of a company limited by guarantee shall state that each member undertakes to contribute to the assets of the company, in the event of its being wound up, for the payment of the debts and liabilities of a company, such amount as may be required, not exceeding specific amount. A company limited by guarantee may or may not have share capital.

The Sachar Committee observed that "although guarantee companies, ..constitute a very negligible fraction of less than three per cent of the total companies—at work in India, they still do have a useful role to play as companies for furthering the objects of commerce, art, science, religion, charity or some other useful objects and usually such a company does not apply its profits or rather income except for these desirable objectives. It is, however, inherent in the very nature of these objectives that such companies be formed as public limited companies, limited by guarantee only and for the purpose enumerated in the present Section 25 of the Act." (Section 25 refers charitable/ social purposes).

As on 30th November 2000, the number of companies limited by guarantees was 2,881.

Limited Companies

In case of a limited company, the liability of its members is restricted to the amount of share capital subscribed by them or standing in their names, should at any time the company is wound up and the value of its assets is insufficient to meet its liabilities. The companies falling under this category are required by law to add the word "limited", at the end of their names.

There are two important kinds of limited companies, viz,

- Private limited company
- Public limited company.

Private Company: A private company is a company which has a minimum paid up capital of one lakh rupees and which has not less than two and not more than fifty members (excluding employees and former employees who continue to be members after the employment ceased). A private company is prohibited from inviting public to subscribe for any shares or debentures of the company and from accepting any deposits from persons other than its members, directors or their relatives. Further, the right to transfer its shares, if any, is restricted.

The name of a private limited company shall end with the words "private limited".

At the end of November 2000, there were 485,195 private limited companies in India. 614 of them were government companies.

Public Company: Public company means a company which is not a private company and which has a minimum paid up capital of five lakh rupees and which has a minimum of seven members (no upper limit).

A private company which is a subsidiary of a company which is not a private company is also regarded a public company.

The Central Government may exempt certain companies from the use of the words "private limited" or "limited" with their names such as a company which intends to apply its profits or other income in promoting its objects and to prohibit payment of any dividend to its members.

As on November 2000, there were 75,172 public limited companies in 655 of them were government companies.

Government Company

Government companies, as a separate class of companies, were recognised for the first time in the Companies Act, 1956. Though the number of Government companies is comparatively small when compared to the number of non-Government companies, they account for a large share of the paid-up capital of all the companies operating in India.

The Companies Act defines a Government company as a company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary of a Government company.

Section 620 of the Companies Act still empowers the Central Government to exempt the Government companies from the application any of the provisions (other than those relating to audit and annual reports) of the Act, although the Sachar Committee (1978) remarked that "there will be no case for Government companies claiming exemption from the provisions of the law."

The Act lays down that the auditor of government company shall be appointed or reappointed by the Comptroller and Auditor General of India and the CAG shall have power to direct the manner in which the company's accounts shall be audited.

Where the Central government is a member of a government company, the Central government shall do the needful to get an annual report on the working and affairs of the company prepared within three months of its annual general meeting and it shall be laid before both houses of the Parliament together with a copy of the audit repot, as soon as possible. Where any State government is also a member of the company, the State government shall cause the annual report along with the audit report to be placed before the State legislature. Where the Central Government is not a member of the Government company, the State Government(s) concerned shall do the needful to get the annual report prepared within the specified time and place it, together with the audit report, before the legislature(s).

At the end of November 2000, there were 1,273 Government companies in India, including four guarantee companies.

Holding and Subsidiary Companies

When a company has control over another, it is known as a holding company, and the company so controlled is regarded as a subsidiary company.

A company shall be deemed to be a holding company of another if, but only if, the other is its subsidiary.

A company shall be deemed to be a subsidiary company in any one or more of the following cases:

(i) Where one company controls the composition of the Board of Directors of another, the latter becomes a subsidiary of the former:

(ii) Where one company holds a majority of the shares in another company, the latter becomes a subsidiary of the former:

(iii) Where one company is a subsidiary of another, which is itself a subsidiary of some other company, the first-mentioned company shall also become the subsidiary of the last-mentioned company.

Foreign Company

Part XI of the Companies Act deals with companies incorporated outside India.

The term *foreign company* means a company incorporated outside India which has a place of business in India. The Companies Act requires that, within 30 days of the establishment of a place of business in India any foreign company, it should submit to the Registrar of Companies certain information such as a certified copy of its Memorandum of Articles or other instrument of its incorporation; the full address of the registered/principal office abroad; the names etc., of its directors, secretary, persons in India authorised to accept documents in India; and the full address of its principal place of business in India.

If not less than 50 per cent of the paid-up share capital, whether preference or equity, is in Indian hands (individuals or body corporates), the provisions of the Companies Act as a whole shall apply to such a foreign company as if it were incorporated in India.

Foreign companies are required to prepare, in every calendar year, a balance sheet and profit and loss account, providing such details as specified (including, in particular, documents relating to every subsidiary of the foreign company) and deliver three copies to the Registrar. The Central Government, however, is empowered to exempt any foreign company or class of foreign companies from this requirement or modify it. The Act also lays down certain conditions to be satisfied by foreign companies inviting subscriptions in India for shares or debentures, such as providing the required information about the company. Further, by the Companies (Amendment) Act of 2000, a new section was incorporated empowering the Central Government to make rules for offer of Indian Depository Receipts by foreign companies.

Every foreign company is required to keep at its principal place of business in India the specified books of account, with respect to moneys received and expended, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.

If any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar so that the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

If any foreign company fails to comply with any of the foregoing provisions of Part XI of the Act, the company, and every officer or agent of the company who is in default, shall be punishable with fine which may extend to ten thousand rupees, and in the case of a continuing offence, with an additional fine which may extend to one thousand rupees for every day during which the default continues. Any failure by a foreign company to comply with any of the provisions of this Part shall not affect the validity of any contract, dealing or transaction entered into by the company or its liability to be sued in respect thereof; but the company shall not be entitled to bring any suit, claim any set off, make any counter-claim or institute any legal proceeding in respect of any such contract, dealing or transaction, until it has complied with the provisions of this Part.

As on February 28, 1998 there were 871 foreign companies in India.

FORMATION OF COMPANIES

The Companies Act prohibits the formation of any company, association or partnership consisting of more than ten persons for carrying on any banking business and more than twenty persons for carrying on any other business unless it is registered under this Act or is formed in pursuance of some other Indian law.

There are several conditions to be fulfilled for registering a company. The formal steps involved in the formation of a company include finding a suitable name for the company, determining the location of the registered office of the company, drawing up the Memorandum of Association and Articles of Association, submitting the necessary documents to the Registrar of Companies, and finally getting the company registered with the Registrar. Once a company is registered, it emerges as a legal entity.

Any seven or more persons may form a public company and any two or more persons (not exceeding 50 persons) may form a private company, for any lawful purpose, by subscribing their names to a memorandum of association and otherwise complying with the requirements of the Companies Act, with or without limited liability.

Name of the Company

A company cannot be given a name which, in the opinion of the Central Government, is undesirable or identical with, or closely resembles, the name of an existing company. The Registrar of Companies maintains up-to-date lists of the names of all the companies in India.

As mentioned earlier, the word "limited" shall be added to name of a public limited company and the name of a private limited company shall end with the words "private limited".

The name of the company must be stated in its memorandum, with the company's seal, on its business letters, negotiable instruments and orders for money and goods. The name must also be affixed outside every office or place in which the business is carried on.

