capital in excess	120 lakhs plus 0.01%

To sum up, a company that has made losses or has inadequate profits will have two options:

- Pay remuneration within the limits specified in the table above, with the approval of the shareholders by ordinary resolution, and in the case of a company that is required by sub-section (1) of section 178 of the Act, to have a nomination and remuneration committee, also with the approval of such committee; Or
- Pay remuneration in excess of the limits specified in the table above, with the approval of shareholders by special resolution.

1 As defined in Part IV of Schedule V.

The resolution at the general meeting can authorize such payment for a period not exceeding 3 years.

For such companies, in case of a managerial person who is functioning in a professional capacity, remuneration as per the above provisions may be paid, if such managerial person is not having any interest in the capital of the company or its holding company or any of its subsidiaries or through any other statutory structures and not having any interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date of appointment and possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates. An employee shall not be considered as having any interest in the capital of the company if he holds shares of the company not exceeding 0.5% of its paid up share capital under any scheme formulated for allotment of shares to such employees or by way of qualification.

Among other things, Schedule V also provides exceptions where the provisions of Section II of Schedule V would not apply.

Payment of Managerial Remuneration to Non-Executive Directors

In any financial year, if a company does not make any profit or if its profits are inadequate, it cannot pay remuneration to its non-executive directors. However, this prohibition does not include sitting fees, which can be paid regardless of whether a company makes profits or not.

Additional Points for Consideration

In addition to the broad framework for payment of managerial remuneration set out above, the following should be considered by a company in relation to payment of remuneration to its managerial personnel.

a) **Articles of association –** A company must always refer to its articles of association which may provide further specifications regarding the manner of determination/ payment of remuneration.

b) **Approval of the board and the nominations and remuneration committee**, where required by the Act, should be taken.

c) **Pending Applications –** Applications for payment of remuneration in excess of the specified limits pending with the Central Government on September 12, 2018 are

deemed to abate. Applicant companies should obtain the approvals required under the Act within one year from that date.
All other amendments to the Act including Schedule V would apply only to the remuneration payable to a managing director/ whole-time director/manager or other directors of a public company, from September 12, 2018.

d) **Remuneration for Services –** The term 'remuneration' generally includes remuneration payable to directors for the services rendered by them in any other capacity. The exception to this general rule is remuneration for services:

(i) which are of a professional nature; and
(ii) if the director concerned possesses the requisite qualification for the practice of the profession, in the opinion of the nomination and remuneration committee, if the company is required by sub-section (1) of section 178 of the Act to have such a committee, or in the opinion of its board of directors, in other cases. The term "services" in this context is to be construed after considering Appendix II to the Act.

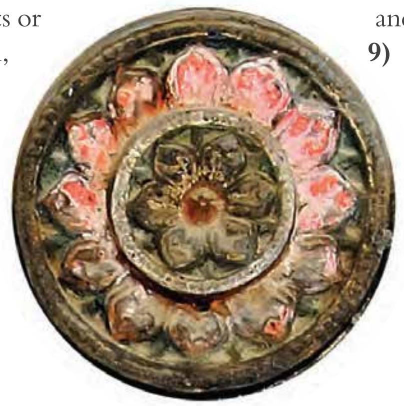
e) **Default in Payment of Dues –** Companies which have defaulted in the payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, are required to obtain the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, before obtaining the approval in the general meeting, where companies wish to exceed the overall limits or the sub-limits on remuneration, and in cases of companies wanting to pay remuneration where they have no profit or inadequate profit; or where companies wish to waive the requirement to refund the excess remuneration drawn or received by directors.

