

India's push for reform

New legislation aims to improve business environment

India is awash with jokes that 2013 is just like the 1990s all over again with the rupee plummeting against the dollar, high inflation and a balance of payments crisis. That sense of déjà vu extends to the regulatory developments currently taking place. During the 1990s India, on its path to economic liberalisation, launched a raft of legislation. Now a new wave of reforms – some of them long overdue – is being implemented. These are intended to change the way business is carried out and to open doors for investors. They have the potential to contribute to India's recovery and return to growth.

A new companies act

The biggest change is the enactment of a new Companies Act (2013 Act) – the first major overhaul of company law in more than 50 years. This replaces the 1956 Act which had been tinkered with over the years in an attempt to keep pace with the changing business landscape. Corporate India and the legal community had long shared the view that it needed to be replaced entirely. India is currently ranked 134th globally by the World Bank in terms of ease of doing business. This new Act is intended to address this and provide India up with to date, relevant legislation and bring it in line with international standards.

The new legislation has some unique features and some implementation issues. It provides the basic framework, while the Government of India will issue rules to implement the framework. This will allow the Government to act more quickly to bring about reform when

required without the need to approach parliament for future amendments.

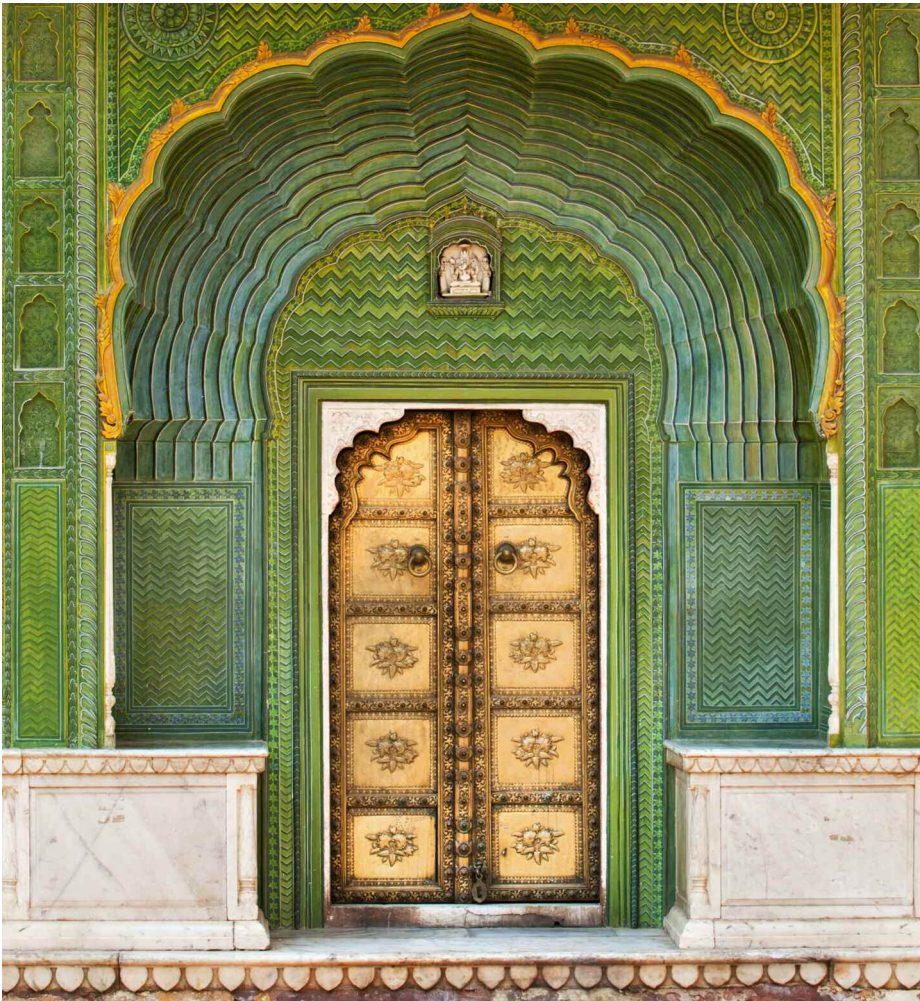
Features include:

- Much stronger penal and fiscal consequences for errant companies, directors, management, auditors and advisors. This reflects the fact that regulators have had to deal with large scale corporate fraud and corruption in India.
- The introduction of the concept of class action suits in India.
- Increased flexibility in company incorporation and corporate structures including shares with differential rights. It also addresses some historical Indian law conundrums relating to restrictions on the transferability of public company shares.



- An important change in the dispute resolution mechanism with the introduction of company law tribunals to deal with company reorganisations, disputes and other matters. This is intended to tackle endemic delays in the Indian court system due to the volumes of litigation. However, the efficacy of the tribunal system will depend largely on where they are set up and their constitution.
- A big push for corporate social responsibility. The 2013 Act seeks to make this part of the corporate culture for all Indian companies. Companies with market net worth above a specified threshold or that have profits in excess of a specified amount will be required to spend 2% of their annual net profits on corporate social responsibility initiatives.