Memorandum of Association

The promoters of a company are required to draw up a Memorandum of Association.

The Memorandum of Association is regarded as the *fundamental* document of the company because it contains "the fundamental conditions upon which alone the company is allowed to be incorporated." It is the charter of the company, defining the object of its formation and its operations, and its purpose is to inform its stake-holders its permitted range of enterprise. It is *ultra vires* for a company to act beyond the scope of its memorandum, and any departure is invalid and cannot be validated even if assented to by all the members of the company. This indicates that the memorandum should be drawn up with utmost seriousness and care.

The promoters of the company shall subscribe their names to the Memorandum. If a private company is to be formed, at least two persons may, and if a public company is to be formed at least seven persons shall subscribe to the memorandum.

The memorandum of *every company* is required to state:

1. The name of the company with "Limited" as the last word of the name in the case of a public limited company, and with "Private Limited" as the last words of the name in the case of a private limited company;
2. The State in India in which the registered office of the company is to be situated.
3. The main objects of the company and objects incidental or ancillary to the attainment of the main objects, and other objects of the company.
4. In the case of companies (other than a trading corporation), with objects not confined to one State, the States to whose territories the objects extend.

The memorandum of a *company limited by shares* shall also state that the liability of its members is limited.

The memorandum of a *company limited by guarantee* shall also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for the payment of the debts and liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case many be, and of the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributors among themselves, such amount as may be required not exceeding a specified amount.

In the case of a *company having share capital,*

1. Unless the company is an unlimited company, the memorandum shall also state the amount of the share capital with which the company is to be registered and the division thereof into shares of a fixed amount.
2. Every subscriber of the memorandum shall take not less than one share.
3. Each subscriber of the memorandum shall write opposite to his name the number of shares he takes.

The memorandum of association of a company shall be in one of the Forms specified in Schedule I to the Companies Act, 1956, which may be applicable to the case of the company, or in a Form as near thereto as circumstances admit.

The memorandum shall *(a)* be printed, *(b)* be divided into paragraphs numbered consecutively, and *(c)* be signed by each subscriber (who shall add his address, description and occupation, if any), in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

Articles of Association

The Articles of Association are the rules, regulations and bye-laws for the *internal* management of the affairs of a company. They are framed with the object of carrying out the aims and objects as set out in the Memorandum of Association.

The Articles usually contain provisions relating to such matters as share capital; rights of shareholders and variation of these rights; lien on shares; calls on shares; transfer of shares; conversion of shares into stock; alteration of capital; general meetings and proceedings thereat; voting rights of members, voting and poll, proxies; directors, their appointments, remuneration, qualifications, powers and proceedings; Board of Directors; and so on.

The provisions of the Articles must be in conformity with the Memorandum and the provisions of the Companies Act.

A public company may have its own Articles of Association; however, this is not essential. If it does not have its own Articles, it may adopt Table A given in Schedule I to the Act.

The Articles of Association of a private company, which must be registered with the Registrar of Companies, must contain the following distinguishing features.

1. A clause restricting the right to transfer its shares.
2. A clause limiting the number of its members to fifty (excluding those who are or were employees in the company at the time of the acquisition of the shares), two or more persons holding shares jointly being accounted as a single member.
3. A clause prohibiting any invitation by the company to the public to subscribe to any shares or debentures of the company.

If the office of any director appointed by the company in the general meeting is vacated before his term of office expires in the normal course, the resulting vacancy may be filled by the Board of Directors at a meeting of the Board.

It shall be the duty of every director, who is required by the Articles of the company to hold a specified share qualification and who is not already qualified in that respect, to obtain his qualification within two months after his appointment as director. The nominal value of the qualification share shall not exceed five thousand rupees, or the nominal value of one share where it exceeds five thousand rupees.

Disqualifications

A person shall not be capable of being appointed director of a company, if:

(a) He has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force.

(b) He is an undischarged insolvent.

(c) He has applied to be adjudicated as an insolvent and his application is pending.

(d) He has been convicted by a court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence.

(e) He has not paid any call in respect of the company shares held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call.

(f) An order disqualifying him for appointment as director has been passed by a court in pursuance of Section 203 of the Act and is in force, unless the leave of the court has been obtained for his appointment in pursuance of that section.

(g) He is already a director of a public company which has not filed the annual accounts and annual returns for an continuous three financial years or has failed to repay its deposit or interest thereon on due date or pay dividend and such failure continues for one year or more. This disqualification is applicable for a period of five years from the date of above mentioned default(s). This provision was inserted by the Companies Amendment Act, 2000.

However, the Central Government may, by notification in the Official Gazette, remove the disqualification incurred by any person in virtue of clause (d) or (e) referred to above.

A private company, which is not a subsidiary of a public company, may, by its articles, provide that a person shall be disqualified for appointment as a director on any grounds in addition to those specified above.

No person shall, hold office at the same time as director in more than *fifteen* companies. Prior to the coming in to effect of the Companies Amendment Act, 2000, the limit was twenty.

Vacation of Office

The office of a director shall become vacant if he:

(a) Fails to obtain or ceases to hold the share qualification, if any, prescribed by the articles;

(b) Is declared to be of unsound mind by a court.

(c) Applies to be adjudicated an insolvent.

(d) Adjudged an insolvent.

(e) Is convicted of an offence involving moral turpitude and sentenced to imprisonment of more than six months.

(f) Fails to pay calls on the shares held by him within six months of the call.

(g) Absents himself from all meetings of the Board for a continuous period of three months or for a period covered by three consecutive meetings of the Board, whichever is longer, without obtaining leave of absence from the Board.

(h) Accepts, or allows another person on his account to accept, a loan or a guarantee or a security from the company except as permitted under the Act.

(i) Fails to disclose, as required under the Act, his interest in contracts entered into by or on behalf of the company.

(j) Is disqualified by a court consequent on conviction of an offence in connection with the formation or management of a company or for being guilty of fraud or misfeasance in relation to a company.

(k) Is removed in the general meeting.

(l) Having been appointed a director by virtue of his holding any office or other employment in the company, ceases to hold such office or other employment in the company.

Meetings of the Board

According to Section 285 of the Act, a meeting of the Board of Directors must be held at least once in every three months and at least four such meetings shall be held in every year. However, the Central Government is empowered to relax Section 285 in relation to any class of companies.

A written notice of the Board meeting should be given to every director. If the officer responsible for this fails to do so, he shall be punishable with a fine which shall extend to one thousand rupees.

The quorum for a Board meeting is one-third of the total strength (a fraction in that one-third being counted as one), or two, whichever is higher. In calculating the quorum, the directors, directly or indirectly interested in the contract or arrangement, if any, under discussion at / the meeting, should be excluded.

Powers of Directors

The powers of the Board of Directors may be broadly divided into:

- General powers
- Powers to be exercised only at Board meetings.

General Powers: Subject to the provisions of the Companies Act, the Board of Directors is entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do, subject to the following two conditions:

(a) The Board shall not exercise any power or do any act or thing which is to be exercised or done by the company in the general meeting.

(b) In exercising any such power or doing any such act or thing, the Board shall be subject to the provisions contained in that behalf in the Companies Act or any other Act, or in the Memorandum or Articles of the company, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in a general meeting.

Further, no regulation made by the company in a general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

Structure of the Board

The Company Law Board shall consist of not more than nine members appointed by the Central Government by notification in the Official Gazette. One of the members shall be appointed by the Central Government as the chairman of the Board.