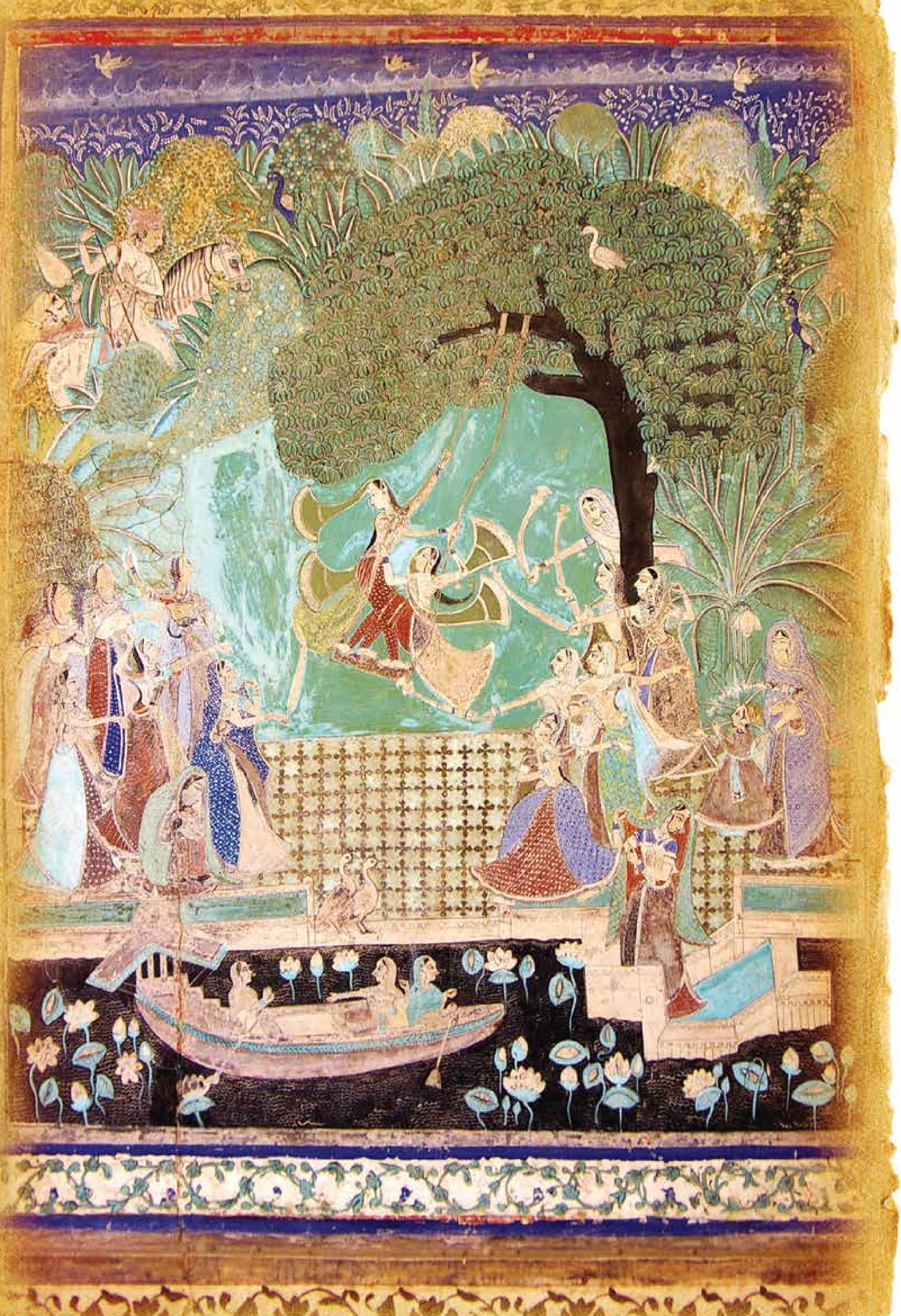
f) **Sitting Fees and Insurance –** The limits to the payment of managerial remuneration do not apply to fees payable to directors for attending meetings of the board or a committee thereof. Thus, a company may pay fees to its directors for each meeting attended within the prescribed limit for such sitting fees and such fees shall be outside the purview of the above stated percentage limits.
Unless such person is found guilty, premium paid on insurance taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company is not included in the remuneration payable to such personnel.

g) **Refund –** As was always the case, directors drawing or receiving excess remuneration are required to refund such sums to the company within two years or such lesser period as may be permitted by the company, and, until refunded, hold such sum in trust for the company. Now, following liberalization of the legal requirements, companies wishing to waive such recovery can do so with a special resolution of their shareholders, instead of requiring Central Government approval to do so, and with approval of creditors, when applicable, as set out in sub-paragraph 5.

h) **A director or manager may be paid** remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

9) **Disclosures –** Companies, especially listed companies must be careful to comply with the disclosures required to be made, both under the provisions of the Act and other applicable regulatory provisions.





