

Mishcon Deals

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Intro

Welcome to the first edition of “Mishcon Deals” for 2009. This quarterly newsletter focuses on corporate activity and how legal issues could affect your business in the New Year. In this issue we take a look at the promising prospects for foreign direct investment in India, the proposed Banking Reform Bill, 2009’s new EU regulations as well as disclosure obligations when borrowing against shares.



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Investing in India

India has seen a significant increase in foreign direct investment ("FDI") since the early nineties and Mishcon's India Group has been involved in assisting parties, in India and overseas, with the process for over a decade.

Prospects for FDI into south and southeast Asia are thought to remain promising, despite concerns about the impact of the world financial crisis [1]. In 2007, Indian FDI reached a level of £14.37 billion [2]. This growth has been attributed to India's robust economic development, an improved investment environment and the increasing deregulation of the telecommunications, retail and other industries. FDI in India was further boosted by substantial investments into the automobile, telecommunications, real estate and other service industries, including large-scale investments by "transnational" corporations such as Vodafone, Oracle, Holcim and Matsushita.

FDI Policy

Foreign private investment in India, and all dealings by residents of India with non-residents and with foreign currency, is regulated by the Foreign Exchange Management Act 1999 and particularly the Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India) Regulations in 2000 ("FDI Regulations"). The Reserve Bank of India ("RBI") generally regulates dealings in Indian securities and the Foreign Investment Promotion Board regulates FDI into India.

The FDI Regulations provide that dealings by persons and companies based outside of India in the shares of Indian companies that carry on trading, commercial or industrial activities in India, are restricted unless the transaction has received prior authorisation from the RBI. However, FDI into India is permitted under what is known as the "automatic route" which, subject to the satisfaction of certain conditions, allows foreign investors to invest in Indian companies that operate in certain sectors by way of a subscription for shares. FDI into such sectors does not require the prior approval of the RBI, but investors are nevertheless required

to notify the RBI of their interest in the Indian company within 30 days of making such an investment.

Sectors that are eligible for the "automatic route" include, amongst others, services, power, drugs and pharmaceuticals, projects for construction for roads, highways, ports and harbours, pollution control, call centres, BPO (business process outsourcing), hotel and tourism and real estate. Prohibited sectors include, amongst others, gambling and betting, lottery business and atomic energy. Investment into other sectors requires prior authorisation from the RBI depending on the sector type and level of investment.

Generally, and subject to the satisfaction of certain conditions, the acquisition of existing shares from an Indian resident by a non-resident and vice versa does not require the prior approval of the RBI. However, such transfers must be notified to the RBI in a prescribed form and should be accompanied by certain documents such as consent letters from the transferors and transferees.

Tax

Companies incorporated in Mauritius have been responsible for the highest investment into India, with over 43 per cent of FDI between 1991 and 2008 [3]. One of the main reasons for this is the India-Mauritius double taxation avoidance treaty ("IM Treaty").

The IM Treaty was established in 1983 for the purposes of encouraging reciprocated investment, trade and commerce between Mauritius and India. The key provision of the IM Treaty is that capital gains earned by a Mauritian investor are taxable in the country of residence of the investor and not in India. There is currently no tax payable on capital gains in Mauritius, so such gains should escape tax altogether. However, in order to take the benefit of the IM Treaty, the investor must hold a Mauritian tax residency certificate and not have any "permanent establishment" in India. In the absence of the IM Treaty, capital gains tax of up to 47.23% would be payable in India as a withholding.

The IM Treaty is the subject of much debate in India and is considered to be somewhat controversial, in that it is

Investing in India (continued)

reported as being open to misuses. The concept of “round tripping” is derived from such misuses and is a method by which resident Indians re-route their money through Mauritius beyond the reach of the Indian tax authorities.

In India, dividends received by shareholders are exempt from tax, irrespective of their residential status. However, an Indian company paying out dividends will be required to pay a dividend distribution tax.
Investment structures

Where a single project in India is involved, investors will often invest through a single holding company in Mauritius. Where multiple projects are involved, investors often invest by establishing a fund holding structure. This allows investments to be made in India into a number of Indian companies operating in the same sector, with investment advice being provided by non-resident advisers who benefit from information sourced from local Indian advisers.