The Board may, by order in writing, form one or more Benches from among its members and authorise each such Bench to exercise and discharge such of the Board's powers and functions as may be specified in the order. Every order made or act done by a Bench in exercise of such powers or discharge of such functions shall be deemed to be the order or act, as the case may be, of the Board.

Powers and Functions

The Company Law Board shall–

- exercise and discharge such powers and functions as may be conferred on it, by or under this Act or any other law, and
- shall also exercise and discharge such other powers and functions of the Central Government under this Act or any other law as may be conferred on it by the Central Government, by notification in the Official Gazette, under the provision of this Act or that other law.

Every Bench shall have powers which are vested in a Court under the Code of Civil Procedure, 1908(5 of 1908), while trying a suit, in respect of the following matters, namely :

(a) discovery and inspection of documents or other material objects producible as evidence;

(b) enforcing the attendance of witnesses and requiring the deposit of their expenses;

(c) compelling the production of documents or other material objects producible as evidence and impounding the same;

(d) examining witnesses on oath;

(e) granting adjournments;

(f) reception of evidence on affidavits.

Every Bench shall be deemed to be a civil court for the purposes of certain section of the Act and every proceeding before the Bench shall be deemed to be a judicial proceeding within the meaning of certain sections of the Indian Penal Code.

Any person aggrieved by any decision or order of the Company Law Board may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Company Law Board to him on any question of law arising out of such order. However, if the High Court is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, it may allow it to be filed within a further period not exceeding sixty days.

INVESTIGATION BY CENTRAL GOVERNMENT

The Companies Act empowers the Central Government to investigate in to the affairs or ownership of companies.

Investigation of Affairs of Company

The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a company and to report thereon in such manner as the Central Government may direct under the following cases:

1. Based on a report by the Registrar of companies, or,
2. Based on a declaration by the Company Law Board, that the affairs of the company ought to be investigated. The Board can make such a declaration, after giving the parties an opportunity of being heard, where it received an application from not less than two hundred members of a company having share capital, or from members holding not less than one-tenth of the total voting power of such company, or in the case of a company having no share capital, an application has been received from not less than one-fifth of the persons on the company's register of members.

   Such an application by members of the company shall be supported by such evidence as the Company Law Board may require for the purpose of showing that the applicants have good reason for requiring the investigation; and the Central Government may, before appointing an inspector, require the applicants to give security, for such amount not exceeding one thousand rupees as it may think fit, for payment of the costs of the investigation.
3. *(i)* The company, by special resolution; or *(ii)* the Court, by order, declares that the affairs of the company ought to be investigated by an inspector appointed by the Central Government; and
4. In the opinion of the Company Law Board, there are circumstances suggesting–

(i) that the business of the company is being conducted with intent to defraud its creditors, members or any other persons, or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive of any of its members, or that the company was formed for any fraudulent or unlawful purpose;

(ii) that persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or

(iii) that the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, or the manager of the company.

The inspector appointed for any such investigation also has the power to investigate in to the affairs of any related company if he thinks it necessary for the purposes of his investigation.

It shall be the duty of all officers and other employees and agents of the company investigated to preserve and to produce for the purpose of investigation documents related to the investigation and all other assistances in connection with the investigation which they are reasonably able to give.

Where in the course of the investigation, the inspector has reasonable ground to believe that the books and papers of, or relating to, any company or other body corporate related to the investigation may be destroyed, mutilated, altered, falsified or secreted, he may seize such documents after obtaining the required Magistrate order. The seized documents shall be kept in the custody of the inspector for such period not later than the conclusion of the investigation as he considers necessary and thereafter shall return the same to the party concerned.

The inspectors may, and if so directed by the Central Government shall, make interim reports to that Government, and on the conclusion of the investigation, shall make a final report to the Central Government.

A company shall be deemed to be unable to pay its debts–

(a) if a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding five hundred rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand under his hand requiring the company to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor;

(b) if execution or other process issued on a decree or order of any Court in favour of a creditor of the company is returned unsatisfied in whole or in part; or

(c) if it is proved to the satisfaction of the Court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company.

An application to the Court for the winding up of a company shall be by petition presented, subject to the provisions of the Act in this respect–

(a) by the company; or

(b) by any creditor or creditors, including any contingent or prospective creditor or creditors; or

(c) by any contributory or contributories; or

(d) by all or any of the parties specified in clauses (a), *(b)* and (c), whether together or separately; or

(e) by the Registrar; or

(f) in a case falling under section 243, by any person authorised by the Central Government in that behalf.

The Act contains provisions for the appointment of an official liquidator to each High Court. In the case of winding up by the Court, the official liquidator becomes the liquidator of the company on a winding up order being made.

Voluntary Winding Up

A company may be wound up voluntarily–

(a) when the period, if any, fixed for the duration of the company by the articles has expired, or the event, if any, has occurred, on the occurrence of which the articles provide that the company is to be dissolved, and the company in general meeting passes a resolution requiring the company to be wound up voluntarily;

(b) if the company passes a special resolution that the company be wound up voluntarily.

When a company has passed a resolution for voluntary winding up, it shall, within fourteen days of the passing of the resolution, give notice of the resolution by advertisement in the Official Gazette, and also in some newspaper circulating in the district where the registered office of the company is situated. If default is made in complying with this requirement, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to *five hundred* rupees for every day during which the default continues.

In the case of a voluntary winding up, the company shall, from the commencement of the winding up, cease to carry on its business, except so far as may be required for the beneficial winding up of such business. However, the corporate state and corporate powers of the company shall continue until it is dissolved.

Where it is proposed to wind up a company voluntarily, its directors, or in case the company has more than two directors, the majority of the directors, may, at a meeting of the Board, make a declaration verified by an affidavit, to the effect that they have made a full inquiry into the affairs of the company, and that, having done so, they have formed the opinion that the company has no debts, or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up as may be specified in the declaration.

The company in general meeting shall appoint one or more liquidators for the purpose of winding up the affairs and distributing the assets of the company; and fix the remuneration, if any, to be paid to the liquidator or liquidators.

Winding Up Subject to Supervision of Court

In certain cases, the supervision of the court is applied to voluntary winding up.

At any time after a company has passed a resolution for voluntary winding up, the Court may make an order that the voluntary winding up shall continue, but subject to such supervision of the Court, and with such liberty for creditors, contributories or others to apply to the Court, and generally on such terms and conditions, as the Court thinks just.

A petition for the continuance of a voluntary winding up subject to the supervision of the Court shall, for the purpose of giving jurisdiction to the Court over suits and legal proceedings, be deemed to be a petition for winding up by the Court.

Where an order is made for a winding up subject to supervision, the Court may, by that or any subsequent order, appoint an additional liquidator or liquidators.

BUY-BACK OF SHARES*

The purchase of its own shares or other securities by a company referred to as *buy-back* has been permitted in Indian since 31st October 1998. This section gives a general overview of buy-back of shares before dealing with the provisions of the Companies Act regarding the buy-back.

Buy-back of share essentially means repurchases by a company of its own shares. A company may do so either for reducing share capital, or for treasury operations. The reduction in share capital implies extinguishing of shares, which have been brought back by the company. This is done by reducing the par value of the equity shares from the equity capital, while the excess of price paid above par value is reduced from reserves and surplus.

Under the treasury operations, the acquired stock can be reissued at a later date or for employees option.