GST VERSION 2.0- GREAT EXPECTATIONS!

Introduction

The Goods and Services Tax (**GST**) regime introduced in July 2017 marks a tectonic shift in the landscape of economic reforms in India, with the replacement of a complex indirect tax system with a simplified and uniform tax regime.

The initial transition to the GST regime was fraught with issues such as glitches on the GST network portal, management of multiple state level registrations and their consequential compliance requirements, invoice matching, multiple tax rate structure, etc.

The Government and the GST Council have proactively reviewed representations, swiftly assessed their impact and acted decisively while providing solutions. They have been persistently conducting workshops, tweaking the rates and clarifying various issues through continuous release of tweets, clarifications and sectoral FAQs to bridge

the information gap. Needless to say, various transitional issues have been ironed out.

With nearly two years and a half under its belt, the Government now needs to ensure that key steps are taken towards GST version 2.0. Some of the aspects which require attention to enable the redesigned version to move a step closer to an ideal structure are discussed below.

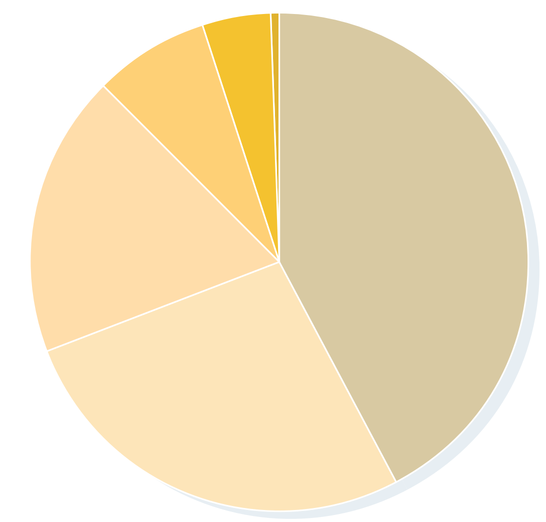
Ease of compliance

Streamlining tax structure

Currently, the GST tax structure in India has as many as six tax rate slabs. While the Government has expressed its intent to merge some of the tax slabs, the GST regime is still miles away from achieving the objective of "*one nation, one tax*". Former Finance Minister of India had once rightly stated in the Parliament that "a BMW and a *Hawai chappal* (flip-flops) can't have the same tax rate", as it is not practical for a country like India, with its vast economic and regional disparities to have a GST structure with a single tax rate.

Multiple tax rate slabs make India's GST regime one of the most complex in the world. The GST regime has not only added India to the list of countries having one of the largest number of tax slabs, but at 28 %, it has the highest GST rate in Asia and the second highest in the world.

The Government has been seamlessly working towards pruning of the GST rates on goods and services. There has been a substantial reduction



in the number of products in the 28% bracket with goods being moved to the 18% bracket. Unfortunately, such changes are being done in an ad-hoc and a piece meal manner, leading to confusion and inviting prolonged litigation.

The need of the hour is a holistic review and rationalisation of the rate structure, to bring it to a lower level while keeping the exemptions to a minimum.

Increase in threshold limit

Based on GST Council recommendation, the threshold limit has been enhanced, from INR 20 lakhs to INR 40 lakhs (*subject to prescribed exceptions*), for a person exclusively engaged in supply of goods to be liable to be registered under the GST legislations. Additionally, the threshold for availing benefits under the composition levy scheme has been increased from INR 1 crore to INR 1.5 crores, except in a few states.

