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ADVOCATES AND LEGAL CONSULTANTS

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❖ **Satyam : The Story till now**

Nothing could have prepared anyone in corporate India for the Satyam news which broke out towards the end of the year 2008. It is India's Enron and Madoff combined. Satyam is India's leading global business and information Technology Company, delivering consulting, systems integration, and outsourcing solutions to clients in over 20 industries.

Following are the key events of India's biggest corporate scandal which rocked the nation in the month of December:

December 16 - Satyam announces plan to buy two building firms part-owned by the outsourcer's founders for \$1.6 billion. It does a rapid U-turn, killing the deal just 12 hours later following a 55 percent plunge in the company's share price in hectic U.S. trading.

December 17 - Chairman B. Ramalinga Raju says the about-turn reflected negative investor reaction. Satyam shares continue to slide, falling by a third on concerns about corporate governance.

December 18 - Satyam board says will meet on December 29 to consider a share buyback in a bid to restore confidence.

December 23 - Satyam barred from business with the World Bank for eight years for providing Bank staff with "improper benefits." Its shares fall another 14 percent to their lowest in more than 4- years.

December 24 - Satyam shares rally amid market talk the outsourcer may have become an attractive takeover prospect given the steep share price fall.

December 25 - Satyam says it asked the World Bank to withdraw "inappropriate" statements.

December 26 - Mangalam Srinivasan, an independent director, resigns.

December 28 - Satyam defers board meeting until January 10 to give itself time to consider options to shore up investor confidence.

December 29 - Three more directors quit, but Satyam shares rise on hopes for moves to improve shareholder value and corporate governance.

December 30 - Shares extend gains on talk of private equity interest and a management change. One of Satyam's largest investors says it could sell its stake.

...and the story goes on

## ❖ Asset re-constructors may get to revive sinking firms

Armed with the RBI mandate to acquire management control of defaulting firms, Asset Reconstruction Companies (ARCs) are set to become reviving agents for sinking companies. So far, they could acquire and sell only the collateral borrowers had pledged and not the company.

RBI's draft guidelines issued last Friday would make corporate rescue and turnaround a robust business for ARCs, which would fetch better returns than from peddling in the secured assets snatched from defaulters, bankruptcy experts say.

✚ ARCs can appoint Professionals on the Board, acquire management control and tie up with non-banking finance companies for fresh working capital

✚ ARC s get preferential rights over corporate assets pledged as collateral for loans from banks

"ARCs can now appoint professionals on the boards of companies to turn them around and tie up with non-banking finance companies to infuse fresh working capital when needed. We will see such pilot projects soon," explained Sumant Batra, a leading bankruptcy lawyer and vice-president of Insol International, a global body of insolvency experts. The role of NBFCs is crucial in the turnaround of a company as they do not insist on collateral as banks do. NBFCs are financial institutions akin to banks but cannot offer savings or current accounts and cannot issue cheques.

ARCs get rights over corporate assets pledged as collateral when they purchase bad loans from banks. As per RBI's latest guidelines, ARCs can acquire management control if the amount due is more than a quarter of the defaulter's total assets. In cases where there are more than one lender having rights over the collateral, then three fourth of them by value of the debt have to agree for the management take over. Management control means taking the responsibility of the company's operations, employees, their compensation and long-term benefits, the company's various contractual obligations and payment of taxes.

As per the proposed norms, the ARC has to restore management control to the borrower as soon as it realises the dues in full or within five years of take over, whichever is earlier. (The central bank can give extensions.) If dues cannot be realised by turning around the company, ARC may opt for selling the company.

"Allowing management takeover is important as selling a going concern would fetch better price than selling the assets of a company that is closed down," said a corporate turnaround professional. Selling an unviable company helps to redeploy the proceeds in more productive ventures, he said.

Asset Reconstruction Co of India Ltd (Arcil) is a major player in the business now. Banks such as Standard Chartered and Kotak are also now into acquisition of non-performing assets from banks. Many banks and financial institutions have also secured licenses to invest in ARCs under RBI guidelines.

RBI's move comes at a time when many firms, especially, small and medium sized ones are finding it difficult to service their debt. Under the law (SARFAESI Act of 2002), if an ARC or lender asks the defaulter to repay dues within two months, the borrower cannot seek a stay on the recovery proceedings from the Board for Industrial and Financial Reconstruction.

