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2.3.10. - Aviation Corporate Laws

Compiled by:

Prof. (Dr.) V. Balakista Reddy

Ms. Ruchi Jain, Research Associate

COURSE OUTLINE

The times when only government used to exercise monopoly on the civil aviation sector are long gone and in its place there has been a splurge of entry of private entities and investors in the domestic and international aviation market. Aviation sector in India has been transformed from an over regulated and under managed sector to a more open, liberal and investment friendly sector since 2004. In order to regulate the business of aviation in India, the varied range of corporate laws that are applicable to regular business enterprises are also applicable to aviation business. Corporate Laws provide the business enterprises with a legal form that possesses these five core attributes. By making this form widely available and user-friendly, corporate law enables entrepreneurs to transact easily through the medium of the corporate entity, and thus lowers the costs of conducting business.

The dominance of private corporations including the aviation corporate enterprises over our economy and society is such that they have come to colonize our thinking. Aviation Corporate Law deals with the formation and operations of corporations and is related to commercial and contract law. A corporation is a legal entity created under the laws of the state it's incorporated within. State laws, which vary from state to state, regulate the creation, organization and dissolution of their corporations. A corporation creates a legal or "artificial person" or entity that has standing to sue and be sued, enter into contracts, and perform other duties necessary to maintain a business, separate from its stockholders.

The objective of this paper is to train the corporate law professionals in the legal formation of corporations and to construct joint ventures, licensing arrangements, mergers, acquisitions, and the countless other transactions entered into by corporations. Other areas of practice include business formations, securities law, venture capital financing, business agreements, internal forms, and business tax consultations.

It is of paramount importance for the course participants to familiarize themselves with the fundamental law of business before starting an aviation business as it will help you operate your business without the hindrances of ignorance. Hence the first module of the paper deals with the fundamentals of company law. Any discussion on the corporate law is incomplete without deliberating upon the mother of corporate laws in India i.e. the Indian Companies Act 2013. It lays down the fundamental legal provisions on start, conduct and regulation of business.

Given the growing trend of mergers and acquisitions in the field of aviation sector, the second module is entirely dedicated towards an elaborate discussion on the issue of mergers and acquisitions. The initial chapters of the second module dwell upon the significance, rationale, procedures and varied forms of mergers and acquisitions. The module thereafter digs deeper in to the cases of mergers and acquisitions in the aviation sector and the contemporary issues that have arisen in the last few years.

Another significant aspect of the civil aviation business is related to the competition law and competition norms. Hence the third module contains a detailed discussion on the competition law of India. The second part of this module consists of a detailed discussion on the emerging issues which have arisen due to application of competition law to Indian civil aviation sector.

Over recent years the global aviation sector has witnessed the rapid growth of air travel in emerging markets, the continuing growth of low cost carriers across the globe, and regulatory changes to global emissions trading schemes to name but a few developments. Increased FDI inflows, surging tourist inflow, increased cargo movement, sustained business growth and supporting government policies are the major drivers for the growth of aviation sector in India and have opened up new doors of intersection between the business and aviation norms. Domestic airlines have been allowed to fly overseas, forge partnerships with foreign carriers while foreign carriers in turn have been interlining with domestic airlines to access secondary destinations. The fourth module on business opportunities in aviation sector focuses on such new contemporary issues that have arisen due to application of business laws on civil aviation. The module thus discusses these contemporary issues.

The final module of the paper briefly throws light on other corporate laws which carry the potential to affect business venture in aviation sector.

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MODULE I

FUNDAMENTALS OF COMPANY LAW

INTRODUCTION TO COMPANY LAW

Industrial has revolution led to the emergence of large scale business organizations. These organizations require big investments and the risk involved is very high. Limited resources and unlimited liability of partners are two important limitations of partnerships of partnerships in undertaking big business. Joint Stock Company form of business organization has become extremely popular as it provides a solution to overcome the limitations of partnership business. The Multinational companies like Indigo Airlines or Spice jet or Kingfisher, etc. have their investors and customers spread throughout the world. The transportation industry also underwent significant transformation during the Industrial Revolution. Before the advent of the steam engine, raw materials and finished goods were hauled and distributed via horse-drawn wagons, and by boats along canals and rivers. In the early 1800s, American Robert Fulton (1765-1815) built the first commercially successful steamboat, and by the mid-19th century, steamships were carrying freight across the Atlantic.

Meaning of Company

Section 3 (1) (i) of the Companies Act, 1956 defines a company as "a company formed and registered under this Act or an existing company". Section 3(1) (ii) Of the act states that "an existing company means a company formed and registered under any of the previous companies laws". This definition does not reveal the distinctive characteristics of a company. In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of, its members.

According to Chief Justice Marshall of USA, "A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation of its creation confers upon it either expressly or as incidental to its very existence".

According to Haney, "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership".

From the above definitions, it can be concluded that a company is registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability. The word company ordinarily means an association of a number of individuals formed for some common object. When such an association is registered under the Companies Act, it becomes an artificial person with perpetual succession and a common seal.

The word "company" is derived from the Latin (Com = with or together; panis = bread), and originally referred to an association of persons who took their meals together. It may be assumed, since human nature does not change that in the leisurely past no less than in the speedy present, merchants took advantage of festive gatherings, to discuss business matters. Now-a-days, the business matters have become most complicated and cannot be discussed at length on festive gatherings. Therefore, the word "company" has assumed great importance as it denotes a joint stock enterprise in which the capital is contributed by a large number of people.

A company may be an incorporated company or a "corporation" or an unincorporated company. An incorporated company is a separate person distinct from the individuals constituting it whereas an unincorporated company, such as a partnership, is mere collection or aggregation of individuals. Therefore, unlike a partnership firm, a company is a corporate body and a legal person having status and personality distinct and separate from that of the members constituting it.

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law, and clothing it with legal personality, and, so turn it into a corporation (The word "corporation" is derived from the Latin term "corpus" which means "body"). Accordingly, "corporation" is a legal person created by the process other than natural birth. It is, for this reason, sometimes called artificial person. This corporate being is capable of enjoying many of the rights and incurring many of the liabilities of a natural person - a human being. The incorporated company owes its existence to a special Act of Parliament or to a company legislation which in India, is the Companies Act, 1956. The public corporations like Life Insurance Corporation of India and Damodar Valley Corporation have been brought into existence through special Acts of Parliament whereas companies like Tata Iron and Steel Co. Ltd., Hindustan Lever Ltd., Delhi Cloth and General Mills Ltd., and State Trading Corporation of India Ltd. have been formed under the Companies Act, 1956. The trading partnership which is governed by Partnership Act is the most apt example of an unincorporated association.

In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country.

Characteristics of Company

Corporate Personality

A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation. It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.

By incorporation under the Act, the company is vested with a corporate personality quite distinct from individuals who are its members. Being a separate legal entity it bears its own name and acts under a corporate name. It has a seal of its own. Its assets are separate and distinct from those of its members. It is also a different 'person' from the members who compose it. As such it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners but they can be its creditors simultaneously as it has a separate legal entity. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. The case of ***Salomon v. Salomon and Co. Ltd.,*** (1897) A.C. 22, has clearly established the principle that once a company has been validly constituted under the Companies Act, 1956 it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member has a large or small proportion of the shares, and whether he holds those shares beneficially or as a mere trustee. The facts of this case are as follows: Salomon had, for some years, carried on a prosperous business as leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed for 1 share each so that the actual cash paid as capital was £ 7. Salomon sold his business (which was perfectly solvent at that time), to the Company for the sum of £ 38,782. The company's nominal capital was £ 40,000 in £ 1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £ 10,000 secured by a floating charge on the company's assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £ 8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors.

Separate Legal Entity

A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and nor for the personal benefit of the shareholders. On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up. At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognized by the Income Tax Act. Where a company is required to pay Income-tax on its profits and when these profits are distributed to shareholders in the form of dividend, the shareholders have to pay income-tax on their dividend of income. This proves that a company that a company and its shareholders are two separate entities.

Limited Liability

The company being a separate entity, leading its own business life, the members are not liable for its debts. The liability of the members of a company is limited to the extent of the nominal value of the shares held by them. In no event can a shareholder be asked to pay anything more than the unpaid value of his shares. In the case of a company limited by guarantee, the members are liable only to the extent of the amount guaranteed by them and not beyond, and only when the company goes into liquidation. For example, if the face value of a share in a company is Rs. 10 and a member has already paid Rs. 7 per share, he can be called upon to pay not more than Rs. 3 per share during the lifetime of the company. In a company limited by guarantee the liability of members is limited to such amount as the member may undertake to contribute to the assets of the company in the event of its being wound up.

Perpetual Succession

A company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholders or director. Law creates it and law alone can dissolve it. Members may come and go but the company can go on for ever. "During the war all the member of one private company, while in general meeting, were killed by a bomb. But the company survived; not even a hydrogen bomb could have destroyed it". The company may be compared with a flowing river where the water keeps on changing continuously; still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership. Variation in members or their identity does not affect the legal existence and identity of a company. It is a creation of law and can be dissolved only under the law.

Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company. The shares of joint stock companies are freely transferable. In the case of a private company, the Companies Act requires it to put certain restrictions on the transferability of shares.

Every member owing fully paid-up shares is at liberty to dispose them off according to his choice but subject to the articles of the company. Any absolute restriction on the right to transfer shares is void. In order to make the right to transfer shares more effective, the shareholder can apply to the Central Government in case of refusal by the company to register a transfer of shares

Separate Property

As a corporate person, the company is entitled to own and hold property in its own name. No member can claim ownership of any item of the company's assets. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property. The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.

Common Seal

On incorporation, a company acquires legal entity with perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal of the company is of very great importance. It acts as the official signature of a company. The name of the company must be engraved on its common seal. A rubber stamp does not serve the purpose. A document not bearing common seal of the company is not authentic and has no legal force behind it.

The law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company. A company may have its own regulations in its Articles of Association for the manner of affixing the common seal to a document. If the Articles are silent, the provisions of Table-A (the model set of articles appended to the Companies Act) will apply. As per regulation 84 of Table-A the seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or a Committee of the Board authorized by it in that behalf, and except in the presence of at least two directors and of the secretary or such other person as the Board may appoint for the purpose, and those two directors and the secretary or other person aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

Capacity to Sue and Be Sued

A company being a body corporate can sue and be sued in its own name. All legal proceedings against the company are to be instituted in its own name. Similarly, the company may bring an action against anyone in its own name. In case of unincorporated association an action may have to be brought in the name of the members either individually or collectively.

Delegated Management

A joint stock company is an autonomous, self governing and self-controlling organization. Since it has a large number of members, all of them cannot take part in the management of the affairs of the company. Actual control and management is, therefore, delegated by the shareholders to their elected representatives, know as directors. They look after the day-to-day working of the company. Moreover, since shareholders, by majority of votes, decide the general policy of the company, the management of the company is carried on democratic lines. Majority decision and centralized management compulsorily bring about unity of action.

Company v. Other Associations

Though there are a number of similarities between a limited company and other forms of associations, there is much dissimilarity. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs a limited company is distinguished from a partnership firm, a Hindu Joint Family business, a club and a registered society.

Though there are a number of similarities between a limited company and other forms of associations, there are a great number of dissimilarities as well. In both the cases individuals are the subjects, and trading is generally the object. In the following paragraphs, a limited company is distinguished from a partnership firm, a Hindu Joint Family business and a registered society

Company v. Partnerships

(a) A company can be created only by certain prescribed methods - most commonly by registration under the Companies Act 1985. A partnership is created by the express or implied agreement of the parties, and requires no formalities, though it is common to have a written agreement.

(b) A company incurs greater expenses at formation, throughout its life and on dissolution, though these need not be excessive.