A new composition scheme has been introduced whereby GST is payable at a concessional rate of 6% on the first supplies, upto an aggregate turnover

of INR 50 lakhs, made by any person engaged exclusively in intra-state supplies (*subject to other conditions*).

The increased threshold limit for registration, combined with the composition scheme have definitely enhanced the ease of doing business for micro, small and medium enterprises (**MSMEs**), who lack the infrastructure or the level of sophistication demanded for ensuring compliance under the GST legislations.

However, issues relating to multiple GST registrations for a company still prevail, especially, for service providers such as IT companies and banks, which have a pan-India presence. Registrations and compliances in each state, not only increases compliance costs but is giving rise to issues relating to taxability of cross charge of expenses from head offices to branch offices, especially on account of shared services.

There is a need to explore alternate options such as centralised registration (*as under the erstwhile regime*), particularly in such sectors that have pan-India presence and multiple transactions on a daily basis, to ease the burden of compliance.

Simpler return filing

Compliance was expected to be an easier exercise under the GST regime due to harmonisation of tax rates, procedures, as well as synergies across the country on account of introduction of common formats/forms, definitions and an interface i.e. the GST network portal.

However, the technical glitches on the GST network portal have led to a lot of anxiety. Often, the portal has not been able to take the load of the traffic during periods of return filing or tax payments.

The Government has deferred filing of returns requiring detailed and continuous disclosure of inward supplies, as well as extended deadlines for various other compliances, while simultaneously attempting to implement a simplified reporting requirement system. Earlier this year, the GST network inroduced a prototype of the offline tool of the new return filing system, allowing stakeholder to use the same on trial basis from July 2019, in order to get accustomed to it. The new returns are likely to be implemented from April 1, 2020.

Even though the GST network portal has been revamped a few times since the introduction of the GST regime, it still offers marginal flexibility to the users. For instance, there is no option to set off the excess tax paid by an entity under one registration against another registration in a different state. The network does not allow filing of returns for a subsequent period till the returns for the previous periods are filed along with the penalty.

Resolution of these issues and several such concerns, and implementation of an easy-to-use online GST network portal is imperative in GST version 2.0.

Enhanced Input Tax Credit (“ITC”)

One of the stated objectives of introducing GST was the removal of the cascading effect of multiple taxes on account of the lack of fungibility of credits. The GST legislations were suppose to allow input credit on all goods and services (*subject to certain restrictions*), irrespective of the nature of business of the assessees i.e. whether a service provider, trader or manufacturer.

However, issues of loss of ITC persist due to the manner in which transitional provisions are structured i.e. arbitrary limitation period, ineligible credit for erstwhile cesses, lack of foresight for assessees availing location based incentives prior to GST. Further, no respite has been offered in situations where dealers have failed to report their eligible credit due to inadvertent errors or because incorrect amounts have been transitioned on the portal.

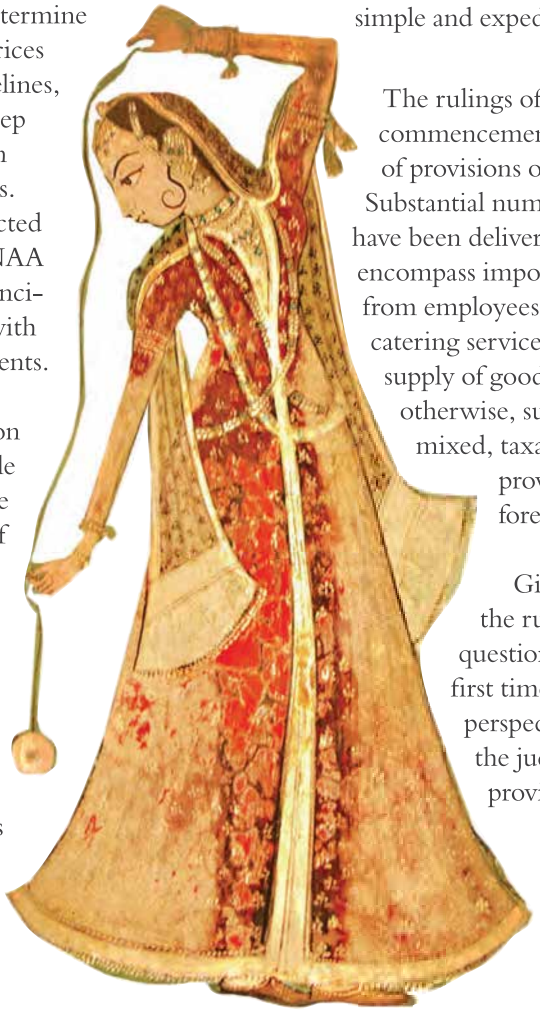
It is expected that the Government will address these concerns soon in GST version 2.0 and give relief to taxpayers who have huge amounts blocked due to the procedural challenges or have failed to report credits due to inadvertent errors.