## ❖ Foreign telcos eye RCOM stake

- Phase I- Investor to pick up shares from secondary market
- Phase II- Company to make preferential allotment of fresh shares to Investor

Strategic investors, including telecom groups from the US and Europe, are in talks with Anil Ambani led R-ADAG to acquire around 20-26% stake in Reliance Communications (RCOM), India's second-largest mobile operator by subscribers, as per a banker in the know. Talks are on for a two phased transaction, which will see the strategic investor first picking up shares in the company from the secondary market and

then being issued fresh shares by the company through the preferential allotment route, the banker said. The source said the deal will be biased in favour of secondary market buys as RCOM is against a big equity dilution. The deal will also hinge on whether RCOM can get a big premium over its current share price. RCOM's market cap is down by 70% over the last one year to under \$10 billion.

## ❖ Govt. nod for FDI via warrants likely to go

Overseas firms may not require the government's approval to acquire stake in local companies through warrants, according to a senior industry ministry official.

The only caveat: the Indian company should belong to a sector where foreign investment is allowed freely or under the automatic route. These include mining, wholesale, retail, construction, real estate and oil exploration.

- Current norm: Issue of shares to foreign partners by companies under automatic FDI route -FIPB approval not required, govt. approval required

The easing of approval norms will allow foreign firms to speedily conclude their equity deals. A decision in this regard is expected in the next fortnight, the official said, on condition of anonymity.

- Proposed Norm: Companies under automatic route can issue warrants to foreign partners without govt. approval

A warrant is a financial instrument that allows the holder to buy shares of a company at a pre-determined price and within a specified period. Warrants are popular with Indian companies as these can be attached to convertible bonds or preferred stock and carry lower interest rates or dividends.

All foreign investment through warrants currently need the approval of Foreign Investment Promotion Board (FIPB), a procedure that usually takes 20 days to a month.

Companies falling under the ambit of automatic foreign direct investment route are permitted to issue shares to their foreign partners without seeking the FIPB approval. However, the government needs to give the go-ahead for the issue of warrants. This lack of clarity compels foreign companies to seek an FIPB clearance across all sectors.

"There is little need for the government's approval if the Indian company conforms to the SEBI's disclosure norms," says Saroj Jha, a partner with FoxMandal, a Delhi-based law firm. Five companies, including Spice Jet and Essel Shyam Telecom, sought the government's permission last month to allot warrants to their foreign partners. Earlier in September, the government had allowed drugmaker Ranbaxy to issue warrants to Japan's Daichi Sanko in a deal worth \$4 billion.

## ❖ PM puts India on global 3G map

Prime Minister Manmohan Singh put the country on the global 3G map this month when he launched the services on state-owned Mahanagar Telephone Nigam's (MTNL) networks in Delhi.

The 3G platform will enable telcos to offer high-end services such as high-speed internet, video conferencing on mobiles, interactive gaming, ultra fast downloads of video and music clips among other services. The PM also witnessed for sometime a live telecast of the India-England test series on a mobile handset using 3G services.

MTNL also became the first teleco in India to launch these high-end services which it has christened 'Jadoo'. But the commercial launch of 3G will happen in January 09. MTNL executives present in the event said the PM had only kicked off the 'soft launch' and that some parts of central Delhi would have free access to these services during the test phase.

MTNL does not want to charge for these services during the soft launch phase as it wants customers to first experience 3G services. "We will also launch 3G in Mumbai by the end-of January," MTNL chairman and managing director RSP Sinha told ET.

## ❖ Companies line up to avail FCCB buyback offer

A host of companies have approached the Reserve Bank of India (RBI) to buy back their foreign currency convertible bonds (FCCBs), which are trading at a massive discount. These include automobile and pharmaceutical companies.