(c) A company is an artificial legal person distinct from its members. Although in Scotland a partnership has a separate legal personality by virtue of s.4 (2) of the Partnership Act 1890, this is much more limited than the personality conferred on companies.

(d) A company can have as little as one member and there is no upper limit on membership. A partnership must have at least two members and has an upper limit of 20 (with some exceptions).

(e) Shares in a company are normally transferable (must be so in a public company). A partner cannot transfer his share of the partnership without the consent of all the other partners.

(f) Members of a company are not entitled to take part in the management of the company unless they are also directors of it. Every partner is entitled to take part in the management of the partnership business unless the partnership agreement provides otherwise.

(g) A member of a company who is not also a director is not regarded as an agent of the company, and cannot bind the company by his actions. A partner in a firm is an agent of the firm, which will be bound by his acts.

(h) The liability of a member of a company for the debts and obligations of the company may be limited. A partner in an ordinary partnership can be made liable without limit for the debts and obligations of the firm.

(i) The powers and duties of a company, and those who run it, are closely regulated by the Companies Acts and by its own constitution as contained in the Memorandum and Articles of Association. Partners have more freedom to alter the nature of their business by agreement and without formality, and to make their own arrangements as to the manner in which the firm will be run.

(j) A company must comply with formalities regarding the keeping of registers and the auditing of accounts which do not apply to partnerships.

(k) The affairs of a company are subject to more publicity than those of a partnership - e.g. companies must file accounts which are available for public inspection.

(l) A company can create a security over its assets called a floating charge, which permits it to raise funds without impeding its ability to deal with its assets. A partnership cannot create a floating charge.

(m) If a company owes a debt to any of its shareholders they can claim payment from its assets ratably with its other creditors. A partner who is owed money by the partnership cannot claim payment in competition with other creditors.

(n) A partnership (unless entered into for a fixed period) can be dissolved by any partner, and is automatically dissolved by the death or bankruptcy of a partner, unless the agreement provides otherwise. A company cannot normally be wound up on the will of a single member, and the death, bankruptcy or insanity of a member will not result in its being wound up.

Company and Joint Hindu Family Business

a. A company consists of heterogeneous members, whereas a Hindu Undivided Family Business consists of homogenous members since it consists of members of the joint family itself.
b. In a Hindu Joint Family business the Karta (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.
c. A person becomes a member of Joint Hindu Family business by virtue of birth. There is no provision to that effect in the company.
d. No registration is compulsory for carrying on business for gain by a Hindu Joint Family even if the number of members exceeds twenty [*Shyamlal Roy v. Madhusudan Roy*, AIR 1959 Cal. 380 (385)]. Registration of a company is compulsory

Company and Corporation

Generally speaking, an association of persons incorporated according to the relevant law and clothed with legal personality separate from the persons constituting it is known as a corporation. The word ‘corporation’ or words ‘body corporate’ is/are both used in the Companies Act, 1956. Definition of the same which is reproduced below is contained in Clause (7) of Section 2 of the Act:

“Body corporate” or “corporation” includes a company incorporated outside India but does not include—

(a) a corporation sole;

(b) a co-operative society registered under any law relating to co-operative societies; and

(c) any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf.”

The expression “corporation” or “body corporate” is wider than the word ‘company’. A corporation sole is a single individual constituted as a corporation in respect of some office held by him or function performed by him. The Crown or a Bishop under the English law are examples of this type of corporation. It may be noted that though a corporation sole is excluded from the definition for the purposes of the Companies Act, it continues to be a legal person capable of holding property and becoming a member of a company.

A society registered under the Societies Registration Act has been held by the Supreme Court in *Board of Trustees v. State of Delhi*, A.I.R. 1962 S.C. 458, not to come within the term 'body corporate' under the Companies Act, though it is a legal person capable of holding property and becoming a member of a company.

Advantages of Incorporation

As compared to other types of business associations, an incorporated company has the following advantages:

- Corporate Personality: Unlike a partnership firm, which has no existence apart from its members, a company is a distinct legal or juristic person independent of its members. Under the law, an incorporated company is a distinct entity, even the one-man company as discussed above in Salomon & Co. Ltd., case is different from its shareholders. Section 34(2) of the Companies Act, 1956 provides that from the date of incorporation, the subscribers to the memorandum and other members shall be a body corporate by the name contained in the Memorandum, capable of exercising all the functions of an incorporated company and having perpetual succession and a common seal.
- Limited Liability: The Companies Act provides that in the event of the company being wound-up, the members shall have liability to contribute to the assets of the company in accordance with the Act [Section 34(2)]. In the case of companies limited by shares, no member is bound to contribute anything more than the nominal value of the shares held by him which remains unpaid. The privilege of limiting the liability is one of the principal advantages of doing business under the corporate form of organization.
- Perpetual Succession: As stated in Section 34(2) of the Companies Act, an incorporated company has perpetual succession. Notwithstanding any change in its members, the company will be the same entity with the same privileges and immunities, estate and possessions. The death or insolvency of individual members does not in any way, affect the corporate entity, its existence or continuity. The company shall continue to exist indefinitely till it is wound-up in accordance with the provisions of the Companies Act.
- Transferable Shares: Section 82 of the Companies Act provides "The shares or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company". This encourages investment of funds in the shares, so that the members may encash them at any time. Thus, it provides liquidity to the investors as shares could be sold in the open market and in stock exchange. It also provides stability to the company.

- Separate Property: A company as a legal entity is capable of owning its funds and other assets. "The property of the company is not the property of the shareholders, it is property of the company" [*Gramophone & Typewriter Co. v. Stanley, (1906) 2* K.B. 856 at p. 869]. "The company is the real person in which all the property is vested, and by which it is controlled, managed and disposed of". In the eyes of law, even a member holding majority of shares or a managing director of a company is held liable for criminal misappropriation of the funds or property of the company, if he unauthorizedly takes it away and uses it for his personal purposes.
- Capacity to Sue: As a juristic legal person, a company can sue in its name and be sued by others. The managing director and other directors are not liable to be sued for dues against a company.
- Flexibility and Autonomy: The company has an autonomy and independence to form its own policies and implement them, subject to the general principles of law, equity and good conscience and in accordance with the provisions contained in the Companies Act, Memorandum and Articles of Association.

The company form of management of business disassociates the "ownership" from the "control" of business, and helps promote professional management and efficiency. The directors and managers can carry on the business activities with freedom, authority and accountability in accordance with the Company Law. Precisely this is the reason why the Government has generally adopted the company form of management for its various undertakings in preference to management through the departmental undertakings.

Disadvantages of Incorporation

There are, however, certain disadvantages and inconveniences in Incorporation. Some of these disadvantages are:

- Formalities and expenses: Incorporation of a company is coupled with complex, cumbersome and detailed legal formalities and procedures, involving considerable amount of time and money. Such elaborate procedures have been laid down to deter persons who are not serious about doing business, as a company enjoys various facilities from the community. Even after the company is incorporated, its affairs and working must be conducted strictly in accordance with legal provisions. Thus various returns and documents are required to be filed with the Registrar of Companies, some periodically and some on the happening of an event. Certain books and registers are compulsorily required to be maintained by a company. Approval and sanction of the Company Law Board, the Government, the Court, the Registrar of Companies or other appropriate authority, as the case may be, is necessarily required to be obtained for certain corporate activities. Certain corporate activities such as corporate meetings, accounts, audit, borrowings, lending, investment, issue of capital, dividends etc. are necessarily required to be conducted and carried out strictly in accordance with the provisions of the Act and within the prescribed time. Any breach of the legal provisions is followed by severe penal consequences. Other forms of business organizations are comparatively free from these legal complexities and procedural formalities.

- Corporate disclosures: Notwithstanding the elaborate legal framework designed to ensure maximum disclosure of corporate information, the members of a company are having comparatively restricted accessibility to its internal management and day-to-day administration of corporate working.
- Separation of control from ownership: Members of a company are not having as effective and intimate control over its working as one can have in other forms of business organisation, say, a partnership firm. This is particularly so in big companies in which the number of members is too large to exercise any effective control over its day-to-day affairs. No member of a company can act in his individual capacity for and on behalf of the company. The members of a company are neither the owners nor the agents of the company. Thus, the position of ownership of members is more passive in nature. The members may not have an active and complete control over the company's working as the partners may have over the firm's affairs.
- Greater social responsibility: Having regard to the enormous powers wielded by the companies and the impact they have on the society, the companies are called upon to show greater social responsibility in their working and, for that purpose, are subject to greater control and regulation than that by which other forms of business organisation are governed and regulated.
- Greater tax burden in certain cases: In certain circumstances, the tax burden on a company is more than that on other forms of business organisation. A company is liable to tax without any minimum taxable limit as is prescribed in the cases of registered partnership firms and others. Also it has to pay income-tax on the whole of its income at a flat rate whereas others are taxed on graduated scale or slab system. These tax implications may have crucial bearing on a decision regarding the selection of any form of business organisation and the time when the existing form of business organisation should be changed to a new one. Thus, tax implications may direct the adoption of the partnership form of business organisation as expedient at the initial stage to be converted into a company later on, when the tax implications may be more favorable because of the size of the organisation and its scale of operations.
- Detailed winding-up procedure: The Act provides elaborate and detailed procedure for winding-up of companies which is more expensive and time consuming than that which is applicable to other forms of business organisation.

Principle of Lifting the Corporate Veil

Law has clothed a corporation with a distinct personality, yet in reality it is an association of persons who are in fact, in a way, the beneficial owners of the property of the body corporate. A company, being an artificial person, cannot act on its own, it can act only through natural persons. Indeed, the theory of corporate entity is still the basic principle on which the whole law of corporations is based. But as the separate personality of the company is a statutory privilege, it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will breakthrough the corporate shell and apply the principle of what is known as "lifting of or piercing through the corporate veil". The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

The corporate veil is lifted when in defence proceedings, such as for the evasion of tax, an entity relies on its corporate personality as a shield to cover its wrong doings. [BSN (UK) Ltd. v. Janardan Mohandas Rajan Pillai [1996] 86 Comp. Cas. 371 (Bom).]

In the following cases the Courts have lifted the corporate veil:

1. Where the corporate veil has been used for commission of fraud or improper conduct, Courts have lifted the veil and looked at the realities of the situation. In Gilford Motor Co. v. Horne, (1933) 1 Ch. 935, a former employee of a company made a covenant not to solicit its customers. He formed a company which undertook solicitation. The company was restrained by the Court.

2. Where the corporation is really an agency or trust for some one else and the corporate facade is used to cover up that agency or trust. In re R.G. Films Ltd., (1953) 1 All E.R. 615, an American company produced a film in India technically in the name of a British Company, 90% of whose capital was held by the President of the American Company which financed the production of the film. Board of Trade refused to register the film as a British film on the ground that English company acted merely as the nominee of the American corporation.

3. Where the doctrine conflicts with public policy, Courts have lifted the corporate veil for protecting the public policy. In Connors Bros. v. Connors (1940) 4 All E.R. 179, the principle was applied against the managing director who made use of his position contrary to public policy. In this case, the House of Lords determined the character of the company as "enemy" company, since the persons who were de facto in control of its affairs, were residents of Germany, which was at war with England at that time. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against "public policy".

4. For determining the true character or status of the company. In Daimler Co. Ltd. v. Continental Tyre and Rubber Co., (1916) 2 A.C. 307, the Court looked behind the facade of the company and its place of registration in order to determine the true character of the company, i.e., whether it was an "enemy" company.

5. Where the veil has been used for evasion of taxes and duties, the Court upheld the piercing of the veil to look at the real transaction. (Commissioner of Income Tax v. Meenakshi Mills Ltd., A.I.R. (1967) S.C. 819).