Several arguments have been advanced for permitting buy-back of shares. Some of the principal reasons for allowing a company to purchase its own shares are given below:

To return surplus cash to the investors — Many companies want to have the facility of buy-back as it allows them to manage their surplus cash. The surplus cash could also be distributed to the shareholders through paying dividends. The share repurchases and dividends are close substitutes

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* Major part of this section is a reproduction from RBI, *Report on Currency and Finance. 1997-98* and Government of India, *Economic Survey, 1998-99.*

(c) The buy-back does not exceed 25 per cent of the total paid-up capital and free reserves of the company;

(d) Debt-equity (including free reserves) ratio does not exceed to 2:1 after the proposed buy-back;

(e) All shares or other specified securities are fully paid-up; and

(f) The buy-back is in accordance with SEBI regulations framed for this purpose.

The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement making a full and complete disclosure of all material facts; the necessity for the buy-back; the class of security intended to be purchased under the buy-back; the amount to be invested under the buy-back; and the time limit for completion of buy-back. A maximum time of one year from the date of passing of resolution has been stipulated to complete the buy-back.

The buy-back may be–

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) from odd lots, that is to say, where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or

(d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

A company which has completed a buy-back of its shares or other specified securities shall not make further issue of the same kind shares or other specified securities within a period of twenty-four months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

Where a company purchases its own shares out if free reserves, then a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall disclosed in the balance-sheet.

Prohibition for buy-back in certain circumstances : No company shall directly or indirectly purchase its own shares or other specified securities–

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any loan or interest payable thereon to any financial institution or bank, is subsisting.

No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with the provisions of sections pertaining to preparation of annual report, balance sheet and payment of dividends.

SEBI Regulations

The salient features of the Securities and Exchange Board of India (Buyback of Securities) Regulations, 1988 are the following.

(a) Regulations cover only the listed securities of company.

(b) Buyback is permitted through the tender offer mode from existing shareholders on proportionate basis and from odd lot holders. Buyback through the book-building mode and purchases through stock exchange are allowed for open market transactions.

(c) In the purchases made through the stock exchange, the details of purchases under the buyback scheme shall be made available to the stock exchange on daily basis: the details in turn shall be made available to public regularly.

(d) Extensive disclosures need to be made in the Explanatory Statement to be annexed for the notice for general meeting and the Letter of Offer.

(e) Pre and post buyback holdings of promoters need to be disclosed carefully.

(f) Buyback through negotiated deals, spot transactions or private arrangements is not permitted.

(g) To ensure strict compliance with the provisions of SEBI Regulations, merchant banker has been made to be associated in every offer for buyback, wherein he has to give a "due diligence" certificate.

(h) To ensure timely completion of buyback process, the Regulations provide for time-bound steps in every mode. Thus, except in cases of purchases through stock exchange, an offer for buyback shall not remain open for more than 30 days.

(i) To ensure security/safety, the company making the buyback offer has to open an escrow account on the same lines as provided in the Takeover Regulations.

COMPANIES (AMENDMENT) ACT, 2000

The Companies (Amendment) Act, 2000, has substantially modified the company law in India. This Amendment Act has:

- Inserted a number of new provisions
- Omitted a number of provisions
- Amended a number of provisions

Provisions Added

An outline of some of the provisions newly inserted by the Amendment Act is given below.

Protection of Small Depositors: Section 58AA added with a view to protect the interest of small investors (a small depositor means a depositor who has deposited in a financial year a sum not exceeding twenty thousand rupees in a company and includes his successors, nominees and legal representatives) requires every company, which accepts deposits from small depositors to intimate to the Company Law Board any default made by it in repayment of any such deposits or interest on deposits. No company shall, at any time, accept further deposits from small depositors, unless each small depositor, whose deposit has matured, had been paid the amount of the deposit and the interest accrued thereupon, barring certain exceptions (like a deposit which has been renewed by the small depositor voluntarily).

This is a very healthy development that will ensure that these companies will maintain proper records and file the annual accounts and other returns within the prescribed time.

Directors' Responsibility Statement: The scope of the annual report of the Board of Directors has been widened by inserting a new section. Accordingly, the Board's report, besides other matters, shall include a Directors' Responsibility Statement, indicating therein that—

1. in preparation of the annual accounts, the applicable accounting standards had been followed alongwith proper explanation relating to material departure therefrom;
2. the directors had followed such policies consistently so as to give a true and fair view of the state of affairs of the company;
3. the directors had taken proper and sufficient care for the maintenance of adequate accounting records so as to safeguard the company's assets and to detect frauds and irregularities; and
4. the directors had prepared the annual accounts on a going concern basis.

The provision for the Directors Responsibility Statement would imply that "henceforth each and every Director of a company will have to compulsorily take active interest in the affairs of the company and first of all ascertain what are those accounting policies and audit standards and then satisfy himself that those have been duly complied with. Apparently, a Director cannot now sign Directors' Responsibility Statement without exercising due care and caution and without acquainting with these basic details relating to company accounts. This would also mean that the officers of the company responsible for preparation of the annual accounts will have to educate/apprise the members of the Board of Directors about the various accounting standards and accounting policies being pursued by the company and then satisfy the Board that those have been complied with. Since many persons on company Boards do not have adequate knowledge and idea about these important accounting policies and standards, it is hoped that the Institute of Chartered Accountants of India would come out with a suitable Guidelines covering the important points to be included in the Directors' Responsibility Statement, which can be easily understood by ordinary Company Directors."[1]

It is also pointed out that the Director's Responsibility Statement "would only be a repetition to the auditor's report. To make it meaningful, it should state that *(a)* the funds raised from the public, institutions, and banks have been put the specified end uses; *(b)* the details of funds invested as capital, loan or otherwise in subsidiary, associated or sister concerns and returns therefrom and also that such investments had not been made from borrowed funds; and *(c)* such statement should be from managing director, finance director, or the chairman where he/she is an executive. The part time directors, though they are collectively responsible, should not be made party to such statement as they are not looking after and/or taking part in conducting in the business/ daytoday affairs of the company."[2]

Provisions Amended

Some of the provisions amended are as follows.

Dividend : Before the Amendment of 2000, the Companies Act did not contain specific provisions relating to interim dividend. By inserting a new section, the Amendment Act has brought interim divided within the meaning of the term 'dividend' and section 205 has been amended to incorporate provisions relating to interim dividend. Accordingly, the Board of Directors may declare

interim dividend. The amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend and the amount so deposited shall be used only for payment of dividend.

Prior to the Amendment Act, if a dividend which has been declared by the company has not been paid to a shareholder or claimed within 42 days from the date of declaration, then the company was required to transfer the amount so unpaid or unclaimed within 7 days from the date of expiry of the period of 42 days to a special account. Now, the period of 42 days has been reduced to 30 days. There is severe penalty for non-compliance with the provisions regarding payment of dividend, – simple imprisonment which may extend to three years (earlier it was seven days) and fine of Rs. 1000 for every day of default. Further, the company is liable to pay simple interest at the rate of 18 per cent per annum for the period of default.

Types of Capital: Prior to the Amendment of 2000, according to section 86 the share capital of a company limited by shares could be of two kinds only, namely:–

(*a*) equity share capital; and

(*b*) preference share capital.

According to the newly substituted section 86, the share capital of a company limited by shares shall be of two kinds only, namely:–

(*a*) equity share capital–

(*i*) with voting rights; or

(*ii*) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

(*b*) preference share capital.

This amendment is regarded as a boon for the existing management of companies because they can now issue shares without voting right so that the capital of the companies may be increased without diluting their control.

Definition of Companies: The Companies Amendment Act, 2000, has changed the definition of certain terms.