Anti-profiteering provisions introduced to pass on the benefit to ultimate consumers

Anti-profiteering provisions have been enacted under the GST regime to curtail undue profiteering by companies and ensure that the benefits by way of reduction in the price of the goods/services, are passed on to the consumers. The National Anti-Profiteering Authority (**NAA**) was initially set-up with a sunset clause of two years. However, its tenure has been extended by another two years, as more than 700 cases are under investigation and around 92 cases have been adjudicated.

The Government has not prescribed any computation mechanism to determine the appropriate reduction in prices and other corresponding guidelines, but has left it to the NAA to step in and fill the legislative gaps in the anti-profiteering provisions. In such a scenario, it was expected that the orders passed by the NAA would become the guiding principle to determine compliance with the anti-profiteering requirements. However, the orders passed in this case by NAA lack clarity on various issues such as reasonable time within which price can be increased, alternate methods of reducing the price, etc.

For ensuring compliance, the provisions of a legislation need to be unambiguous and should provide adequate notice to the tax payers. Additionally, there has to be a sense of proportionality to its intended objective. The NAA has taken a hard stance that profiteering has occurred unless there is a tangible price reduction at a stock keeping unit level. A bare reading of the provisions does not mandate this and most of the NAA orders are currently being subjected to judicial scrutiny.



The continuing agenda of rate rationalisation before the GST council should bring about more certainty and clarity in GST version 2.0, on the computation mechanism to determine the appropriate reduction in prices for a more systematic compliance with the anti-profiteering provisions by the companies.