A fund structure established in Mauritius is useful in that it allows a pool of investors that are located in a number of regions to invest in diversified securities of companies operating in a single sector or a number of sectors in India. A fund can be structured to be; “open ended” meaning, new shares are continually offered to investors and shares can be bought back by the company when investors wish to withdraw their investment, or “closed-ended” meaning, investors see a return at a specified time in the future or in the event of a pre-defined exit. However, it is unusual to see open-ended funds for FDI into India, as conditions for investment into certain sectors such as real estate require, amongst other things, a minimum investment period.

Whether or not a company is eligible (in compliance with Mauritian and Indian law and policy) to establish a structure based in Mauritius, with a view to undertaking FDI in India, is determined on a case by case basis.

If you are a company already investing in India or you see your business moving in the direction of undertaking FDI into India, please contact Chris Jones or Shika Thakrar to discuss any of the matters set out in this article.

[1] United Nations Conference on Trade and Development World Investment Report 2008, which analyses the latest trade in foreign direct investment

[2] Applying a rate of US\$1.6 to one pound sterling

[3] Department of Industrial Policy and Promotion – Ministry of Commerce and Industry. FDI statistics. March 2008

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Banking Bill 2008 and Future Developments

Recent events in the finance sector have highlighted a number of areas in need of improvement in the UK banking regime.

The Banking Reform Bill proposes a permanent way of dealing with bank collapses which goes beyond the emergency measures put in place after the collapse of Northern Rock (which measures will expire in February 2009). If the Bill is passed, where financial stability in the UK is threatened by a failing bank, the authorities will have a range of tools available and be able to share information efficiently, to ensure that the bank is dealt with in an effective and timely manner, whilst protecting consumers and minimising the impact on the economy overall.

A new Special Resolution Regime would allow HM Treasury, the Bank of England and the FSA to sell a failing bank to another bank, nationalise it or transfer it to a bank established by the Bank of England.

Furthermore, the introduction of a statutory financial stability obligation for the Bank of England, widening its remit from regulating monetary policy and in particular targeting inflation, is likely to be received well. The Bank of England will also now not need to publicly disclose short term loans made available to ailing banks.

The Bill is part of the wider set of general measures which the Government, the Bank of England and the FSA have taken to restore stability to the financial system. These measures include the Government provision of financial support to the banking system through the recapitalisation scheme and credit guarantee scheme, the Bank of England's Special Liquidity Scheme and the increase to £50,000 of the FSCS' deposit protection limit.

In widespread complaints about the banks' behaviour during the credit crisis, the Government has also announced that the previously voluntary Banking Code

of Practice operated by the banks will be transformed into a legally binding code of conduct regulated by the FSA.

In addition, a revised Statement of Principles on bank lending to small and medium sized enterprises (SMEs) has been agreed with the Small Business Finance Forum, a body set up in October 2008 comprising of amongst others major UK banks, the Bank of England, the British Bankers Association, the Department of Business, Enterprise and Regulatory Reform ("BERR"), various small businesses and certain of their key representatives. The principles set out industry best practice in lending to SMEs and dealing with them if they run into difficulties.

The Secretary of State for BERR commented that the "Prime Minister has stated that the current Banking Code will also be put on a statutory footing. The statement of principles will be folded and incorporated into that Banking Code."

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Rome II - Time to amend your choice of law clauses

From 11 January 2009 a new EU regulation, referred to as Rome II, will harmonise the rules by which the applicable law of a contract is determined. It will extend to non-contractual obligations, including torts such as misrepresentation and negligence, arising between parties in civil and commercial matters.

Under current English law the applicable law for non-contractual obligations is that of the place where the harmful act is committed. The general rule to be introduced by Rome II (subject to certain exceptions, e.g. for defective products or intellectual property rights) is that the law applicable to non-contractual obligations will be the law of the country in which the damage occurs, irrespective of the country in which the act giving rise to the damage occurs or the country in which indirect damage occurs.