6. Where it was found that the sole purpose for which the company was formed was to evade taxes the Court will ignore the concept of separate entity, and make the individuals liable to pay the taxes which they would have paid but for the formation of the company. In the case of Sir Dinshaw Manakjee Petit, AIR 1927 Bombay 371, the assesse was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability. The Court disregarded the corporate entity on the grounds that the company was formed by the assessee purely and simply as a means of avoiding tax and the company was nothing more than the assessee himself.

7. Where the purpose of company formation was to avoid welfare legislation.Where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction (The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar and another, A.I.R. 1986 SC 1).

KINDS OF COMPANIES

Private Companies

By virtue of Section 3(1)(iii), a private company means a company which has a minimum paid-up capital of one lakh rupees or such higher paid up capital as may be prescribed, and by its articles:

a) restricts the right to transfer its shares, if any;
b) limits the number of members to fifty not including: (i) persons who are in the employment of the company, and (ii) persons who, having been formerly in the employment and have continued to be members after the employment ceased;
c) prohibits any invitation to the public to subscribe for any shares in, or debentures of the company; and
d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

Provided that where two or more persons hold one or more shares in a company jointly, they shall be counted as a single member.

There should be at least two persons to form a private company. A private company can therefore be registered with a minimum of 2 members and cannot have more than 50 members (excluding employee and ex-employee members). It cannot invite the public to subscribe for its shares or debentures nor can its shares be freely transferred.

The words “Private Limited” must be added at the end of its name by a private limited company.

Privileges and Exemptions of Private Company

The Companies Act, 1956, confers certain privileges on private companies. Such companies are also exempted from complying with quite a few provisions of the Act.

The basic rationale behind this is that since the private limited companies are restrained from inviting capital and deposits from the public, not much public interest is involved in their affairs as compared to public limited companies.

A private limited company which is or becomes subsidiary of a public limited company is not allowed to avail of all the privileges and concessions which otherwise are available to a private company which is not a subsidiary of a public company, because such company, is a public company by virtue of Section 3(1)(iv)(c) of the Companies Act, 1956.

Public Company

Public Company means a company which

a. is not a private company;
b. has a minimum paid-up capital of five lakh rupees or such higher paid-up capital as may be prescribed;
c. is a private company which is a subsidiary of a company which is not a private company.

A public company may be said to be an association consisting of seven or higher number of members, which is registered under the Companies Act, 1956, and which is not a private company within the meaning of the Act. The articles of a public company do not contain provisions restricting the number of its members or excluding generally the offer or transfer of shares or debentures to the public. In principal any member of the public who is willing to pay the price may acquire shares in, or debentures, of a public company. Also, shares and debentures of public companies are capable of being dealt on a stock exchange. Unlike a private company, there is no restriction with regard to the maximum number of members of a public company.

Distinction between a Public and a Private Company

1. Minimum number: The minimum number of persons required to form a public company is 7. It is 2 in case of a private company. [Section 12(1)]

2. Maximum number: There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company. [Section 3(1)(iii)(b)]

3. Number of directors: A public company must have at least 3 directors [Section 252(1)], whereas a private company must have at least 2 directors. [Section 252(2)]

4. Restriction on appointment of directors: In the case of a public company, the directors must file with the Registrar a "consent" to act as directors or sign an undertaking for their qualification shares [Section 266(1)]. The directors of a private company need not do so. [Section 266(5)(b)]

5. Restriction on invitation to subscribe for shares: A public company invites the general public to subscribe for the shares in, or the debentures of the company. A private company by its Articles prohibits any such invitation to the public. [Section 3(1)(iii)(c)]

6. Transferability of shares: In a public company, the shares are freely transferable (Section 82). In a private company the right to transfer shares is restricted by the Articles. [Section 3(1)(iii)(a)]

7. Special privileges: A private company enjoys some special privileges. A public company enjoys no such privileges.

8. Managerial remuneration: Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits. No such restriction applies to a private company.

Private Company to become Public in certain cases (Section 43A)

The provisions of Section 43A of the Companies Act, 1956 have been made inoperative by the Companies (Amendment) Act, 2000 by insertion of sub-section (11) to Section 43A. A new sub-section (2A) has been inserted in Section 43A by the Companies (Amendment) Act, 2000 which provides that every public company which becomes a private company on or after the commencement of the Amendment Act, shall inform the Registrar about its status of private company and then the Registrar shall substitute the word "private company" for the word "public company" in the Register and shall also make necessary alterations in the Memorandum of Association and Certificate of Incorporation within four weeks from the date of application made by the company.

A Company Limited by Shares

A company limited by shares may be defined as a "registered company" whether public or private company having the liability of its members limited by its memorandum to the amount, if any, unpaid on the shares respectively held by them. In other words, a member of a company limited by shares is required to pay only the nominal amount of shares held by him and nothing more. If the shares are fully paid-up he has nothing more to pay.

A Company Limited by Guarantee

A company limited by guarantee is a registered company having the liability of its members limited by its memorandum to such an amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.

A special feature of this type of company is that the liability of members to pay their guarantee amount arises only when the company goes into liquidation and not when it is a going concern.

Clubs, trade associations and societies for promoting different objects are at times incorporated as companies limited by Guarantee to take the advantages of incorporation without running the risk of heavy liabilities.

An Unlimited Company

An unlimited company is a company not having any limit on the liability of its members. Thus, the maximum liability of the members of such a company, in the event of its being wound up, might stretch up to the full extent of their properties to meet the obligations of the company by contributing to its assets. However, the members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of its being wound up only the liquidator can ask the members to contribute to the assets of the company which will be used in discharging the debts of the company.

A company registered as an unlimited company may subsequently convert itself as a limited company, subject to the condition that any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

Association not for Profit

As per Section 13(1)(a) of the Companies Act, it is necessary that the name of every company registered with a limited liability should have the last word "Limited" if it is a public company and "Private Limited" if it is a private company. However, Section 25 permits the registration, under a licence granted by the Central Government, of associations not for profit with limited liability without being required to use the word "Limited' or the words 'Private Limited" after their names. This is of great value to companies not engaged in business like bodies pursuing charitable, educational or other purposes of great utility.

The Central Government may grant such a licence if:

a. it is intended to form a company for promoting commerce, art, science, religion, charity or any other useful object; and
b. The company prohibits payment of any dividend to its members but intends to apply its profits or other income in promotion of its objects.

On registration, the Association enjoys all the privileges of a limited company and is subject to all its obligations, except, those in respect of which exemption by a special or general order is granted by the Central Government.

A Company, which has been granted licence under Section 25 cannot alter the provisions of its Memorandum with respect to its objects except with the previous approval of the Central Government in writing.

The Central Government has issued some notifications exempting certain companies under Section 25. The Central Government may at any time revoke the licence whereupon the word "Limited' or "Private Limited' as the case may be, shall have to be used as part of its name and the company will lose the exemptions that might have been granted by the Central Government. However, the Central Government can do so only after providing such association an opportunity to be heard and the aggrieved association can challenge the order of the Central Government under Article 226 of the Constitution.

Government Companies (Section 617)

Section 617 defines a "Government company" as any 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 or partly by one or more State Governments. A subsidiary of a Government company is also treated as a Government company.

Government companies being public sector companies, their audit assumes special relevance. Hence, the Companies Act makes separate provision for their Audit. The auditor of a Government company is appointed or reappointed by the Comptroller and Auditor General of India. The Comptroller and Auditor General of India has the power to direct the manner in which the accounts are to be audited and to give instructions to the auditor in regard to any matter relating to the performance of his functions. He (C & AG. of India) may also conduct a supplementary test audit by persons authorised by him. The auditor of the company must submit a copy of his audit report to the C & AG, who may comment upon, or supplement, the audit report. Such comments or supplementary report must be placed before the annual general meeting of the company at the same time and in the same manner as the auditor's report.

In addition, where the Central Government is holding shares in Government company, the Central Government is required to place before both the Houses of Parliament an annual report on the working and affairs of each Government Company within three months of its annual general meeting together with a copy of the audit report and any comments upon, or supplement to such report made by the Comptroller and Auditor General of India. Where a State Government is the member of a Government company, the annual report is likewise to be placed before the State Legislature.

Though Government companies are also governed by the provisions of the Companies Act as any other company; the Act empowers the Central Government to direct by notification in the Official Gazette that any of the provisions of the Act shall not apply to them or shall apply to them only with such exceptions, modifications and adaptations, as may be specified in the notification.

In exercise of this power, the Central Government has issued various notifications modifying the operations of different provisions of the Companies Act to Government Companies. A detailed discussion of notifications is not within the limited scope of this study.

Foreign Companies

A "foreign company" is a company which is incorporated in a country outside India under the law of that other country and has established a place of business in India. Sections 591 to 602 of the Act deal with such companies.

Foreign companies are of two classes namely:

a. Companies incorporated outside India, which have established a place of business in India after April 1, 1956; and
b. Companies incorporated outside India, which established a place of business in India before that date and continue to have an established place of business in India.

Section 592 of the Companies Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies at New Delhi and also with the Registrar of Companies of the State in which such place of business is situated:

a. a certified copy of the charter, statutes, or memorandum and articles of the company, or other instrument constituting or defining the constitution of the company, and if the instrument is not in the English language, a certified translation thereof;
b. the full address of the registered or principal office of the company;

c. a list of the directors and secretary of the company containing particulars of their names, nationality, addresses and business occupations;
d. the names and addresses of one or more persons resident in India who are authorised to accept service of process and any notices or other documents required to be served on the company; and
e. the full address of the principal place of business in India.

Every foreign company must conspicuously exhibit on the outside of its every office or place of business in India its name ending with the words "Limited" or "Private Limited", as the case may be, if it is a limited company; and the country of its incorporation in English as well as in the local language. The prospectus issued in India must also disclose the above information.

The same requirement as regards accounts and their filing and also the registration of the charges created in India are applicable to them as to Indian companies.

The requirements regarding prospectus have been brought in line with those applicable to Indian companies. Hence, no application form for shares or debentures can be issued in India by a foreign company without a copy of the prospectus attached to them.

<u>Holding and Subsidiary Companies (Section 4)</u>

"Holding and subsidiary" companies are relative terms. A company is a holding of another if the other is its subsidiary. According to Section 4 of the Companies Act, a company shall be deemed to be a subsidiary of another, if and only if:

a. that other controls the composition of its Board of directors; or
b. that other holds more than half of the nominal value of its equity share capital; or
c. the first-mentioned company is a subsidiary of any company which is that other's subsidiary. To illustrate, company A is subsidiary of company B if, but only if:
    - company B (holding company) controls the composition of the Board of directors of company A (subsidiary); or
    - company B (holding company) controls more than 50% voting power of company A (subsidiary); or
    - if company A (the subsidiary) is a subsidiary of the company C which is subsidiary of company B, then company A is a subsidiary of company B.
d. If company D is the subsidiary of company A, then D will be the subsidiary of company C and also of company B.

For the purpose of clause (a) above, the composition of Board of directors of a company shall be deemed to be controlled by another company if, but only if, the other company can at its discretion appoint or remove all or a majority of directors. The company shall be deemed to have power to appoint a directorship with respect to which any of the following conditions are satisfied, viz:

a. if a person cannot be appointed to a directorship, without the exercise in his favour by that other company of such a power of appointment;
b. if a person's appointment to a directorship follows necessarily from his appointment as director or manager of or to any other office or employment in that other company; or
c. if the directorship is held by an individual nominated by that other company or by a subsidiary thereof.

Classification of Companies by Mode of Incorporation

Depending on the mode of incorporation, there are three classes of joint stock companies.

Chartered Companies:

These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charted, the Sovereign can annul the latter and close the company. Such companies do not exist in India.