The definitions of private and public companies have been amended by fixing a minimum paid up capital of Rs. One lakh for private company and Rs. 5 lakh for public company. By inserting a new provision, a private company is now required to prohibit by the Articles of Association any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

Prior to the amendment of 2000, according to section 43A, certain private companies were regarded *deemed public companies* on the basis of their share holding pattern or turn over. According to the newly inserted sub section 43 (2A), after the commencement of the Companies Amendment Act, 2000, the provision recognizing deemed public companies does not exist.

Conclusion

The amendments effected by the Companies (Amendment) Act, 2000 were long overdue. To some extent, some of these amendments reflect the response to the changing business environment.

The amendments seek to provide more transparency in corporate governance, enjoins more responsibility and accountability on the Directors of the company, make small companies also to comply with accounting disciplines, seek to protect the interests of small investors and depositors and debenture holders etc.

19 PATENTS AND TRADE MARKS

Protection of intellectual property rights has become an issue of wide and serious discussion with the formation of the General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) under the Uruguay Round (UR) Agreement of the GATT (now the WTO).

Intellectual property rights may be defined as "information with commercial value". IPRs have been characterised as a composite of "ideas, inventions and creative expression" plus the "public willingness to bestow the status of property" on them and give their owners the right to exclude others from access to or use of protected subject matter".

IPRs may be legally protected by patents, copyrights, industrial designs, geographical indications, and trade marks. Special *(sui generis)* forms of protection have also emerged to address specific needs of knowledge-producers as in the case of plant breeder's rights and the protection of layout designs of integrated circuits. A number of countries also have trade secret laws to protect undisclosed information that gives a competitive advantage to its owner.

The UR Agreement on TRIPs covers seven intellectual properties, *viz.*,

1. Copyright and related rights
2. Trademark
3. Geographical indications
4. Industrial designs
5. Patents
6. Layout designs (topographies) of integrated circuits
7. Undisclosed information, including trade secrets

On copyrights and related rights, the Agreement requires compliance with the provisions of *Bern Convention to* which India is a signatory and the new Copyright Act of India already meets the requirements of the TRIPs Agreement. Trade and Merchandise Marks Act of 1958 was replaced by a new Act, namely, The Trade Marks Act, 1999, so as to provide for the protection of service marks also.

PATENTS

A patent is a legal protection granted for an invention that is new, non-obvious and useful. The patent grants the patent holder the exclusive right to make use or sell the patented products or process. The main purpose of the patent system is to benefit the society. Patents, by providing an

opportunity to recoup the cost of invention (which is quite substantial in many cases) and to make profit out of the invention, encourage research and development and thereby contribute to the well being of the society.

An invention, to be patentable, must satisfy the following three conditions.

- It is new.
- It is useful to the society.
- It is non-obvious to a person possessed of average skill in the art.

Exclusion of an invention from patentability for commercial exploitation is permitted if it is necessary to protect public order or morality, including to protect human, animal or plant life or health or to avoid serious prejudice to the environment. A nation may also exclude from patentability *(a)* diagnostic, therapeutic and surgical methods for the treatment of humans or animals; *(b)* plants and animals other than microorganisms and essentially biological process for the production of plants or animals other than non-biological and micro-biological process. However, members shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof.

According to the Indian Patents Act, 1970, invention means any new and useful *(i)* art, process, method or manner of manufacture; *(ii)* machine, apparatus or other article; *(iii)* substance produced by manufacture; and includes any new and useful improvement of any of them, and an alleged invention.

While the patent grants the exclusive right to the inventor to exploit his invention for commercial gain for a specific period of time, it also imposes on him the duty of fully disclosing the invention.

Indian Patent Law and the UR Agreement

The UR Agreement on patents is in substantial variance with the Indian Patent Act of 1970 and, therefore, has given rise to a lot of controversy in India. Being a member of the WTO, India is bound to align its patent law with the UR Agreement.

The UR Agreement in respect of patents lays down more stringent conditions and stronger protection than the Indian law.

Under the Indian Patent Act of 1970, only process patent (and no product patent) is applicable in respect of inventions relating to substances intended for use as food, drug or medicines, or substances produced by chemical processes is limited to the methods or processes of manufacture only. This means that one can make and market a product similar to the patented product through a different process or method than the patented one. This practice has been very prevalent in the Indian pharmaceutical industry. The UR Agreement requires both product and process patents.

Under the 1970 Act, patent expiry period is 5 to 7 years for some products and 14 years for other products, whereas the UR Agreement stipulates 20 years for all products.

Table 19.1 highlights the major differences between the 1970 Indian law and the UR Agreement.

(i) in relation to Chapter XII (other than Sec. 107), a registered trade mark or a mark used in relation to goods or services for the purpose of indicating or as to indicate a connection in the course of trade between the goods or services, as the case may be, and some person having the right as proprietor to use the mark; (Chapter XII deals with offences and penalties) and

(ii) in relation to other provisions of this Act, a mark used or proposed to be used in relation to goods or services for the purpose of indicating or so as to indicate a connection in the course of trade between the goods or services, as the case may be, and some person having the right, either as proprietor or by way of permitted user, to use the mark whether with or without any indication of the identity of that person, and includes a certification trade mark or collective mark.

According to the Trade marks Act, certification trade mark means a mark capable of distinguishing the goods or services in connection with which it is used in the course of trade which are certified by the proprietor of the mark in respect of origin, material, mode of manufacture of goods or performance of services, quality, accuracy or other characteristics from goods or services not so certified and registrable as such under Chapter IX (which deals with Certification Trade Marks) in respect of those goods or services in the name, as proprietor of the certification trade mark, of that person.

Collective Mark: According to the Trade Marks Act, collective mark means a trade mark distinguishing the goods or services of members of an association of persons, not being a partnership within the meaning of the Indian Partnership Act, 1932 (9 of 1932), which is the proprietor of the mark from those of others.

THE TRADE MARKS ACT, 1999

The Indian law relating to trade marks has been amended and consolidated and Trade and Merchandise Marks Act, 1958 has been replaced by The trade Marks Act 1999.

Objectives

The objectives of The Trade Marks Act, 1999, are to provide for:

- The registration and better protection of trade marks for goods and services
- The prevention of the use of fraudulent marks

Registrar and Trade Marks Registry

The Controller-General of Patents, Designs and Trade Marks, appointed by the Central Government, is the Registrar of Trade Marks for the purpose of the Trade Marks Act. Further, the Central Government may appoint other officers with such designations as it thinks fit for the purpose of discharging, under the superintendence and direction of the Registrar, such functions of the Registrar under this Act as he may authorise them to discharge.

For the purposes of this Act, there shall be a Trade Marks Registry with its head office at such place as the Central Government may specify. For the purpose of facilitating the registration of trade marks, there may be branch offices of the Trade Marks Registry established at such places as the Central Government may think fit.

The Act also lays down that a Register of Trade Marks shall be kept at the head office of the Trade Marks Registry, wherein shall be entered all details regarding the registered trade marks.

(*i.e.*, the names, addresses and description of the proprietors, notifications of assignment and transmissions, the names, addresses and descriptions of registered users; conditions, limitations and such other matter relating to registered trade marks as may be prescribed).

A copy of the register and the other relevant documents shall be kept at each branch office of the Trade Marks Registry.

Registration of Trade Marks

Any person claiming to be the proprietor of a trade mark used or proposed to be used by him, who is desirous of registering it, shall apply to the Registrar in the prescribed manner for the registration of his trade mark.