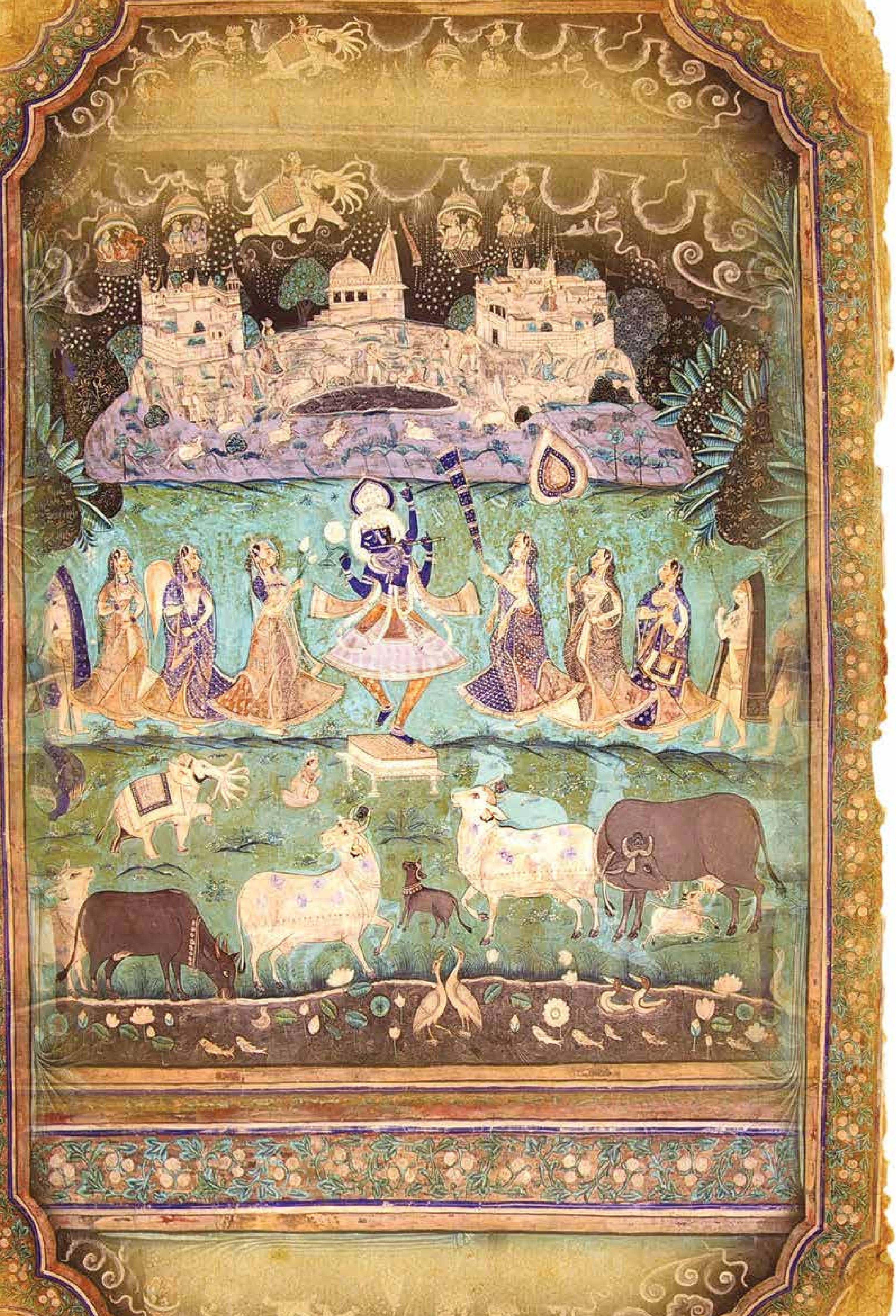
Authority for advance ruling (AAR)

An AAR has been set up in each state with the aim of facilitating certainty in determining the tax liability of the applicant. It also seeks to avoid long drawn and expensive litigation at a later date. Seeking an advance ruling is inexpensive and the procedure is simple and expeditious.

The rulings of the AAR, mark the commencement of judicial interpretation of provisions of the GST legislations. Substantial number of advance rulings have been delivered and quite a few of them encompass important issues like recovery from employees for canteen services, outdoor catering services provided to factory owners, supply of goods with brand name or otherwise, supplies being composite or mixed, taxability of back office services provided by Indian offices to foreign offices, etc.

Given that the GST law is new, the rulings of the AAR on the questions brought before it for the first time, provide insights into the perspective of the department and the judicial interpretation of various provisions.

At the same time, a review of the precedents also reflect



divergent rulings by the AAR, constituted in each state. This has fuelled confusion on the issues of classification, valuation and application of tax rates. For example, in recent cases on the query pertaining to levy of GST on solar engineering, procurement and construction projects, divergent rulings have been given by the Maharashtra and Karnataka AAR.

Although, the Finance Act, 2019 has mandated the creation of the National Appellate Authority, the same has not yet been constituted. There is an urgent need to operationalise the National Appellate Authority to serve its purpose of providing clarity and avoiding unnecessary litigation.

Augmenting Exports

The Government has constantly aimed at increasing the output and the quality of exports from India as portrayed by the "*Make in India*" policy. As a result, many tax benefits have been extended to the exporters under the GST legislations. The export of goods and/or services from India, are treated as zero-rated supplies. Such supplies can be undertaken without upfront payment of tax, or a taxpayer may opt to discharge tax on such supplies and subsequently, claim the refund of tax paid.