Statutory Companies

These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading Corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alternations in the powers of such companies can be brought about by legislative amendments. The provisions of the Companies Act shall apply to these companies also except in so far as provisions of the Act are inconsistent with those of such Special Acts [Sec 616 (d)].

These companies are generally formed to meet social needs and not for the purpose of earning profits.

Registered or incorporated companies

These are formed under the Companies Act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar of Companies. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories of the following:

a. Companies limited by Shares :
   These types of companies have a share capital and the liability of each member or the company is limited by the Memorandum to the extent of face value of share subscribed by him. In other words, during the existence of the company or in the event of winding up, a member can be called upon to pay the amount remaining unpaid on the shares subscribed by him. Such a company is called company limited by shares. A company limited by shares may be a public company or a private company. These are the most popular types of companies.
b. Companies Limited by Guarantee:
   These types of companies may or may not have a share capital. Each member promises to pay a fixed sum of money specified in the Memorandum in the event of liquidation of the company for payment of the debts and liabilities of the company [Sec 13(3)] This amount promised by him is called 'Guarantee'. The Articles of Association of the company state the number of member with which the company is to be registered [Sec 27 (2)]. Such a company is called a company limited by guarantee. Such companies depend for their existence on entrance and subscription fees. They may or may not have a share capital. The liability of the member is limited to the extent of the guarantee and the face value of the shares subscribed by them, if the company has a share capital. If it has a share capital, it may be a public company or a private company. The amount of guarantee of each member is in the nature of reserve capital. This amount cannot be called upon except in the event of winding up of a company. Non-trading or non-profit companies formed to promote culture, art, science, religion, commerce, charity, sports etc. are generally formed as companies limited by guarantee.
c. Unlimited Companies:
   Section 12 gives choice to the promoters to form a company with or without limited liability. A company not having any limit on the liability of its members is called an 'unlimited company' [Sec 12(c)]. An unlimited company may or may not have a share capital. If it has a share capital it may be a public company or a private company. If the company has a share capital, the article shall state the amount of share capital with which the company is to be registered [Sec 27 (1)]
   The articles of an unlimited company shall state the number of member with which the company is to be registered.

INCORPORATION OF COMPANY

We know that a company is a separate legal entity which is formed and registered under the Companies Act. It may be noted that before a company is actually formed (i.e., formed and registered under the Companies Act), certain persons, who wish to form a company, come together with a view to carry on some business for the purpose of earning profits. Such persons have to decide various questions such as
(a) which business they should start,
(b) whether they should form a new company or take over the business of some existing company,
(c) if new company is to be started, whether they should start a private company or pubic company,
(d) what should be the capital of the company etc. After deciding about the formation of the company, the desirous persons take necessary steps, and the company is actually formed.

Thereafter, they start their business. Thus, there are various stages in the formation of a company from thinking of starting a business to the actual starting of the business.
Company is an artificial person created by following a legal procedure. Before a company is formed, a lot of preliminary work is to be performed. The lengthy process of formation of a company can be divided into four distinct stages:

a. Promotion
b. Incorporation or Registration;
c. Capital subscription; and
d. Commencement of business.

However, a private company can start business as soon as it obtains the certificate of incorporation. It needs to go through first two stages only. The reason is that a private company cannot invite public to subscribe to its share capital. But a public company having a share capital has to pass through all the four stages mentioned above before it can commence business or exercise any borrowing powers (Section 149).

These four stages are discussed as followS.

Promotion
The term ‘promotion’ is a term of business and not of law. It is frequently used in business. Haney defines promotion as “the process of organizing and planning the finances of a business enterprise under the corporate form”. Gerstenberg has defined promotion as “the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.” First of all the idea of carrying on a business is conceived by promoters. Promoters are persons engaged in, one or the other way; in the formation of a company. Next, the promoters make detailed study

to assess the feasibility of the business idea and the amount of financial and other resources required. When the promoters are satisfied about practicability of the business idea, they take necessary steps for assembling the business elements and making provision of the funds required to launch the business enterprise. Law does not require any qualification for the promoters. The promoters stand in a fiduciary position towards the company about to be formed. From the fiduciary position of promoters, the following important results follow:

1. A promoter cannot be allowed to make any secret profits. If any secret profit is made in violation of this rule, the company may, on discovering it, compel the promoter to account for and surrender such profit.
2. The promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed. If he contracts to sell his own property to the company without making a full disclosure, the company may either rescind the sale or affirm the contract and recover the profit made out of it by the promoter.
3. The promoter must not make an unfair or unreasonable use of his position and must take care to avoid anything which has the appearance of undue influence or fraud.

Promoter’s Remuneration

A promoter has no right to get compensation from the company for his services in promoting it unless the company, after its incorporation, enters into a contract with him for this purpose. If allowed, remuneration may be paid in cash or partly in cash partly in shares and debentures of the company.

Promoter’s Liability

If a promoter does not disclose any profit made out of a transaction to which the company is a party, then the company may sue the promoter and recover the undisclosed profit with interest Otherwise, the company may set aside the transaction i.e., it may restore the property to promoter and recover its money.

Besides, Section 62 (1) holds the promoter liable to pay compensation to every person who subscribes for any share or debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement included in it. Section 62 also provides certain grounds on which a promoter can avoid his liability. Similarly Section 63 provides for criminal liability for misstatement in the prospectus and a promoter may also become liable under this section.

Promoter’s Contracts

Preliminary contracts are contracts made on behalf of a company yet to be incorporated. Following are some of the effects of such contracts;

1. The company, when it comes into existence, is not bound by any contract made on its behalf before its incorporation. A company has no status prior to its incorporation.

2. The company cannot ratify a pre-incorporation contract and hold the other party liable. Like the company, the other party to the contract is also not bound by such a contract.
3. The agents of a proposed company may sometimes incur personal liability under a contract made on behalf of the company yet to be formed [*Kelner v Bexter* (1886) L.R. 2 C.P.174]. A hotel company was about to be formed and promoters signed an agreement for the purchase of stock on behalf of the proposed company. The company came into existence but, before paying the price, went into liquidation. The promoters were held personally liable to the plaintiff.
Further, an agent himself may not be able to enforce the contract against the other party. So far as ratification of a pre-incorporation contract is concerned, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. The reason is simple; ratification can be done only if an agent contracts for a principal who is in existence and who is competent to contract at the time of the contract by the agent.

Incorporation of a Company

This is the second stage of the company formation. It is the registration that brings a company into existence. A company is legally constituted on being duly registered under the Act and after the issue of Certificate of Incorporation by the Registrar of Companies. For the incorporation of a company the promoters take the following preparatory steps:

a. To find out form the Registrar of companies whether the name by which the new company is to be started is available or not. To take approval of the name, an application has to be made in the prescribed form along with requisite fee;
b. To get a letter of Intent under Industries (Development and Regulation) Act, 1951, if the company's business comes within the purview of the Act.
c. To get necessary documents i.e. Memorandum and Articles of Association prepared and printed.
d. to prepare preliminary contracts and a prospectus or statement in lieu of a prospectus.

Registration of a company is obtained by filing an application with the Registrar of Companies of the State in which the registered office of the company is to be situated. The application should be accompanied by the following documents:

a. Memorandum of association properly stamped, duly signed by the signatories of the memorandum and witnessed.
b. Articles of Association, if necessary.
c. A copy of the agreement, if any, which the company proposes to enter into with any individual for his appointment as managing or whole-time director or manager.
d. A written consent of the directors to act in that capacity, if necessary.
e. A statutory declaration stating that all the legal requirements of the Act prior to incorporation have been complied with.

The Registrar will scrutinize these documents. If the Registrar finds the document to be satisfactory, he registers them and enters the name of the company in the Register of Companies and issues a certificate called the certificate of incorporation (Section 34).
The certificate of incorporation is the birth certificate of a company. The company comes into existence from the date mentioned in the certificate of incorporation and the date appearing in it is conclusive, even if wrong. Further, the certificate is ‘conclusive evidence that all the requirements of this Act in respect of registration and matters precedent and related thereto have been fulfilled and that the association is a company authorized to be registered and duly registered under this Act.
Once the company is created it cannot be got rid off except by resorting to provisions of the Act which provide for the winding up of company. The certificate of incorporation, even if it contains irregularities, cannot be cancelled.

Capital Subscription
A private company can start business immediately after the grant of certificate of incorporation but public limited company has to further go through ‘capital subscription stage’ and ‘commencement of business stage’. In the capital subscription stage, the company makes necessary arrangements for raising the capital of the company.
With a view to ensure protection on investors, Securities and Exchange Boar of India (SEBI) has issued ‘guidelines for the disclosure and investor protection’. The company making a public issue of share capital must comply with these guidelines before making a public offer for sale of shares and debentures. If the capital has to be said through a public offer of shares, the directors of the public company will first file a copy of the prospectus with the Registrar of Companies.
On the scheduled date the prospectus will be issued to the public. Investors are required to forward their applications for shares along with application money to the company’s bankers mentioned in the prospectus. The bankers will then forward all applications to the company and the directors will consider the allotment of shares. If the subscribed capital is at least equal to 90 percent of the capital issue, and other requirements of a valid allotment are fulfilled the directors pass a formal resolution of allotment. However, if the company does not receive applications which can cover the minimum subscription within 120 days of the issue of prospectus, no allotment can be made and all money received will be refunded.
If a public company having share capital decides to make private placement of shares, then, instead of a ‘prospectus’ it has to file with the Registrar of Companies a ‘statement in lieu of prospectus’ at least three days before the directors proceed to pass the first share allotment resolution.
The contents of a prospectus and a statement in lieu of a prospectus are almost alike.

Commencement of Business
A private company can commence business immediately after the grant of certificate of incorporation, but a public limited company will have to undergo some more formalities before

it can start business. The certificate for commencement of business is issued by Registrar of Companies, subject to the following conditions.

a. Shares payable in cash must have been allotted up to the amount of minimum subscription
b. Every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others.
c. No money should have become refundable for failure to obtain permission for shares or debentures to be dealt in any recognized stock exchange.
d. A declaration duly verified by one of directors or the secretary that the above requirements have been complied with which is filed with the Registrar.

The certificate to commence business granted by the Registrar is a conclusive evidence of the fact that the company has complied with all legal formalities and it is legally entitled to commence business. It may also be noted that the court has the power to wind up a company, if it fails to commence business within a year of its incorporation [Sec. 433 (3)].

Memorandum of Association

The formation of a public company involves preparation and filing of several essential documents. Two of basic documents are :

1. Memorandum of Association
2. Articles of Association

The preparation of Memorandum of Association is the first step in the formation of a company. It is the main document of the company which defines its objects and lays down the fundamental conditions upon which alone the company is allowed to be formed. It is the charter of the company. It governs the relationship of the company with the outside world and defines the scope of its activities. Its purpose is to enable shareholders, creditors and those who deal with the company to know what exactly its permitted range of activities is. It enables these parties to know the purpose, for which their money is going to be used by the company and the nature and extent of risk they are undertaking in making investment. Memorandum of Association enable the parties dealing with the company to know with certainty as whether the contractual relation to which they intend to enter with the company is within the objects of the company.

Form of Memorandum (Sec. 14)

Companies Act has given four forms of Memorandum of Association in Schedule I. These are as follows:

a. Table B Memorandum of a company limited by shares
b. Table C Memorandum of a company limited by guarantee and not having a share capital

c. Table D Memorandum of company limited by guarantee and having share capital.
d. Table E Memorandum of an unlimited company. Every company is required to adopt one of these forms or any other form as near there to as circumstances admit.

Printing and signing of Memorandum (Sec. 15).