A single application is enough for registration of a trade mark for different classes of goods and services.

The application shall be filed in the office of the Trade Marks Registry within whose territorial limits the principal place of business in India of the applicant is situated. In the case of joint applicants it shall be filed in the office of the Trade Marks Registry within whose territorial limits the principal place of business in India of the applicant whose name is first mentioned in the application as having a place of business in India is situated.

Where the applicant or any of the joint applicants does not carry on business in India, the application shall be filed in the office of the Trade Marks Registry within whose territorial limits the place mentioned in the address for service in India as disclosed in the application is situated.

Subject to the provisions of this Act, the Registrar may accept the application absolutely or subject to such amendments, modifications, conditions or limitations, if any, as he may think fit, or refuse the application.

In the case of a refusal or conditional acceptance of an application, the Registrar shall record in writing the grounds for such refusal or conditional acceptance and the materials used by him in arriving at his decision.

When an application for registration of a trade mark has been accepted, the Registrar shall cause the application as accepted together with the conditions or limitations, if any, subject to which it has been accepted, to be advertised in the prescribed manner. In certain cases, such advertisement may be made before the acceptance of the application. The purpose of the advertisement is to allow any person who has any opposition to the registration of the proposed trade mark to give proper notice to the Registrar, of opposition to the registration.

If any proper notice of opposition is received, the Registrar shall serve a copy of the notice on the applicant for registration and, within two months from the receipt by the applicant of such copy of the notice of opposition, the applicant shall send to the Registrar in the prescribed manner in counter-statement of the grounds on which he relies for his application. If he does not do so, he shall be deemed to have abandoned his application.

If the applicant sends such counter-statement, the Registrar shall serve a copy thereof on the person giving notice of opposition. The Registrar shall take an appropriate decision after hearing the parties, if so required, and considering the evidence.

On the registration of a trade mark, the Registrar shall issue to the applicant a certificate in the prescribed form of the registration thereof, sealed with the seal of the Trade Marks Registry.

SUMMARY

Legal protection of intellectual property rights provide the owners of them the exclusive right to their commercial use so that they are rewarded for their innovative or marketing ingenuity.

Patent

A patent is a legal protection granted for an invention that is new, non-obvious and useful. The main purpose of the patent system is to benefit the society. Patents, by providing an opportunity to recoup the cost of invention and to make profit out of the invention, encourages research and development and thereby contributes to the well being of the society.

The Indian Patent Act of 1970 has significant differences from the patent regulation stipulated by the GATT / WTO. The Uruguay Round Agreement imposes more stringent regulations than stipulates more stringent conditions for compulsory licensing of patents, when compared to the Indian law.

It is argued that the acceptance of product patents will strangle the growth of the Indian pharmaceutical industry and the monopolisation of the vital areas of this industry by multinationals will result in sharp increase in drug prices. This fear, however, seems to be exaggerated. Patented drugs account for only a small share of the Indian pharmaceutical market and within the patented drugs segment, more than half of the drugs have other therapeutic equivalents.

While there are strong criticisms against the WTO patent regime on the one hand, there are many who argue that it will be beneficial to India in several ways. This has made several Indian pharmaceutical firms to pay more attention to R&D.

Trade Mark

According to the Trade Marks Act, 1999, trade.mark means a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colours.

The Indian law relating to trade marks has been amended and consolidated and Trade and Merchandise Marks Act, 1958 has been replaced by The trade Marks Act 1999. This Act provides for the registration and better protection of trade marks for goods and services, and the prevention of the use of fraudulent marks.

A registered trade mark is assignable and transmissible, whether with or without the goodwill of the business concerned. It may be done in respect either of all the goods or services in respect of which the trade mark is registered or of only some of those goods or services.

The registration of a trade mark gives the registered proprietor of the trade mark the exclusive right to the use of the trade mark in relation to the goods or services in respect of which the trade mark is registered. This also entitles him to relief in respect of infringement of the trade mark. No person is entitled to institute any proceeding to prevent, or to recover damages, for the infringement of an unregistered trade mark.

The Registrar of Trade Marks for the purposes of this Act is known as the Controller-General of Patents, Designs and Trade Marks.

There is a Trade Marks Registry with its head office at such place as the Central Government may specify. For the purpose of facilitating the registration of trade marks, there may be branch offices of the Trade Marks Registry established at such places as the Central Government may think fit.

Under the Trade Marks Act, an Appellate Board to be known as the Intellectual Property Appellate Board is established by the Central Government to exercise the jurisdiction, powers and authority conferred on it by or under this Act.

Any person aggrieved by an order or decision of the Registrar under this Act, or the rules made thereunder may prefer an appeal to the Appellate Board.

Offences such as falsifying and falsely applying trade marks, applying false trade marks and trade descriptions etc., and selling goods or providing services to which false trade marks or false trade description is applied are punishable under the Act by imprisonment and fine.

ANNEXURE 19.1

FALSIFYING AND FALSELY APPLYING TRADE MARKS

1. A person shall be deemed to falsify a trade mark who, either–

(*a*) without the assent of the proprietor of the trade mark makes that trade mark or a deceptively similar mark; or

(*b*) falsifies any genuine trade mark whether by alteration, addition, effacement or otherwise.

2. A person shall be deemed to falsely apply to goods or services a trade mark who, without the assent of proprietor of the trade mark–

(*a*) applies such trade mark or a deceptively similar mark to goods or services or any package containing goods;

(*b*) uses any package bearing a mark which is identical with or deceptively similar to the trade mark of such proprietor, for the purpose of packing, filling or wrapping therein any goods other than the genuine goods of the proprietor of the trade mark.

3. Any trade mark falsified as mentioned in sub-section (1) or falsely applied as mentioned in sub-section (2) is in this Act referred to as a false trade mark.

4. In any prosecution for falsifying a trade mark or falsely applying a trade mark to goods or services, the burden of proving the assent of the proprietor shall lie on the accused.

Falsely Representing a Trade Mark as Registered

Falsely representing a trade mark as registered means making any representation–

(*a*) with respect to mark, not being a registered trade mark, to the effect that it is a registered trade mark; or

(*b*) with respect to a part of a registered trade mark, not being a part separately registered as a trade mark, to the effect that it is separately registered as a trade mark; or

(*c*) to the effect that a registered trade mark is registered in respect of any goods or services in respect of which it is not in fact registered; or

(*d*) to the effect that registration of a trade mark gives an exclusive right to the use thereof in any circumstances in which, having regard to limitation entered on the register, the registration does not in fact give that right.