The scope of export has been widened by allowing receipt of payment in INR in case of export of services, wherever permissible as per the Reserve Bank of India (**RBI**). The said amendment harmonises the GST legislations with the RBI regulations.

However, glitches in the GST portal have led to export refunds piling up, resulting in a grave situation of cash crunch for exporters due to blockage of working capital. The Government has issued guidance notes that clarify various aspects of refund claims. The Government has also initiated special fortnight-long refund drives to process pending refunds on priority, clearing a major portion of the backlog.

The efforts of the Government, in streamlining the provisions relating to exports would enable the export industry in India to have internationally competitive prices due to smooth processing of the refund claims. This would provide a level playing field for the domestic companies and promote exports.

The Government must pursue a time-bound approach to execute plans already announced to ease taxpayers' woes, such as an e-wallet scheme and notional refunds for exporters, to advance towards an evolved GST regime.

Conclusion

The time is opportune to refresh and introduce sweeping changes in the existing GST structure, procedures and systems to move towards a flawless and simpler regime. The changes being made by the Government to converge tax slabs, to simplify compliances, to revamp the GST network portal, etc. are a right foot forward in the direction of achieving an ideal GST structure.

However, it is imperative for the authorities to chalk out a definitive plan for effecting a smooth implementation to GST version 2.0, even if it requires implementation in incremental stages.

Given the track record of the GST Council so far, it is hoped that the roadblocks on the journey towards GST version 2.0, would be suitably addressed and the distance between the dream of GST version 2.0 and reality would no longer exist.

CONTRIBUTORS

Editors:

Smruti Shah
Devika Ghosh
Jhini Phira

Contributors:

Abhinav Kumar
Ankoosh Mehta
Anshuman Sakle
Arun Prabhu
Avaantika Kakkar
Bharat Vasani
Daksha Baxi
Dhananjay Kumar
Garima Joshi
Manita Doshi
Mekhla Anand
Rashmi Pradeep
Rohan Banerjee
Ruetveij Pandya
S. Vivek
Shruti Rajan
Ankit Namdeo
Ankita Ray
Anumeha Saxena
Aanchal Merchant
Aviral Sahai
Esha Himadri
Hamraj Singh
Jesika Babel
Komal Gupta
Kritika Sethi
Lvanika Parti
Mitali Mehta
Molla Hasan
Nandini Pahari
Samraat Basu
Shara Madan
Sharmistha Mitra
Surajkumar Shetty
Tanya Nayyar

cyril amarchand mangaldas
advocates & solicitors

character • competence • commitment

www.cyrilshroff.com

mumbai
peninsula chambers,
peninsula corporate park,
gk marg, lower parel,
mumbai – 400 013.
t: +91 22 2496 4455
email: cam.mumbai@cyrilshroff.com

new delhi
4th floor, prius platinum,
d-3, district centre,
saket,
new delhi – 110 017.
t: +91 11 6622 9000
email: cam.delhi@cyrilshroff.com

bengaluru
3rd floor, prestige falcon towers,
19, brunton road,
off m.g.road,
bengaluru - 560 025.
t: +91 80 6792 2000
email: cam.bengaluru@cyrilshroff.com

ahmedabad
shapath -v, 1304/1305,
opp. karnavati club
s.g. road,
ahmedabad – 380 051.
t: +91 79 49039900
email: cam.ahmedabad@cyrilshroff.com

hyderabad
8-2-622/5/a, 3rd floor, indira chambers,
road no. 10, banjara hills,
hyderabad – 500 034,
telangana.
t: +91 40 6730 6000
email: cam.hyderabad@cyrilshroff.com

chennai
2nd floor, asv chamiers square,
87/48, chamiers road,
r. a. puram,
chennai – 600 028.
t: +91 44 6668 4455
email: cam.chennai@cyrilshroff.com

to subscribe to our blog, please visit: www.cyrilamarchandblogs.com