The memorandum of Association of a company shall be (a) printed, (b) divided into paragraphs numbered consecutively, and (c) signed by prescribed number of subscribers (7 or more in the case of public company, two or more in the case of private company respectively). Each subscriber must sign for his/her name, address, description and occupation in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

Contents of Memorandum

1. Name clause:
   Promoters of the company have to make an application to the registrar of Companies for the availability of name. The company can adopt any name if :
   i) There is no other company registered under the same or under an identical name;
   ii) The name should not be considered undesirable and prohibited by the Central Government (Sec. 20). A name which misrepresents the public is prohibited by the Government under the Emblems & Names (Prevention of Improper use) Act, 1950 for example, Indian National Flag, name pictorial representation of Mahatma Gandhi and the Prime Minister of India, name and emblems of the U.N.O., and W.H.O., the official seal and Emblems of the Central Government and State Governments. Where the name of the company closely resembles the name of the company already registered, the Court may direct the change of the name of the company
   iii) Once the name has been approved and the company has been registered, then
      - the name of the company with registered office shall be affixed on outside of the business premises;
      - if the liability of the members is limited the words “Limited” or “Private Limited” as the case may be, shall be added to the name; [Sec 13(1) (1)]: Omission of the word ‘Limited’ makes the name incorrect. Where the word’ Limited” forms part of a company’s name, omission of this word shall make the name incorrect. If the company makes a contract without the use of the word “Limited”, the officers of the company who make the contract would be deemed to be personally liable [Atkins & Co v Wardle, (1889) 61 LT 23]. The omission to use the word ‘Limited’ as part of the

name of a company must have been deliberate and not merely accidental. In Dermatine Co. Ltd. v Ashworth, (1905) 21 T.L.R. 510. A bill of exchange drawn upon a limited company in its proper name was duly accepted by 2 directors of the company. The rubber stamp by which the word of acceptance were impressed on the bill was longer that the paper of the bill and hence the word 'Limited' was missed. Held, the company was liable to pay and the directors were not personally liable.

- the name and address of the registered office shall be mentioned in all letterheads, business letters, notices and Common Seal of the Company, etc. (Sec.147). In Osborn v The Bank of U. A. E., [9 Wheat (22 US), 738]; it was held that the name of a company is the symbol of its personal existence. The name should be properly and correctly mentioned. The Central Government may allow a company to drop the word "Limited" from its name.

2. Registered Office Clause:

   Memorandum of Association must state the name of the State in which the registered office of the company is to be situated. It will fix up the domicile of the company. Further, every company must have a registered office either from the day it begins to carry on business or within 30 days of its incorporation, whichever is earlier, to which all communications and notices may be addressed. Registered Office of a company is the place of its residence for the purpose of delivering or addressing any communication, service of any notice or process of court of law and for determining question of jurisdiction of courts in any action against the company. It is also the place for keeping statutory books of the company.

   Notice of the situation of the registered office and every change shall be given to the Registrar within 30 days after the date of incorporation of the company or after the date of change. If default is made in complying with these requirements, the company and every officer of the company who is default shall be punishable with fine which may extend to Rs. 50 per during which the default continues.

3. Object Clause:

   This is the most important clause in the memorandum because it not only shows the object or objects for which the company is formed but also determines the extent of the powers which the company can exercise in order to achieve the object or objects.

   Stating the objects of the company in the Memorandum of Association is not a mere legal technicality but it is a necessity of great practical importance. It is essential that the public who purchase its shares should know clearly what the objects for which they are paying are.

   In the case of companies which were in existence immediately before the commencement of the Companies (Amendment) Act. 1965, the object clause has simply to state the objects of the company. But in the case of a company to be registered after be amendment, the objects clause must state separately the main objects and other objects.

4. Capital Clause:

   In case of a company having a share capital unless the company is an unlimited company, Memorandum shall also state the amount of share capital with which the company is to be registered and division there of into shares of a fixed amount [Sec. 13(4)]. The capital with which the company is registered is called the authorized or nominal share capital. The nominal capital is divided into classes of shares and their values are mentioned in the clause. The amount of nominal or authorized capital of the company would be normally, that which shall be required for the attainment of the main objects of the company. In case of companies limited by guarantee, the amount promised by each member to be contributed by them in case of the winding up of the company is to be mentioned. No subscriber to the memorandum shall take less than one share. Each subscriber of the Memorandum shall write against his name the number of shares he takes.

5. Liability Clause:

   In the case of company limited by shares or by guarantee, Memorandum of Association must have a clause to the effect that the liability of the members is limited. It implies that a shareholder cannot be called upon to pay any time amount more then the unpaid portion on the shares held by him. He will no more be liable if once he has paid the full nominal value of the share.

   The Memorandum of Association of a company limited by guarantee must further state that each member undertakes to contribute to the assets of the company if wound up, while he is a member or within one year after he ceased to be so, towards the debts and liabilities of the company as well as the costs and expenses of winding up and for the adjustment of the rights of the contributories among themselves not exceeding a specified amount.

   Any alteration in the memorandum of association compelling a member to take up more shares, or which increases his liability, would be null and void (Sec 38). If a company carries on business for more than 6 months while the number of members is less than seven in the case of public company, and less than two in case of a private company, each member aware of this fact, is liable for all the debts contracted by the company after the period of 6 months has elapsed (Sec. 45).

6. Association and Subscription Clause:

   In this clause, the subscribers declare that they desire to be formed into a company and agree to take shares stated against their names. No subscriber will take less than one share. The memorandum has to be subscribed to by at least seven persons in the case of a public company and by at least two persons in the case of a private company. The signature of each subscriber must be attested by at least one witness who cannot be any of the subscribers. Each subscriber and his witness shall add his address, description and occupation, if any.

After registration, no subscriber to the memorandum can withdraw his subscription on any ground.

Alteration in Memorandum of Association

Alteration of Memorandum of association involves compliance with detailed formalities and prescribed procedure. Alternations to the extent necessary for simple and fair working of the company would be permitted. Alterations should not be prejudicial to the members or creditors of the company and should not have the effect of increasing the liability of the members and the creditors.

Articles of Association:

Every company is required to file Articles of Association along with the Memorandum of Association with the Registrar at the time of its registration. Companies Act defines 'Articles as Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies Acts.

They also include, so far as they apply to the company, those in the Table A in Schedule I annexed to the Act or corresponding provisions in earlier Acts. Articles of Association are the rules, regulations and bye-laws for governing the internal affairs of the company. They may be described as the internal regulation of the company governing its management and embodying the powers of the directors and officers of the company as well as the powers of the shareholders. They lay down the mode and the manner in which the business of the company is to be conducted.

In framing Articles of Association care must be taken to see that regulations framed do not go beyond the powers of the company it self as contemplated by the Memorandum of Association nor should they be such as would violate any of the requirements of the companies Act, itself. All clauses in the Articles ultra vires the Memorandum or the Act shall be null and void.

Article of Association are to be printed, divided into paragraphs, serially numbered and signed by each subscriber to Memorandum with the address, description and occupation. Each subscriber shall sign in the presence of at least one witness who shall attest the signatures and also mention his own address and occupation.

Contents of Articles of Association

Articles generally contain provision relating to the following matters;

(i) the exclusion, whole or in part of Table A;
(ii) share capital different classes of shares of shareholders and variations of these rights
(iii) execution or adoption of preliminary agreements, if any;
(iv) allotment of shares;
(v) lien on shares
(vi) calls on shares;
(vii) forfeiture of shares;
(viii) issue of share certificates;
(ix) issue of share warrants;
(x) transfer of shares;
(xi) transmission of shares;
(xii) alteration of share capital;
(xiii) borrowing power of the company;
(xiv) rules regarding meetings;
(xv) voting rights of members;
(xvi) notice to members;
(xvii) dividends and reserves;
(xviii) accounts and audit;
(xix) arbitration provision, if any;
(xx) directors, their appointment and remuneration;
(xxi) the appointment and reappointment of the managing director, manager and secretary;
(xxii) fixing limits of the number of directors
(xxiii) payment of interest out of capital;
(xxiv) common seal; and
(xxv) winding up.

Model form of Articles

Different model forms of memorandum of association and Articles of Association of various types of companies are specified in Schedule I to the Act. The schedule is divided into following tables.

a. Table A deals with regulations for management of a company limited by shares.
b. Table B contains a model form of Memorandum of Association of a company limited by shares

c. Table C gives model forms of Memorandum and Articles of Association of a company limited by guarantee and not having a share capital.
d. Table D gives model forms of Memorandum and Articles of Association of a company limited by guarantee and having a share capital. The Articles of such a company contain in addition to the information about the number of members with which the company proposes to be registered, all other provisions of Table A
e. Table E contains the model forms of memorandum and Articles of Association of an unlimited company.

A Public Company may have its own Article of Association. If it does not have its own Articles, it may adopt Table A given in Schedule I to the Act.

Alteration of Articles

Section 31 grants power to every company to alter its articles whenever it desires by passing a special resolution and filing a copy of altered Articles with the Registrar. An alteration is not invalid simply because it changes the company's constitution. Thus in *Andrews v Gas Meter Co*., A company was allowed by changing articles to issue preference shares when its memorandum was silent on the point.

Alteration of articles is much easier than memorandum as it can be altered by special resolution. However, there are various limitations under the Companies Act to the powers of the shareholders to alter the articles.

In case of conversion of a public company into a private company, alteration in the articles would only be effective after approval of the Central Government [Section 31]. The powers are now vested with the Registrar of Companies.

Alteration of the articles shall not violate provisions of the Memorandum. It must be made bonafides the benefit of the company. All clauses in the articles ultra vires the Memorandum shall be null and void, and the articles shall be held inoperative. Alteration must not contain anything illegal and shall not constitute fraud on the minority. Alteration in the articles increasing the liability of the members can be done only with the consent of the members.

The whole process of formation of a company can be divided into four distinct stages namely promotion incorporation, capital subscription and commencement of business. However, a private company can start business as soon as it obtains the certificate of information. The memorandum of Association of a company tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. The memorandum of association of every clause, objects clause, liability clause, Memorandum of association cannot be altered by the sweet will of the members of the company. It can be altered only by following the procedure prescribed in the Companies Act. Articles of association contain the rules and regulations which are granted for the internal management of the company. The company may alter its articles of association any time by following the procedure as prescribed in the Companies Act. Every person dealing with the company is presumed to have read the memorandum and articles of association and understood them in their time perspective. This is known as doctrine of constructive notice.

PROSPECTUS AND COMMECEMENT OF BUSINESS

The promoters of a public company will have to take steps to raise the necessary capital for the company, after having obtained the Certificate of Incorporation. A public company may invite the public to subscribe to its shares or debentures. Prospectuses are to be issued for this purpose. To issue a prospectus is very essential for a public company. If the promoters of the company are confident of raising the required capital privately from their friend or relatives, they need not issue a prospectus. In such a case, a statement in lieu of prospectus must be filed with the Registrar. A private company is not allowed to issue a prospectus since it cannot invite the general public to subscribe to its shares and debentures. It is not required to file a statement in lieu of prospectus.

Section 2(36) defines a prospectus an "any document described as issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting orders from the public for the subscription or purchase of any share in, or debentures of, a body corporate". In simple words, a prospectus may be defined as an invitation to the public to subscribe to a company's shares or debentures. By virtue of the Amendment Act of 1974, any document inviting deposits from the public shall also come within the definition of prospectus. The word "Prospectus" means a document which invites deposits from the public or invites offers from the public to buy shares or debentures of the company. A document will be treated as a prospectus only when it invites offers from a public. According to Section 67 the term "public" is defined as, "It includes any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner". It further provides that no offer of invitation shall be treated as mode to the public if, (i) the same is not calculated to result in the shares or debentures becoming available other than those receiving the offer or invitation; (ii) it appears to be a domestic concern of the person making and receiving the offer or invitation. The 'public' is a general word. No particular numbers are prescribed. The point is that the offer makes the shares and debentures available for subscription to any one who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not. A private communication does not satisfy the above point.