If any person contravenes any of the provisions pertaining to falsely representing a trade mark as registered shall be punishable with imprisonment for a term which may extend to three years, or with fine, or with both.

of legislative enactment having the character of enforceability in a court of law. Government made decisions by way of executive policies and executive guidelines are pronounced in trade policy areas, in terms of which trade is regulated or even liberalised without the promulgation of a law or without the requirement of having to secure the approval of die legislature before applying the same. In policies which are not having the cover of law, there is always the danger of discrimination, abuse of discretion and non-rule based decisions. While one can easily appreciate the difficulties involved in covering and supporting every executive made competition policy by a legislative enactment, it is desirable that there is a codification of the principles the competition law which should act as an umbrella framework for making executive policies. Furthermore, such a competition law should have necessary provisions and teeth, to review any executive policy on the touchstone of competition and also have the power to require the executive to amend its policies, as may be necessary. This will ensure the spirit of competition in the executive policies relating to trade and market.[3]

As an UNCTAD report observes, the main objective of competition laws is to preserve and promote competition as a means to ensure the efficient allocation of resources in an economy, resulting in the best possible choice of quality, the lowest prices and adequate supplies for consumers. In addition to promoting efficiency, many competition laws make reference to other objectives, such as the control of concentration of economic power, promoting the competitiveness of domestic industries, encouraging innovation,' supporting small and medium-size enterprises and encouraging regional integration. Some of these additional objectives may sometimes be in conflict with the efficiency objective. The manner in which efforts are made to reconcile these conflicting objectives can be relevant to domestic firms and to the way TNCs are allowed to enter and operate in domestic markets.[4]

Most competition laws deal with enterprise ***behaviour*** by prohibiting such restrictive business practices as competition-restricting horizontal agreements, acquisitions and abuses of dominant positions, as well as substantially restrictive vertical distribution agreements. In addition, an increasing number of competition laws deals with alterations to the ***structure*** of markets, through the control of M&As, as well as joint ventures aimed at avoiding the creation of dominant firms, monopolies, or even oligopolies. In some laws, the divestment of 'parts of monopolies is also authorized, to change the structure of markets.[5]

Most competition laws contain exceptions (basically sectoral) and exemptions (in most cases adopted in respect to categories of practices) to the application of their provisions. These can cover, among others, labour, regulated industries (*e.g.*, telecommunications, defence, agriculture), small and medium-size enterprises, and certain types of cooperative arrangements, including R&D joint ventures. The rationales behind exemptions vary. In some cases (market failures, for example), competition and market forces are not viewed as the best tools leading to the maximization of economic efficiency; rather, direct regulation of prices or entry is used. A number of countries, however, are reviewing the soundness and validity of those across-the board exemptions. The emphasis is increasingly on applying competition law to all business practices not explicitly imposed on firms by statutory provisions. It is then the task of the competition authority or courts to consider business practices, and focus on those that have the highest probability of anticompetitive effects and the least justification based on efficiency. Usually, such cartel practices as price fixing, collusive tendering and market allocation are prohibited without need for market analysis, while distribution, joint ventures and merger agreements are assessed in a market context and increasingly under a rule-of-reason standard taking into account the efficiencies likely to be achieved and passed on to consumers.[6]

BOX 20.1 : SELECTED RESTRICTIVE BUSINESS PRACTICES ADDRESSED BY COMPETITIVE LAW

There are four main types of business practices that can have anticompetitive effects: practices undertaken by a single firm (when a firm enjoys a dominant position); anticompetitive mergers and acquisitions; horizontal restraints (*i.e.*, arrangements between competitors to restrain competition) and vertical restraints (anticompetitive arrangements between firms along the production-distribution chain). Horizontal and vertical restraints include the following arrangements, which can be undertaken individually or in combination.

HORIZONTAL RESTRAINTS^

Price fixing — Competing suppliers enter into cooperative agreements regarding prices and sales conditions.

Restraint of output — Competing suppliers enter into agreements regarding output and product quality.

Market allocation — Competing suppliers allocate customers amongst themselves, who therefore cannot benefit from competition by other suppliers.

Exclusionary practices — Competing suppliers employ practices that inhibit or preclude the ability of other actual or potential suppliers to compete in the market for a product.

Collusive tendering (bid-rigging) — Competing suppliers exchange commercially sensitive information on bids and agree to take turns as to who will make the most competitive offer.

Conscious parallelism — Competing suppliers generally set the same prices, but without an explicit agreement.

Other restraints on competition — Generally characterized by suppliers entering into cooperative agreements not to undertake certain actions of competitive value (*e.g.*, advertising).

VERTICAL RESTRAINTS

Exclusive dealing — A producer supplies distributors and guarantees not to supply other distributors in a given region.

Reciprocal exclusivity — A producer supplies on the condition that the distributor does not carry anybody else's products.

Refusal to deal — A supplier refuses to sell to parties wishing to buy.

Resale price maintenance — A producer supplies distributors only on the condition that the distributor sells at a minimum price set by the supplier.

Territorial restraint — A supplier sells to distributors only on the condition that the distributor does not market the product outside a specified territory.

Discriminatory pricing — A supplier charges different parties different prices under similar circumstances.

Predatory pricing — Suppliers sell at a very low price (or supply intermediate inputs to competitors at excessive prices) in order to drive competitors out of business.

should fall within the contours of the competition principles; all physical and fiscal controls on the movement of goods throughout the country should be abolished; Government should divest its shares and assets in State monopolies and public enterprises and privatise them in all sectors other than those subserving defence and security needs and sovereign functions; all State monopolies and public enterprises will be under the surveillance of Competition Policy to prevent monopolistic, restrictive and unfair trade practices on their part; any form of discrimination in favor of the public sector and Government commercial enterprises except where they relate to security concerns must be removed, while at the same time taking care not to create private monopolies out of public monopolies; the Industrial Disputes Act, 1947 and the connected statutes need to be amended to provide for an easy exit to the nonviable, ill-managed and inefficient units subject to their legal obligations in respect of their liabilities; structures like BIPR and the Sick Industrial Companies Act itself may be scrapped; concerns relating to trade dimensions vis - a - vis WTO agreements and principles need to be squarely addressed; Urban Land Ceiling Act should be repealed.

All the recommendations of the Committee apply to all industrial and professional enterprises including those in public and private sector.

The Committee suggested that the Government while enacting an appropriate Competition Law for the country needs to address the prerequisites as recommended above and that the pre-requisites will constitute a foundation over which the edifice of Competition Policy and Competition Law needs to be built.

Contours of Competition Policy

Noting that the focus for most Competition Laws today in the world is in the following three areas, the Committee centered its recommendations on the same.

- Agreement among enterprises
- Abuse of dominance
- Mergers or, more generally, Combinations among enterprises

Agreement Among Enterprises: Horizontal and Vertical agreements between firms have the potential of restricting competition. Horizontal agreements refer to agreements among competitors and vertical agreements to an actual or potential relationship of buying or selling to each other.

The Committee recommended that both these types of agreements should be covered by the Competition Law, if it is established that they prejudice competition. Horizontal agreements relating to prices, quantities, bids (collusive tendering) and market sharing are particularly an-ticompetitive. Vertical agreements like tie-in arrangements, exclusive supply/distribution agreements and refusal to deal are also generally anti-competitive. Agreements that contribute to the improvement of production and distribution and promote technical and economic progress, while allowing consumers a fair share of the benefits should be dealt with leniently. Blatant price, quantity, bid and territory sharing agreements and cartels should be presumed to be illegal.

Abuse of Dominance: Dominance needs to be appropriately defined in the Competition Law in term of "the position of strength enjoyed by an undertaking which enables it to operate independently of competitive pressure in the relevant market and also to appreciably affect the relevant market, competitors and consumers by its actions". The definition needs to be also in terms of "substantial impact on the market including creating barriers to new entrants". The Committee did not consider it desirable to prescribe any arithmetical figure like percentage of market share to define

dominance, as a firm with a high market share may conduct business ethically if there is a strong and effective rival in the relevant market and likewise, a firm with a small market share may abuse its market power if its competitors diffusedly hold the remaining market share.

Abuse of dominance rather than dominance should be the key for Competition Policy/Law. Abuse of dominance will include practices like restriction of quantities, markets and technical development. Abuse of dominance which prevents, restricts or distorts competition needs to be frowned upon by Competition Law. Relevant market needs to be an important factor in determining abuse of dominance.