In addition, the applicable governing law will also govern the assessment of damages and the extent of a party's liability. Parties can contract out of this and so we would expect to see standard wording being developed in choice of law and jurisdiction clauses.

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Borrowing Against Your Shares – Would you have disclosed?

So David Ross was late in disclosing to the board of Carphone Warehouse that he had borrowed against his shares. He wasn't in default under his borrowings and he still owned the shares. He resigned as a result. Would you have known to disclose?

For a Main Market company, like Carphone Warehouse, the obligation to disclose arises under the Listing Rules and the Model Code and applies to a "person discharging managerial responsibility" ("PDMR"). A PDMR is either a director of the company or a senior executive of the company who has regular access to inside information relating, directly or indirectly, to the company and who also has the power to make managerial decisions affecting the future development and business prospects of the company. In practice, it is not always easy to identify who is and is not a PDMR and judgment calls have to be made in some instances.

For an AIM company it will be no surprise that the position of the AIM Team, as a regulator, is that the AIM Rules do require directors to disclose borrowings against their shares. The AIM Rules do not expressly cover this point, but if one wishes to construct an argument for non-disclosure then the nominated adviser to the company would need to be consulted and a formal submission to the AIM Team would be prudent.

It should be noted that for both Main Market and AIM companies a stricter share dealing code is sometimes adopted and so the position under the company's own share dealing code would need to be checked, as should the terms of any service agreement or appointment letter. The disclosure obligations also apply to connected persons and family.

Also to be considered is the general disclosure requirement under the DTRs on any shareholder holding 3% or more of a company's share capital to disclose

their interest whenever they move up or down through a whole percentage point. This obligation focuses on voting rights and so the terms of the security need to be considered: Does the lender's charging document transfer the shares into the lender's name? Are the voting rights still freely exercisable by the borrower?

One recurring theme in the enquiries we are receiving is whether the mere knowledge that, say, a fellow director has borrowed against his shares constitutes inside information that prohibits the other directors from dealing. The answer to this question very much depends on the facts of each case.

The disclosure obligations can be difficult to navigate. Now more than ever, directors and shareholders need to remind themselves of the relevant rules.

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Act Now

A number of papers relating to corporate legislation have been published, which require responses during January 2009.

Limited liability partnerships

From 1 October 2008, the accounts and audit provisions of the Companies Act 2006 ("CA06") were applied to limited liability partnerships ("LLPs"). From 1 October 2009, the rest of the CA06 will come into effect for LLPs. Draft regulations for this have been published and the Department for Business Enterprise and Regulatory Reform ("BERR") invites comments by 28 January 2009.

The remainder of the CA06 will also come into effect for companies on 1 October 2009. This includes provisions relating to: formation and constitution, company names, a company's registered office, re-registration as a public/private/limited/unlimited company, the register of members, residential addresses of directors and secretaries, share capital, acquisition by a limited company of its own shares, annual returns and company charges.

We will be providing a briefing relating to these changes nearer to October 2009.

Contracts for difference

The Financial Services Authority ("FSA") has published a feedback and policy statement relating to an earlier consultation paper on disclosure of contracts for difference ("CfDs"). The consultation paper had discussed the regulatory framework for CfDs and highlighted issues of concern, mainly relating to the lack of adequate disclosure of CfD positions. The

statement considers the feedback it has received and proposes a general disclosure regime, together with exemptions. Technical (i.e. not policy) comments are invited on the proposed new rules and the deadline is 23 January 2009. It is intended that the final rules will be issued in February 2009 and will come into force on 1 September 2009.

Shareholder rights directive

BERR has published a consultation paper on its proposed approach to the implementation of the EU Shareholder Rights Directive. The Directive aims to improve corporate governance in EU companies traded on regulated markets by enabling shareholders to exercise their voting rights and rights to information more easily. In the course of this implementation, the government also proposes to amend the CA06 to correct some anomalies in the existing law on shareholders' rights, which will affect all companies. Comments are invited by 30 January 2009, with BERR publishing a summary of responses within three months of that date. The deadline for implementation of the Directive is August 2009.

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