Where directors make an offer to a few of their friends, relatives or customers by sending them a copy of the prospectus marked "not for publication" it is not considered an offer to the public. The provisions of the Act relating to prospectus are not attracted unless the prospectus is issued to the public. Issued means issued to the public. Whether the prospectus has been issued to the public or not is a matter of fact. The leading case of this point is Nash v Lynde (1929) A.C. 158. In this case the managing director of a company prepared a document that was marked "strictly private and confidential" and did not contain the particulars required to be disclosed in a prospectus. A copy of the document along with application forms was sent to a solicitor who in turn sent it to the plaintiff. The document was held not be prospectus and as such the claim of the plaintiff for compensation was dismissed.

In the case Re South of England Natural Gas and Petroleum Co. Ltd (1911) 1 Ch. 573, the distribution of 3,000 copies of a prospectus among the members of certain gas companies was held to be an offer to the public because person other than those receiving the offer could also accept it. One may note that under Section 67 an offer or invitation to any section of the public, whether selected as members or debenture holders of the company or as clients of the person making the invitation, will be deemed to be an invitation to the public.

The term "subscription of purchase of shares" means taking or agreeing to take shares for cash. Any document to be called a prospectus must have the following ingredients:

i. There must be an invitation offering to the public;
ii. The invitation must be or on behalf of the company or in relation to an intended company;
iii. The invitation must be to subscribe or purchase.
iv. The invitation must relate to shares or debentures.

Object of Prospectus

a. To bring to the notice of public that a new company has been formed.
b. To preserve an authentic record of the terms of allotment on which the public have been invited to but its shares or debentures
c. The secure that the directors of the company accept responsibility of the statement in the prospectus.

Pre-Requisites to Issue of Prospectus

a. Issue after Incorporation: Section 55 of the Act permits the issue of prospectus in relation to an intended company. A prospectus may be issued by or on behalf of the company:
    i. by a person interested or engaged in the formation company or
    ii. through an offer for sale by a person to whom the company has allotted shares.
b. Dating of Prospectus: A prospectus issued by a company shall be dated and that date shall be taken as the date of publication of the prospectus (Section 55). Date of issue of the prospectus may be different from the date of publication.

c. Registration of Prospectus:
A copy of every prospectus must be delivered to the Registrar for registration before it is issued to the public. Registration must be made on or before the date of its publication. The copy sent for registration must be signed by every person who is named in the prospectus as a director or proposed director of the company or by his agent authorized in writing. Where the prospectus is issued in more than one language,

a copy of its as issued in each language should be delivered to the registrar. This copy must be accompanied with the following documents:

a) If the report of an expert is to be published, his written consent to such publication;

b) a copy of every contract relating to the appointment and remuneration of managerial personnel;

c) a copy of every material contract unless it is entered in the ordinary course of business or two years before the date of the issue of prospectus;

d) a written statement relating to adjustments; if any, made by the auditors or accountants in their reports relating to profits and losses, assets and liabilities or the rates of dividends, etc.; and

e) written consent of auditors, legal advisers, attorney, solicitor, banker or broker of the company to act in that capacity.

A copy of the prospectus along with specific documents must been field with the Registrar. The prospectus must be issued within ninety days of its registration. A prospectus issued after the said period shall be deemed to be a

Prospectus, a copy of which has not been delivered to the Registrar for registration.

The company and every person who is knowingly a party to the issue of prospectus without registration shall be punishable with fine which may extend to five thousand rupees (Section 60).

d. List of Experts: A prospectus must not include a statement purporting to be made by an expert such as an engineer, value, accountant etc. unless the expert is a person who has never been engaged or interested in the formation or promotion as in the management of the company (Section 57).

   A statement of an expert cannot be include in the prospectus without his written consent and this fact should be mentioned in the prospectus. Further, this consent should not be withdrawn before delivery of the prospectus for registration Section (58).

e. Terms of the contract not to be varied:

   The terms of any contract stated in the prospectus or statement in lieu of prospectus cannot be varied after registration of the prospectus except with the approval of the members in the general meeting (Section 61).

f. Application Forms to be Accompanied with the Copy of Prospectus

   Every from of application for subscribing the shares or debentures of a company shall not be issued unless it is accompanied by a copy of prospectus except when it is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to shares or debentures or in relation to shares or debentures which were not offered to the public.

g. Personation for Acquisition etc. of Shares

   The provision, consequences of applying for shares in fictitious names to be prominently displayed must be reproduced in every prospectus and every application form issued by the company to any person. A person who makes in a fictitious name to a company for acquiring shares or subscribing any shares or subscribing any shares shall be liable to imprisonment which may extend to five years similarly, a person who induces a company to allot any shares or to register any transfer of shares in a fictitious name is also liable to the same punishment.

h. Contents as per Schedule II

   Every prospectus must disclose the matters as required in Schedule II of the Act. It is to be noted that if any condition binding on the applicant for shares or debentures in a company to waive compliance with any requirements of the

   Act as to disclosure in the prospectus or purporting to affect him with notice of any contract, document or matter not specifically referred to in the prospectus shall be void [Section 56(2)].

   If a prospectus is issued without a copy thereof, the necessary documents or the consent of the experts the company and every person, who is knowingly a part to the issue of the prospectus, shall be punishable with fine which may extend to Rs. 5,000/-.

<u>Contents of Prospectus</u>

We know that a prospectus is issued to the public to purchase the share or debentures of the company. Every person wants to invest his money in some sound undertaking. The soundness of a company can be known from the prospectus of a company. Thus, the prospectus must disclose the true nature of company's activities which enable the public to decide whether or not to invest money in the company. In fact, the public invest money in the company on the faith of the representation contained in the prospectus. Therefore, everything should be stated with strict accuracy, and the complete and true position of the company should be disclosed to the public.

Section 56 lays down that every prospectus issued (a) by or on behalf of a company, or (b) by on behalf of any person engaged or interested in the formation of a company, shall:

1. State the matters specified in Part I of Schedule II, and.
2. Set out the reports specified in Part II or Schedule II both Part I and II shall have effect subject to the provisions contained in Part III of that Schedule II.

<u>Part I of Schedule II</u>

1. The main objects of the company with names, descriptions, occupations and addresses of the signatories to the Memorandum of association, and number of shares subscriber by them.
2. The number and classes of shares, and the nature and extent of the interests of the shareholders in the property and profits of the company.
3. The number of redeemable preference shares intended to be issued with particulars as regards their redemption.

4. The number of shares fixed by the articles of company as the qualification of a director.
5. The names, addresses, description and occupation of directors, managing director or manager or any of those proposed person.
6. Any provisions in the articles or any contract relating to appointment, remuneration and compensation for loss of office of directors, managing director or manager.
7. The amount of minimum subscription.
8. The time of the opening of the subscription list cannot be earlier than the beginning of the fifth day after the publication of prospectus.
9. Amount payable on application and allotment on each share shall be stated. If any allotment was previously made within two preceding years, the details of the shares allotted and the amount; if any, paid thereon.
10. Particulars about any option or preferential right to be given to any person to subscribe for shares or debentures of the company.
11. The number, description and amount of shares and debentures which, within the last two years, have been issued or agreed to be issued as fully or partly paid up than in cash.
12. The amount paid or payable as a premium, if any, on such share issued within two years preceding the date of the prospectus or is to be issued stating the necessary particulars.
13. The names of the underwriters of shares or debentures, if any, and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations.
14. The names or addresses description and occupations of the vendors from whom the property has been purchased or is to be purchased, and the amount paid or payable in cash, shares or debentures respectively.
15. The amount of underwriting commission paid within two preceding years or payable to any person for subscribing or procuring subscription for any shares or debentures of the company.
16. Any benefit given to any promoter or officer in preceding two years and the consideration for giving of the benefit.
17. Particulars as to the date, parties and general nature of every contract appointing or fixing the remuneration of managing director or manager, whenever entered into.
18. Particulars of every material contract not entered into in the ordinary course of business carried on or intended to be carried on by the company or a contract entered into more than two years before the date of the prospectus.
19. Names and addresses of the auditors of the company.
20. Full particulars of the nature and extent of interested of the directors or promoter in the promotion of the company or in the property acquired by the company within two years of the issue of the prospectus.

21. If the share capital of the company is divided into different classes of shares, the rights of voting at meeting of the company and the rights in respect of capital and the dividends attached to several classes of shares respectively.
22. Where the articles of the company impose any restriction upon the members of the company in respect of the rights to attend, speak or vote at meetings of the company or the rights to transfer shares or on the directors of the company in respect of their powers of management, the nature and extent of these restrictions.
23. Where the company carries on business, the length of time during which it has been carried on. If the company proposes to acquire a business which has been carried on for less than three years, the length of time during which the business had been conducted.
24. If any reserves or profits of the company or any of its subsidiaries have been capitalized, particulars of the capitalization and particulars of the surplus arising from any revaluation on the assets of the company.
25. A reasonable time and place at which copies of all balance sheets and profits and loss accounts, if any, on which the report of the auditors under part II below is based, may be inspected.

Part II of Schedule II

General Information:

1. Names and address of the Company Secretary, Legal Adviser, Lead Managers, Co-managers, Auditors, Bankers to the company, Bankers to the issue and Brokers to the issue.

2. Consent of Directors, Auditors, Solicitors/Advocates, Managers to issue, Registrar of Issue, Bankers to the company, and Bankers to the issue and Experts.

3. Expert's opinion obtained, if any.

4. Change, if any, in directors and auditors during the last 3 years, and reasons thereof.

5. Authority for the issue and details of resolution passed for the issue.

6. Procedure and time schedule for allotment and issue of certificates.

Financial Information:

1. Auditor's Report

2. Accountant's Report

3. Statutory and Other Information

Part III of Schedule II

Part III of the schedule consists of provisions applying to Part I and II of the said schedule.

1. Every person shall, for the purpose of this schedule, be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase of any property to be acquired by the company, in any case where (a) the purchase money is not fully paid at the date of the issue of the prospectus (b) the purchase money is to be paid or satisfied, wholly or in part, out of the proceeds of the issue offered for subscription by the prospectus; (c) the contract depends for its validity or fulfillment on the result of that issue.
2. In the case of a company which has been carrying on business for less than 5 financial years, reference to 5 financial years means reference to that number of financial years for which business has been carried on.
3. Reasonable time and place at which copies of all balance sheets and profit and loss accounts on which the report of the auditors is based, and material contracts and other documents may be respected. "Term year" wherever used herein earlier means financial year

Declaration

That all the relevant provision of the Companies Act, 1956 and the guidelines issued by the Government have been complied with and no statement made in the prospectus is contrary to the provisions of the Companies Act, 1956 and rules thereunder. The prospectus shall be dated and signed by the directors.

Statement by Experts

1. Experts to be unconnected with formation or management of company (Section 57). Where a prospectus includes a statement made by an expert, he shall not be engaged or interested in the formation, promotion or management of the company. The expression 'expert' includes an engineer, accountant, a valor and, any other person whose profession gives authority to a statement made by him.

2. Expert's consent to issue of prospectus containing statement by him (Section 58). A prospectus including a statement made by an expert shall not be issued, unless (a) he has given his written consent to be issued of the prospectus with the statement included in the form and context in which it is included and; (b) statement that he has given and has not withdrawn his consent as aforesaid appears in a prospectus.

A wholesome rule intended to protect intending investors by making the expert a party to the issue of the prospectus and making him liable for untrue statements (Section 58). Penalty [Section 59 (1)], if any, prospectus is issued in contravention of Section 57 or 58, the company, and every person who is knowingly a party to the issue thereof, shall be punishable with fine which may extent to Rs. 5,000/-.