🚩 Rupee Buyback permitted at min. 25% discount on book value; only internal accruals to be utilised  
🚩 Limited To \$50 Million of the Redemption Value

The FCCBs of most companies are quoting at a discount of 30-70%. Corporates that are eligible and have funds would, therefore, be able to buy back their bonds at a steep discount. RBI officials have said they had received a lot of proposals from companies to buy back the bonds. Bankers said that a couple of pharma companies, an auto company and a few other corporates had approached RBI recently seeking approval after the central bank eased the norms for buyback of these bonds. In its announcement on

Saturday, RBI had said that corporates could use their foreign exchange resources held in India – including Exchange Earners Foreign Currency Accounts (EEFC) – or overseas or raise fresh foreign borrowings, provided there was a minimum discount of 15% on the book value of the FCCB. According to the new norms, corporates can buyback FCCBs out of rupee resources if there is a minimum discount of 25% on the book value and provided that the resources for buyback are drawn out of internal accruals of the company which have to be certified by the statutory auditor.

The central bank has, however, limited the rupee buyback to \$50 million of the redemption value for each company. When a company issues an FCCB, it gets split into a straight bond and the equity portion with the investors varying for both. The debt portion is usually subscribed by insurance companies and pension funds while the equity portion is picked up by hedge funds and foreign portfolio investors. The companies will now have to appoint a lead banker to buy back the bonds.

According to broking firm CLSA, domestic companies have raised \$20 billion through FCCBs in the past five years. Several large FCCBs will come up for redemption in the next couple of years. Overseas investors have opted for not converting their bonds into equity in most cases as the stock price is trading at significant discount to the conversion price. A recent CSFB report said that on an average, stock prices are at 78% below the

conversion prices. In such a scenario, it makes sense for firms to buyback the FCCBs than wait till the maturity of the bond to redeem it as they will have to pay the face value of the bond that would be significantly higher than the current rate.

According to Standard Chartered Bank MD & head (global markets) Hemant Mishr, the RBI move was a step in the right direction as it allows corporate treasuries to actively manage their liability mix. "The move to permit FCCB buyback out of EEFC dollars accounts and dollars held offshore is particularly welcome as it will help them take advantage of the distortion in the global credit market. While there could be short term mismatches from a foreign exchange perspective on a longer term basis, it will be foreign exchange neutral."

Says Mr Mishr, "The move permitting corporates to buy back FCCBs based on rupee accruals is a pleasant surprise."

## ❖ Fidelity puts technology solutions unit on block

Global financial services behemoth Fidelity Investments has put its 2,000-member captive technology solutions unit on the block, two people involved with the bidding process said.

The possible suitors include large Indian IT majors like Infosys, Wipro, Satyam and transnational peers like Accenture and IBM.

The successful bidder will acquire the employees and facilities located at Bangalore and Chennai through an upfront cash transaction and will also walk away with a committed multiyear outsourcing contract from Fidelity, sources added. Citigroup and insurance giant Aviva offloaded their captive back office operations in similar deals earlier this year.

The technology solutions group or IT services, is part of Fidelity Research & Management Company (FMR) India that provides captive back office support to Fidelity in US. The sale of technology solutions unit involves around 70% of FMR India's employee strength, but does not include those working in Business Analytics, BPO and Implementations.

- 🚩 Tech solutions group involves 2000 members-70% of Fidelity's Indian employees' strength
- 🚩 Employees informed via internal letter by the company
- 🚩 Winner gets: units at Bangalore and Chennai; multiyear outsourcing contract from Fidelity
- 🚩 Indian IT Majors, MNCs in the race

Sources said the move is part of Fidelity's cost-cutting efforts in the backdrop of a global financial meltdown. Several American financial giants are re-working operational strategies as they battle the worst crisis in a century.

When contacted, a Fidelity spokesperson said: "As part of our global business transformation strategy, we are exploring options to optimise our technology delivery model, including that contained in our captive unit in India. We are evaluating sourcing options with leading global technology service

providers that will help us maximise the value we can offer our key stakeholders including employees in the long term. Owing to the confidentiality of such transactions, we cannot disclose the names of service providers. It is too early in the process to talk about specific details but we can confirm this is more about optimising our technology delivery model and not about eliminating jobs."

Fidelity will not comment on the nature of the transaction or who the bidders are, the spokesperson added.

Meanwhile FMR India, in an internal letter, told its employees about the possibility of transferring captive technology operations to an outsourcing partner, which will be a company with global operations and reputation comparable to Fidelity. It also mentioned that the deal would entail a complete transfer of assets and human capital to the acquirer.