Predatory pricing which is defined as the situation where a firm with market power prices below costs so as to drive competitors out of the market is generally prejudicial to consumer interest in the long run. Instead of always taking an adverse view, it is desirable in the Committee's view that predatory pricing may be treated as an abuse, only if it is indulged in by a dominant undertaking.

By and large, abuse of dominance and exclusionary practices will need to be dealt with by the adjudicating Authority on the rule of reason basis.

Mergers: Mergers need to be discouraged, if they reduce or harm competition. The Committee, however, cautions against monitoring of all mergers by the adjudicating Authority, for the reason that very few Indian companies are of international size and that in the light of continuing economic reforms, opening up of trade and foreign investment, a great deal of corporate restructuring is taking place in the country and that there is a need for mergers, amalgamations etc. as part of the growing economic process before India can be on an equal footing to compete with global giants, as long as the mergers are not prejudicial to consumer interest.

It is in this context that the Committee recommended that mergers beyond a threshold limit in terms of assets should require pre-notification. The threshold limit suggested is the value of assets of the merged identity at Rs. 100 crore or more and of the group to which merged entity belongs at Rs. 2000 crore or more, both linked to Wholesale Price Index.

The Competition Law needs to be designed and implemented in terms of the contours enunciated above.

Competition Policy/Law needs to have necessary provisions and teeth to examine and adjudicate upon anti-competition practices that may accompany or follow developments arising out of the implementation of *WTO* Agreements. In particular, agreements relating to foreign investment, intellectual property rights, subsidies, countervailing duties, antidumping measures, sanitary and phytosanitary measures, technical barriers to trade and Government procurement need to be reckoned in the Competition Policy/Law with a view to dealing with anti-competition practices.

Furthermore the Committee recommended as follows regarding State Monopolies, Regulatory Authorities, Government procurement, Foreign companies, Professions and Standards.

- The State Monopolies, Government procurement and foreign companies should be subject to the Competition Law. The Law should cover all consumers who purchase goods or services, regardless of the purpose for which the purchase is made.
- All decisions of the Regulatory Authorities can be examined under the touchstone of Competition Law by the Competition Commission.

(*d*) refusal to deal (*i.e.*, an agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought);

(*e*) resale price maintenance (*i.e.*, an agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged).

Nothing contained in this Sub-section shall restrict the right of any person to restrain any infringement of, or to impose reasonable conditions, as may be necessary for protecting any of his intellectual property rights which have been or may be conferred upon him under the appropriate Acts. Agreements related to export from India is also exempted.

Abuse of Dominant Position

Section 4 of the Competition Act lays down that no enterprise shall abuse its dominant position. Dominant position means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (*i*) operate independently of competitive forces prevailing in the relevant market; or (*ii*) affect its competitors or consumers or the relevant market in its favour.

The following cases are regarded as an abuse of dominant position, *viz.*, an enterprise—

(*a*) directly or indirectly, imposes unfair or discriminatory —

(*i*) condition in purchase or sale of goods or service; or

(*ii*) price in purchase or sale (including predatory price, *i.e.*, price which is kept below the cost with a view to reduce competition or eliminate the competitors) of goods or service.

However, such discriminatory condition or price which may be adopted to meet the competition is excluded from the application of this Section.

(*b*) limits or restricts —

(*i*) production of goods or provision of services or market therefore; or

(*ii*) technical or scientific development relating to goods or services to the prejudice of consumers; or

(*c*) indulges in practice or practices resulting in denial of market access; or

(*d*) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or

(*e*) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

Regulation of Anti-Competitive Agreements and Abuse of Dominance

Where the Commission finds that any agreement causes or is likely to cause an appreciable adverse effect on competition or action of an enterprise is or is likely to be an abuse of its dominant position, it may pass all or any of the following orders, namely: —

(*a*) direct any party involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position, as the case may be;

(*b*) impose such penalty, as it may deem fit which shall be not more than ten per cent of the average of the turnover for the last three preceding financial years, upon each of such person or enterprises which are parties to such agreements or abuse. If the anti-competitive agreement has been entered into by any cartel, the Commission shall impose upon each producer, seller, distributor, trader or service provider included in that cartel, a penalty equivalent to three times of the amount of profits made out of such agreement by the cartel or ten per cent of the average of the turnover of the cartel for the last preceding three financial years, whichever is higher;

(*c*) award compensation to parties in accordance with the provisions contained in the Act;

(*d*) direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission;

(*e*) direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, if any;

(*f*) recommend to the Central Government for the division of an enterprise enjoying dominant position;

(*g*) pass such other order as it may deem fit.

Even if an anti-competitive agreement has been entered into outside India; or any party to such agreement is outside India; or any enterprise abusing the dominant position is outside India; or a combination has taken place outside India; or any party to combination is outside India; or any other matter or practice or action arising out of such agreement or dominant position or combination is outside India, Commission shall the have power to inquire into such agreement or abuse of dominant position or combinations if such agreement or dominant position or combination has, or is likely to have, an appreciable adverse effect on competition in the relevant market in India.

Division of Enterprise Enjoying Dominant Position: According to Section 28 of the Act, on recommendation of the Competition Commissions Government for the division of an enterprise enjoying dominant position, the Central Government may order the division of the enterprise enjoying dominant position to ensure that such enterprise does not abuse its dominant position. Such may provide for all or any of the following matters, namely:—

(*a*) the transfer or vesting of property, rights, liabilities or obligations;

(*b*) the adjustment of contracts either by discharge or reduction of any liability or obligation or otherwise;

(*c*) the creation, allotment, surrender or cancellation of any shares, stocks or securities;

(*d*) the payment of compensation to any person who suffered any loss due to dominant position of such enterprise;

(*e*) the formation or winding up of an enterprise or the amendment of the memorandum of association or articles of association or any other instruments regulating the business of any enterprise;

(*f*) the extent to which, and the circumstances in which, provisions of the order affecting an enterprise may be altered by the enterprise and the registration thereof;

(*g*) any other matter which may be necessary to give effect to the division of the enterprise.

Factors Considered in Determining Adverse Effect of an Agreement: The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition have due regard to all or any of the following factors, namely:—

(a) creation of barriers to new entrants in the market;

(b) driving existing competitors out of the market;

(c) foreclosure of competition by hindering entry into the market;

(d) accrual of benefits to consumers;

(e) improvements in production or distribution of goods or provision of services;

(f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

Factors Considered in Determining Dominant Position: The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not shall have due regard to all or any of the following factors, namely:—

(a) market share of the enterprise;

(b) size and resources of the enterprise;

(c) size and importance of the competitors;

(d) economic power of the enterprise including commercial advantages over competitors;

(e) vertical integration of the enterprises or sale or service network of such enterprises;

(f) dependence of consumers on the enterprise;

(g) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;

(h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;

(i) countervailing buying power;

(j) market structure and size of market;

(k) social obligations and social costs;

(l) relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;

(m) any other factor which the Commission may consider relevant for the inquiry.

Regulation of Combinations

Section 5 of the Act, which deals with combinations, considers only those acquisitions, mergers or amalgamations which results in assets or turnover above the specified threshold limits or control of enterprises with assets or turnover above the specified threshold limits. Accordingly the following fall under combination.

Any acquisition, merger or amalgamation which results in combined assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores in India; or assets of the value of more than five hundred million US dollars or turnover more than fifteen hundred million US dollars in India or outside India. When a group of enterprises is involved, the