Misstatement in Prospectus

A prospectus is an invitation to the public to subscribe to the shares or debentures of a company. Every person authorizing the issue of prospectus has a primary responsibility to seed that the prospectus contains the true state of affairs of the company and does not give any fraudulent picture to the public.

People invest in the company on the basis of the information published in the prospectus. They have to be safeguarded against all wrongs or false statements in prospectus. Prospectus must give a full, accurate and a fair picture of material facts without concealing or omitting any relevant fact. This is known as the 'Golden Rule' for framing prospectus as laid down in *New Brunswick etc. Co. v. Muggeridge* [(1860) 3 LT 651]. The true nature of company's venture should be disclosed. The statements which do not qualify to the particulars mentioned in the prospectus or any information is intentionally and willfully concealed by the directors of the company, would be considered as misstatement.

Thus, the term 'venture statement' as 'misstatement' is used in a broader sense. It includes not only false statements which produce a impression of actual facts. Concealment of a material fact also comes within the category of misstatement.

A statement included in a prospectus shall be deemed to be untrue, if

- The statement is misleading in the form and context in which it is included; and
- the omission from a prospectus of any matter is calculated to mislead (Section 65).

If there is any misstatement of a material fact in a prospectus as if the prospectus is wanting in any material fact, this may arise-

- Civil Liability
- Criminal Liability

Statement in Lieu of Prospectus

A company having a share capital which does not issue a prospectus or which has issued a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, shall not allot any of its shares or debentures, unless at least three days before the allotment of shares or debentures, this has been delivered to the Registrar for registration a 'statement in lieu of prospectus' signed by every person who is named therein as a director or a proposed director of the company or by his agent authorized in writing, in the form and containing the particulars set out in Part I of Schedule III and setting out the reports specified in Part II of Schedule III subject to the provisions contained in Part III of that Schedule (Section 70).

A private company on becoming a public company shall deliver to the Registrar a statement in lieu of prospectus in the form containing the particulars specified in Part I of Schedule IV with report set out in Part II of Schedule IV subject to the provisions contained in Part III of that Schedule [Section 44(2) (b)].

If the company acts in contravention of the provisions, the company and every director who is at fault shall be punishable with fine which may extent to Rs. 1,000/-.

If the ‘statement in lieu of prospectus’ include any untrue statement, any person who authorized the delivery of the statement in lieu of prospectus shall be, punishable with imprisonment up to two years or with fine which may extent to Rs. 5,000/- or with both. He can avoid liability if he proves either that the statement was immaterial or that he had reasonable ground to believe that the statement was immaterial or that he had reasonable ground to believe that the statement was true. The civil and criminal liability for misstatements or misrepresentations is the same as in the case of a prospectus [Section 70(5)].

Commencement of Business

A private company can commence business immediately on its incorporation. A public company has to however, comply with certain additional formalities before it can commence its business.

No public company having a share capital and issuing a prospectus inviting the public to subscribe for its shares shall commence business or borrow unless it has obtained ‘certificate of commencement of businesses from the Registrar of Companies. The certificate of commencement of business will be issued after the following formalities are complied with -

a) At least minimum subscription has been raised;

b) every director of the company has paid to the company, on each of the shares taken by him or agree to be taken by him the amount payable by him on application and allotment of the shares;

c) Obtain or apply for permission for dealing of the shares or debentures on the recognized stock exchange so that no money is repayable to application for an shares of debentures offered for public subscription by reason of any failure to apply for, or to obtain stock exchange permission;

d) A duly verified declaration has been filed with the Registrar by one of the director or the secretary or of the secretary in whole time practice that the above provisions have been complied with [Section 149(1)].

Where a company having a share capital has not issued a prospectus inviting the public subscribe for its shares, it can commence business or exercise any borrowing powers if the following conditions are fulfilled:

a) A statement in lieu of prospectus has been filled in the Registrar.
b) Every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him for cash, the application and allotment money.
c) There has been filed with the Registrar a duly verified declaration by one of the directors or the secretary, a secretary in whole time practice, in the prescribed form, that the above provisions have been complied with.

When the company fulfills the above conditions, the Registrar shall certify that it is entitled to commerce business and that the certificate shall be conclusive evidence that the company is so entitled [Section 149(3)]. Any contract made by a public company after incorporation but before the date on which it is entitled to commence business shall be provisional only and shall not be binding on the company until the certificates is obtained [Section 149(4)].

The court has the power to wind up a company, if it does not commence its business within a year of its incorporation.

A prospectus means any invitation issued to the public inviting it to deposit money with the company or to take share or debentures of the company such invitation may be in the form of a document or a notice, circular, advertisement etc. Section 55 states that every prospectus must be dated, and that date is deemed to be the date of publications of the prospectus, prospectus should neither contain any misstatement i.e. untrue or misleading nor omit to disclose any material fact. It there is any misstatement or omission of material facts, then the directions promoters, the persons responsible for the issue of prospectus, and the company incur a liability for the same. The company can also allot shares or debentures without issuing the prospectus. However, in such a case, a statement known as 'Statement in lieu of Prospectus' is required to be prepared and field with the Registrar of Companies.

SHARES AND DEBENTURES

To start an industry on a large scale requires huge amount of capital, professional skills, and other resources. Sometime it may not be possible for a single individual to do the needful. In such cases, a group of like minded people get together and set up a company, called a Joint-Stock Company registered under companies act. The people who start the company are called promoters of the company, who frame the constitution of the company, which lays down the objectives of the company.

Shares

To raise the capital from the general public, the company issues a prospectus giving details of the projects undertaken, background of the company, its strength and risks involved. The capital of the company is divided into convenient units of equal value, called shares.

The total capital of the company is divided into convenient units of equal value and each unit is called a ***share***. An individual who purchases/possesses the share/shares of the company is called a ***shareholder*** of the company. Each share holder is issued a share certificate by the company, indicating the number of shares purchased and value of each share. The original value of the share, which is written on the share certificate, is called its ***par value***. This is al***so*** called ***nominal value*** or face value of the share. When the company starts production and starts earning profit, after retaining some profit for running expenses interest on loans, if raised, the remaining part of the profit is divided among shareholders, and is called ***dividend***. Dividend is usually expressed as certain percentage of its par value or certain among per share. Like other commodities, shares are also sold and purchased in the market. This market is given a special name "***Stock Exchange*** ". The price of a share as quoted in the market is called the ***market value*** of the share. Like other commodities, the market value of shares keeps on changing according to demand in the market.

When a company issues a prospectus inviting the public to subscribe for the shares of a company, it is merely an invitation rather than an offer. An application for shares is an offer by the prospective shareholders to take the shares of the company. Such offers are made on application forms supplied by the company. When an application is accepted, it is called allotment. Allotment is the acceptance by the company of the offer made by the applicant.

Debentures

The capital is not only raised through shares, it is sometimes raised through loans, taken in the form of debentures. A debenture is a written acknowledgment of a debt taken by a company. It contains a contract for the repayment of principal sum by some specific date and payment of interest at a specified rate irrespective of the fact, whether the company has a profit or loss. Debenture holders are therefore, creditors of the company. Of course, they do not have any right on the profits declared by the company. Like shares, debentures can also be sold in or purchased from the market and all the terms used for shares also apply in this case.

Rules on Allotment of Shares and Debentures

Allotment results in a binding contract between the parties. The term allotment has not been defined in the Companies Act.

Principles on Allotment of Shares

1. Call and Issue should be made by proper authority
2. Absolute and Unconditional
3. Should be made within a reasonable time
4. Allotment must be communicated
5. An offer to take shares can be revoked at any time before the allotment is communicated

Transfer of Shares and Transmission of Shares

The shares in a company are movable property and they can be transferred in the manner provided by the articles of the company. A private company with a share capital, by its very nature as provided by Section 3(1) (iii) of the Act restricts the right of transfer in shares by its articles. Transfer of shares is less strict in a public company.

In a public company, every shareholder has right to transfer his shares to any person without the consent of other shareholders subject to such express restrictions as are found in the articles of the company. A restriction on transfer of shares which is not specified in the articles is not binding on the company or the shareholders. A transfer of share is valid if it is not forbidden under the articles of the company, even if it has been made with the object of escaping liability on the shares.

When a registered shareholder dies or becomes bankrupt his share are transmitted to his legal representative or the Official Assignee or Receiver, This is called transmission of shares. It takes place when a registered shareholder (a) dies or (b) becomes bankrupt.

The Companies Act 2013 lays down the detailed provision on transfer and transmission of shares.

<u>Share Warrant and Share Certificate</u>

A public company limited by shares may issue share warrants under its common seal in the following circumstances:

(i) if it is authorized by its articles ;
(ii) shares are fully paid up ; and
(iii) previous approval of the Central Government is obtained.

A share warrant is a document which shows that the bearer of the warrant is entitled to the shares specified therein. It is a substitute for the share certificate. A shares warrant may have coupons attached to it to provide for the payment of future dividends on the shares specified in the warrant. A shares warrant shall entitle the bearer thereof to the shares specified therein. The shares may be transferred by delivery of the warrant. On issue of a share warrant, the company shall strike out of its register the name of the member then entered therein as holding the shares specified in the warrant as if he had ceased to be a member. The following particulars shall be entered in the register :

(i) the fact of the issue of the warrant ;
(ii) a statement of the shares specified in the warrant, distinguishing each share by its number ; and
(iii) the date of the issue of the warrant.

The bearer of a share warrant shall subject to the articles of the company be entitled to have his name entered as a member in the register of members on surrendering the warrant for cancellation and paying such fee to the company as the Board of Directors may from time to time determine. The bearer of the share warrant may, if the articles of the company so provide, be deemed to be a member of the company.

The holder of share or shares is issued a share certificate by the company. A certificate under the common seal of the company, signed by one or more of directors, specifying shares held by the member and the amount paid up on the shares shall be prima facie evidence of the title of the member to such share or shares. Every company shall deliver the certificates to the allottee within three months from the date of allotment and to the transferee within two months of making of the application for the registration of the transfer of shares, debentures or debenture stock.

If default is made, the company and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 5,000/- for every day during which the default continues. The person may make an application to the court if default is not made good by the company within 10 days after the service of the notice. The court may order the company and any officer of the company to make good the default.

MANAGEMENT OF COMPANY

A company is composed of certain persons who constitute it as a corporate body. However, the identity of the company is different from the persons composing it. The persons composing the company are the 'members' or 'shareholders' of the company. A member is a person who has signed company's memorandum of association. Any other person who agrees in writing to become a member and whose name is entered in companies register of members is also a member of the company.

It is important to note here that the terms 'member' and 'shareholder' are used inter-changeably in the Companies Act. A shareholder means a person who holds the shares of the company. A part from a few exceptional cases, the terms member and shareholder are synonymous. In these exceptional cases, a person may be a member but not a shareholder, or he may be a shareholder but not a member.

The terms 'member' and 'shareholder' have been used interchangeably in the Companies Act. The word 'shareholder' is used in relation to a company having a share capital and there can be no membership except through the medium of shareholding. A holder of shares becomes a member only when his name is entered on the register of members. But the term 'member' is wider in scope and may be used in relation to all types of company. A person may become a member of a company without holding any shares. Companies limited by guarantee or unlimited companies having no share capital can have no shareholders but do have members.

The following are the points of distinction between members and shareholders:

1. A holder of a share warrant is a shareholder but not a member as his name is struck off the register of members immediately after the issue of such share warrant.

2. Every registered shareholder is a member but every registered member may not be a shareholder because the company may or may not have share capital.
3. The transferor or the deceased person is a member so long as his name is on the register of members whereas he cannot be termed as shareholder.
4. Similarly, a shareholder by transfer is not a member until his name is entered in the company's register of members.
5. A person who misrepresents himself to be a member is estopped from denying his position subsequently. He is said to have become a member by estoppel.
6. A person may become a member by an order or decree of a court.