Fidelity has existing outsourcing ties with IT vendors like Infosys and Keane. The US giant is a significant client for Infosys which has over 3,000 people working on the account. Sources said this placed Infosys on strong footing to take over the captive operations even though its cross town rival Wipro is believed to be making a strong pitch to acquire what could be a large outsourcing deal.

Another source said Fidelity may prefer MNC players that could see Accenture, IBM, or even Cognizant, emerge as strong contenders. Sectoral analysts said there was a possibility of Fidelity consolidating its outsourced work with one vendor, but this could not be verified independently.

This year, UK insurance giant Aviva sold its captive back office operations to WNS Holdings while Citigroup sold its BPO to Tata Consultancy Services. Both these transactions came with committed multi-year outsourcing contract to the acquirer. Citigroup would provide TCS with services totalling \$2.5 billion over the next 9.5 years, and Aviva committed \$1 billion outsourced work to WNS for eight years.

## ❖ Global biggies vie for 26% in UTI AMC

**India story still red hot among foreign firms, banks, PEs**

### **PROMOTERS MULL EXIT OPTION TO TIDE OVER CASH CRUNCH**

UTI Asset Management Company (AMC), the country's oldest fund house, is in advanced talks with top global players for offering a 26% strategic stake.

The AMC is understood to have short-listed four international players, including US firm T Rowe Price, Shinsei Bank of Japan and two European firms, according to a person familiar with the negotiations.

- UTI mulls offering 26% strategic stake to tide over cash crunch
- Two US and two European firms short-listed
- Good valuation expected owing to profitability, high equity component and pan-India presence

According to plans approved by the finance ministry, the four sponsors of UTI AMC—State Bank of India (SBI), Life Insurance Corporation of India (LIC), Bank of Baroda and Punjab National Bank—will offload a part of their holdings to the strategic partner. The four state-owned entities currently hold 25% each in the fund house.

UTI AMC chairman and managing director UK Sinha was unavailable for comment. The plan to induct a strategic partner was announced a few months ago by then finance minister P Chidambaram, in an address to the AMC board at its headquarters in Mumbai.

Despite the turmoil in the global financial market, the prospect of a stake in UTI AMC has evoked interest from leading international players due to its strong foothold in the Indian mutual fund industry. Though it has slipped from its numero uno position, UTI AMC is still the most profitable fund house, clocking a Rs 147-crore net profit in the previous fiscal. According to industry analysts, the firm could command decent valuations because of its profitability, high equity component of its assets and a strong pan-India presence.

UTI AMC managed Rs 38,358 crore as on November 30, 2008, and is the country's third-largest fund house.

Due to its heavy retail presence, the fund house has not faced a crisis in recent months even as most other players were reeling under redemption pressure in their debt schemes. It is among the few AMCs that did not have to borrow from banks to meet redemptions. And despite poor market conditions, the AMC managed to garner over Rs 300 crore in its recently launched UTI Wealth Builder scheme.

## ❖ I-T Department puts foreign banks' HQ expenses under scanner

### To Also Assess Domestic Banks' Tax Returns & Their Statements with RBI

Indian branches of foreign banks have come under the scanner of the Income-Tax Department. The Central Board of Direct Taxes (CBDT) has instructed its field forces to carefully examine their claims of head office expenses to ensure they were in conformity with transfer pricing provisions and relevant tax treaty.

As per the provisions of the I-T Act, in case of a non-resident, head office expenditure is allowed to be deducted from total income at the rate of 5% of the adjusted total income or expenditure actually incurred by the taxpayer, whichever is less.

Also, deduction for any expenditure arising from an international transaction has to be in conformity with its arms'-length price, which is the price at which two unrelated parties would agree to a transaction. Assessing officers will check if these norms were being adhered to properly, an I-T department official, who did not wish to be named, said. At times, some branches of foreign companies prop up expenses charged as head office expenditure to show lower profits so that they have to pay lower tax.

✚ Claims of head office expenses to be examined to ensure conformity with transfer pricing provisions & relevant tax treaty.