“The new Companies Act is the first major overhaul of company law in more than 50 years.”



While the 2013 Act has many highlights there are also some issues that will need to be addressed. These include:

- A degree of regulatory overlap with the provisions of the Act and existing rules and regulations promulgated by other regulators in India, most notably the Indian securities regulator.
- The 2013 Act extends the offence of insider trading to unlisted companies which could present issues for private equity and other investors.
- The construct of the parent and subsidiary relationship is also a cause for concern. Companies will have to

evaluate their holding in all companies to examine whether or not they are now parents or subsidiaries with the attendant consequences of financial information reporting and other issues.

- The changes brought about to the winding up and insolvency process under the 2013 Act are not a complete code and leave scope for further legislative reform.

- The 2013 Act is being implemented in phases in a haphazard manner with no clear timetable or timeline for companies to plan around.

However, the 2013 Act is a long overdue step in the right direction. There will be a need to revisit some of the issues that have been left unanswered, but for now it provides a very robust platform for the governance of corporate India.

A new law on land acquisition and rehabilitation

All land acquisition in India, was until this year, governed by the Land Acquisition Act 1894, a relic of India's colonial past. It was inadequate for dealing with the resettlement and rehabilitation of people whose agricultural land was acquired for new infrastructure and industrial projects. The new legislation, which comes into force in 2014, brings together land acquisition and resettlement and rehabilitation into a single act called 'The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013.' It reduces government involvement in the land acquisition process and increases the obligation on potential acquirers to deal with rehabilitation and resettlement issues.

The new legislation introduces benchmark valuations for land acquisitions. Companies or state governments acquiring rural land for industry will have to pay the market price and additional compensation payments. The Act also provides novel ways for giving people affected by resettlement, continued support rather than just a one-time payment as settlement. For example, people are to be given

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employment in the project and can opt to receive shares in the project company as part of their compensation. This will enable them to participate in any potential upside from the development of their lands. It's an interesting piece of social and economic legislation that also encapsulates democratic principles. For example, government purchases of land for a designated public purpose that will be transferred to a private party can only be acquired if a specified threshold of families affected by the project give their consent. This is an important change from the earlier legislation in which acquisitions could be forced through.

The new legislation has been criticised by corporate India which says that it will make the process of land acquisition too expensive. However, given the number of rural poor that depend on land for survival this piece of legislation was long overdue. A land acquisition process that did not preserve the constitutional rights of its people was an anomaly that had to be corrected.

Reforms in foreign investment

Liberalised retail

India has continued its move towards a liberalised economy with changes to foreign direct investment in the retail sector. India remains one of the most important markets for retail players and the opening of the market is a welcome move. However, actual investment in this sector has not yet taken place as protectionist measures around the requirement for locally sourced products has presented problems for foreign retail investors.

Liberalised entry regime

In an effort to streamline foreign investment in Indian stock markets, the Securities and Exchange Board of India (SEBI), has simplified the entry norms for foreign portfolio investors into India. The measures that SEBI has approved - and is in the process of implementing - will do away with the requirement for pre-registration with SEBI.

For investors that fall within the categories of foreign sovereign entities or are considered regulated entities such as banks, the licensing requirements and documentation will be simpler. For other entities, the requirements will be very stringent but those complying with the requirements will now be able to invest in Indian securities. These measures require some legislative amendments at the central government level and once introduced the regime for foreign investment will see a marked change and easier access.

Banking sector reforms

New bank licenses

The last set of bank licenses were handed out to private players in 2003, but the Reserve Bank of India has finally got to grips with this aspect of financial sector reform. It has invited private players who want to set up a bank to come forward and apply for banking licenses. There are 26 applicants vying for these licenses - which are expected to be issued by January 2014 - including Indian multinational conglomerates and public sector enterprises looking to restructure themselves as banks. The expansion of the Indian banking sector is widely perceived to be slower than the growth of

the economy as a whole and the introduction of new banks into the system should go some way to address this criticism.

Foreign bank subsidiaries

Another new banking reform is a framework for foreign banks operating in India as branches to convert to wholly owned subsidiaries and operate as 'local banks'. One of the issues facing foreign banks operating in India has been the requirement to obtain approvals for the opening of bank branches. With the new guidelines in place, existing branches of foreign banks would be encouraged to explore the wholly owned subsidiary route. An important aspect that has not been adequately addressed is the question of M&A in the banking sector and whether foreign bank subsidiaries would be permitted to acquire other banks. This will be considered by the Reserve Bank of India at a future date.

Conclusion

This provides a snapshot of some of the important changes that have occurred in India in 2013. Unlike the reforms of the 1990's where the impact was almost immediate and kick started a sustained period of economic growth, the gains from the present set of reforms will be seen only in the coming years. This is due to the global economic climate and the domestic political situation in India with general elections around the corner.

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