✚ Indian banks to be assessed after proper verification of accounts: Banks' detailed statements filed with RBI will be matched with income tax

The CBDT has also instructed its field officers to carry out assessments in case of Indian banks after proper verification of their accounts. Banks' detailed statements filed with RBI will be matched with their income tax returns filed with the department, as part of the verification exercise. This is being particularly done to ensure that banks do not show higher non-performing assets or bad debts in their income returns than they do in their submissions to the RBI, to claim higher deduction. By claiming higher deduction on account of expenses, taxpayers reduce their taxable income.

The CBDT instruction follows an observation by the Comptroller and Auditor General that income tax department was allowing large amounts of deductions under various sections to banks without proper verification causing loss of revenue, an official with the I-T department said.

"It is, therefore, necessary that assessments in the cases of banks are completed with due care and after proper verification," the CBDT instruction said.

## ❖ LLP Bill gets Parliament nod

The Lok Sabha approved the Limited Liability Partnership Bill, 2008, which would provide a new flexible business model for professionals, traders and entrepreneurs. The Bill, which was earlier cleared by the Rajya Sabha, was approved in the lower house this month by a voice-vote after a brief debate.

“Our effort would be to have the first LLP registered by April 1, 2009,” corporate affairs minister Prem Chand Gupta said while winding up a discussion on the Bill. The legislation now only requires a procedural formality of the president’s approval to become law. For all practical purposes, the legislative process introducing this business model is over, a ministry official said.

The tax structure of the new form of business would be addressed separately in the Income-Tax Act. The limited liability partnership format for companies is new to the country and is expected to bring cheer for lawyers, chartered accountants and others to set up large entities with multiple specialisations. The LLP legislation would allow professionals to join hands in setting up bigger enterprises. The government is banking on the LLP format to help domestic professionals compete with international firms when the legal and accounting professions are opened up eventually.

LLP is a hybrid business form offering the flexibility of a company and a partnership. The LLP will be a separate legal entity, liable to the full extent of its assets.

- Separate legal entity
- Taxation aspect to be dealt with in the Income tax Act
- Features like no limit on no. of members, partners liable to the extent of their share, no joint liability for others’ misdeeds

However, the liability of the partners in an LLP will be limited to their agreed contribution in the entity, and no partner will be liable on account of the independent or unauthorised actions of any other partner. This will allow individual partners to be shielded from joint liability created by another partner’s wrongful business decisions or misconduct.

There will be no upper limit on number of partners in an LLP unlike an ordinary partnership firm where the maximum number of partners cannot exceed 20.

## ❖ SEBI panel may tighten asset-liability norms

The Securities and Exchange Board of India’s (SEBI) Mutual Fund Advisory Committee (MFAC) met this month to discuss key issues on the agenda, including further tightening of asset liability norms and valuation of non-traded debt. The meeting was also to review limits on exposure to individual securities and whether there should be limits on exposure to pass-through certificates.

- Key issues on the agenda of the MFAC
- Review Limits on Exposure to Individual Securities
- Practice of MFs Giving Indicative Yields
- Valuation of non-traded debt securities
- Hiking the net worth requirement for an asset management company

Another related issue on the agenda of the committee was the valuation of non-traded debt securities. Some issuers believe that there is a need to value such securities fairly so that the underlying value of the portfolio is reflected better in the net asset value. In this context, the advisory committee proposed to review the practice of indicative yields by mutual funds.

There is a school of thought that doing away with such a practice would bring in more transparency in the marketing of debt instruments, particularly in current market conditions. Indicative yields mean the fund houses usually display a set of typical returns on the instruments, but with a caveat that the same level of returns cannot be assured.

However, in the recent past this had been more the norm than the exception. For instance, in September this year, Fixed Maturity Plans (FMPs) – both short-and long-term plans – gave indicative yields of 11%. This has slipped to less than 10% for all the plans by November. Options such as whether there should be multiple agencies which value these securities will also be discussed.

Of late, FMPs have been in the news for all wrong reasons. One issue of concern is that many funds are positioning it as an alternative to fixed deposits because of tax advantages. This aspect would also be debated at the meeting.

Other issues on the committee's agenda included that of reviewing norms for liquid schemes and investment restrictions for portfolios. The most-debated issue of hiking the net worth requirement for an asset management company is also likely to be finally addressed.

This was the second meeting of SEBI constituted MF Advisory Committee. The committee is headed by former SEBI chairman SA Dave, Amfi chairman AP Kurian, among others, and senior fund officials.

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