MEMBER OF A COMPANY

The membership of a company is open to any person who is competent to enter into a valid contract. The Companies Act does not prescribe any qualifications for becoming a member of a company. However, only such a person who is competent to contract as per the Indian Contract Act, 1872 may become a member. This is, however, subject to the provisions of the memorandum and articles of the company. The articles may provide that certain persons cannot become members of the company.

Modes of Acquiring Membership:

1. By Subscribing to the MoA
2. Membership by Qualification shares
3. Membership by Application and Allotment
4. Membership by Transfer
5. Membership by Transmission
6. Membership by Estoppel

Cessation of Membership:

A person may cease to be a member of a company:

1. If he transfers his shares to another person.
2. By the sale of his shares by the company in exercise of right of lien over his shares.
3. by forfeiture of his shares;
4. By a valid surrender of his shares.
5. By the death of a member. The estate of the deceased remains liable until the shares are registered in the name of his legal representative.
6. By his insolvency.
7. By his rescission of contract to take shares on the ground of misrepresentation or fraud.
8. By the winding-up of the company, of course he remains liable as a contributory.
9. By redemption of redeemable preference shares.
10. By issue of share warrants to him in exchange of fully paid shares.

Duties of Member:

(a) as a subscriber of the memorandum, to take the share written opposite his name direct from the company and pay for them ;

(b) to take shares when they are duly allotted to him and pay for them according to the terms of issue of the shares ;

(c) to pay all valid calls as and when they are made;

(d) to abide by the decisions of the majority of members unless the majority acts vindictively, oppressively, mala fide or fraudulently;

(e) to contribute to the asset of the company when it goes into liquidation.

Liabilities of Member

The liability of the members of a company depends upon the nature of the company.

Company limited by shares. In the case of a company limited by shares, the liability of a member of company is the amount, if any unpaid on his shares. If his shares are fully paid, his liability is nil for all purposes.

Company limited by guarantee. The liability of the members of a company limited by guarantee is limited to the amount they undertook to contribute to the assets of the company in the event of winding up.

Company with unlimited liability. Every member of an unlimited company is liable in full for all debts contracted by the company during the period he was a member.

Rights of Members:

a. Statutory Rights: Statutory rights are those which are given to the members by the statute, i.e. the Companies Act, 1956. No document of the company can take away or modify such rights. These rights are spread throughout the Companies Act 2013
b. Documentary Rights: There rights are the rights given by the two basic documents i.e. memorandum of association and articles of association. The company may also give certain rights to its members by expressly providing for them in the memorandum or the articles of the company.
c. Legal Rights: These rights are given to members under general law. For example, a person who has taken shares of a company on the faith of a misleading prospectus can avoid the contract and claim damages under the general law.

DIRECTOR:

A company, though a legal entity in the eyes of law, is an artificial person, existing only in contemplation of law. It has no physical existence. It has neither soul nor body of its own. As such, it cannot act in its own person. It can do so only through some human agency. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of Directors or the Board. The directors are the brain of a company. They occupy a pivotal position in the structure of the company.

Directors take the decision regarding the management of a company collectively in their meetings known as Board Meetings or at the meetings of their committees constituted for certain specific purposes. A meeting of the Board of Directors must be held once in every three calendar months and atleast 4 meetings must be held every year.

The decisions at the Board Meetings are taken by majority of votes but in the case of equal number of votes for and against any resolution, the Chairman has the power to exercise his casting vote for deciding the matter.

Meaning of a Director

As the name implies, a director is one who directs. The Shorter Oxford Dictionary defines a director as "a member of a Board appointed to direct the affairs of a commercial corporation". The Companies Act makes no attempt to define a director.

However, according to Section 2(13) of the Act, a director includes "any person occupying the position of a director by whatever name called". In any event, it can be said that directors are persons appointed according to the law and authorised to direct, control, conduct or superintend the affairs of the Company.

Eligibility to be a Director

The Act does not lay down any qualifications for a director except the holding of a specific number of shares, if any, which the articles may fix as a requisite for the appointment of a director. But any provision in the articles of the company which requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than two months after his appointment as such shall be void. Also the nominal value of the qualification shares should not exceed five thousand rupees, or the nominal value of one share where it exceeds five thousand rupees. If no such share qualification has been laid down in the articles, a director even need not be a member of the company. It follows that any one can be a director, provided he does not suffer from any of the statutory disqualifications stipulated under the Companies Act, 1956.

Disqualifications from being a Director:

The Companies Act states that a person shall not be capable of being appointed as a director of a company, if

(a) he has been found by the Court to be of unsound mind;

(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 failed to pay any call on his shares in the company for six months from the date fixed for the payment;

(f) he has been disqualified by a Court under Section 203 which empowers the Court to restrain fraudulent persons from managing companies; and

(g) such person is already a director of a public company which:

- has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day or April, 1999; or
- has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more:

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director failed to file annual accounts and annual returns under sub-clause (A) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause (B).

The Central Government may, however, remove the disqualification incurred by any person by virtue of clause (d) or clause (e) above. A private company, which is not a subsidiary of a public company, may, by its articles, provide for additional disqualifications for a person to be appointed as a director.

Only individuals to be Directors

According to Section 253 of the Act, no body corporate, association or firm can be appointed as director of any company, and only an individual can be so appointed. The effect of this provision is that only individuals (i.e. natural persons) can become the directors of a company.

Number of Directors

However, no company shall appoint or re-appoint any individual as director of the company unless he has been allotted a Director Identification Number under Section 266B.

Every public company shall have at least 3 directors provided that a public company having a paid-up capital of five crore rupees or more and one thousand or more small

These provisions have not come into force shareholders, may have a director elected by such small shareholders in the manner as may be prescribed and every other company shall have at least 2 directors (Section 252).

Subject to this statutory limit, the Articles of a company may prescribe the maximum and minimum number of directors for its Board of directors. If the number falls below the minimum, prima facie the Board cannot act, unless the Articles allow it to act notwithstanding vacancies.

Any increase in number of directors beyond the maximum permitted by the Articles is to be approved by the Central Government. But where the increase in number does not make the total number of directors more than 12, no approval of the Central Government is needed.

Appointment of Directors

Directors may be appointed:

(a) by a provision in the articles. The first directors are usually named in the articles. However, if they are not so named, the subscribers to the memorandum who are individuals are deemed to be the directors;

(b) by shareholders in general meeting;

(c) by the Board of directors;

(d) by Central Government;

(e) by third parties.

Removal of Directors

(NCLT) if it is satisfied on making a reference to it by the Central Government or on an application of not less than 100 members of the Company or of the members holding 1/10 of the total voting power, that the affairs of the company are being conducted either in a manner which is oppressive to any member of the company or in a manner which is prejudicial to the interests of the company or to the interests of the public. The directors so appointed hold office for a period of three years but can be reappointed by the Central Government for further periods of three years each.

The removal of directors rests with the following authorities:

a. By Company in General Meeting
b. The Central Government
c. The Company Law Board:
    - Removal by the company: Section 284 states that a company may, by ordinary resolution passed in general meeting after special notice, remove a director before the expiry of his period of office. But the following exceptions to the Section are noteworthy:
        - The Section does not apply to a director appointed by the Central Government.
        - In the case of a private company, the Section does not authorize the removal of a director holding office for life on April 1, 1952.
        - It does not apply to a company which has adopted the system of appointing two thirds of its directors by the principle of proportional representation.
        - Directors appointed by financial institutions pursuant to stipulations under their agreements viz., IDBI, IFCI, etc. under their respective Acts.
        - Directors appointed by Board for Industrial and Financial Reconstruction.
    - Removal by the Central Government: A director may also be removed at the initiative of the Central Government. The Central Government may remove managerial personnel from office on the recommendations of Company Law Board/National Company Law Tribunal.
    - Removal by the Company Law Board/National Company Law Tribunal: When the Company Law Board/National Company Law Tribunal finds on an application made to it for prevention of oppression and mismanagement that a relief ought to be granted, it may terminate or set aside any agreement of the company with a director or managing director or other managerial personnel. When the appointment of a director is so terminated he can not except with the leave of the Board/Tribunal, serve any company in a managerial capacity for a period of five years.

<u>General Powers vested in the Board (Section 291)</u>

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. In the exercise of its powers the board is subjected to the provisions of the Companies Act, the memorandum and the articles and any regulations, not inconsistent with them, made by the company in general meeting.

The powers which are vested in the Board can be exercised only by the Board. The shareholders cannot interfere in their exercise. Thus if the general powers of management are vested in the directors, the shareholders cannot direct them to bring an action against a particular individual or to sell the assets of the company, or to declare a dividend. The true relationship of the Board with the general meeting is more of federation than of subordinate and superior.

The powers of the Board of directors are limited in two ways: first being agents of the company, the directors can do nothing that the company itself cannot do under its memorandum, and any ultra vires act done by them will be void and ineffective.

Secondly, when acting within the power of the company, the powers of the directors are limited to the extent the company has delegated to them by its articles. If they act beyond their own powers but intra vires the company, the latter may ratify such acts in general meeting. If these acts are not ratified by the shareholders in general meeting, the directors may be liable to third parties for breach of warranty of authority.

Subject to these limitations, the directors are the exclusive representatives of the company and charged with the administration of its internal affairs and the management and use of its assets. The shareholders cannot usurp the powers which by the articles are vested in the directors. These are, however, exceptions to this rule.

Where the directors act mala fide, or their personal interest is in conflict with their duty so that they will not take steps to seek redress to the wrong done to the company (being themselves wrong-doers), the majority of the shareholders may take steps to redress the wrong.

Majority of the shareholders may exercise the power vested in the Board in the following exceptional cases:

(a) Where the actions of directors are mala fide, against the interest of the company, the members may reconstitute the Board.

(b) When the Board for some valid reasons becomes incompetent to act,

(c) When there is a deadlock in the Board i.e., when the members of the Board are equally divided.

Powers to be exercised only at Board Meetings (Section 292)

The following powers of the company can be exercised only by means of resolutions passed at meetings of the Board:

(a) the power to make calls on shareholders in respect of money unpaid on their

shares;

(aa) the power to authorize the buy-back referred to in the first proviso to Clause (b) of Sub-section (2) of Section 77A.

(b) the power of issue debentures;

(c) the power to borrow money otherwise than on debentures;

(d) the power to invest the funds of the company; and

(e) the power to make loans.

The Board may, however, by a resolution passed at its meeting delegate the last three powers mentioned in clauses (c), (d) and (e) above, to any committee of directors, the managing director, the manager or any other principal officer of the company. However, the resolution delegating the power must specify the extent to which the delegates can exercise the power.

MANAGERIAL PERSONNEL

The general principle is that the Board of directors should direct and control the company's affairs. But at the same time the Act allows a person to accept directorship in twenty companies and does not prescribe the time and attention that he should devote to a particular company. Moreover, a Board meeting is a very formal affair and cannot be called very frequently, whereas the business of the company has to be managed every day. Accordingly, the day to day management has to be delegated to "professional management". The duty of the management is to carry out the policy and to attend the day to day conduct of the business of the company. The person appointed to do this may be either one of the directors of the Board and known as a managing director or may not be a director and may be designated as manager or chief executive officer.

A whole time director on the other hand is a director of the company who is in whole time employment of the company. A company can have one or more whole time directors but in can have only one Managing Director or Manager. A company cannot have both—a Managing Director and a Manager.

A managing director, as defined in Section 2(26) of the Act, means "a director who is entrusted with substantial powers of management which would not otherwise be exercisable by him". The term includes a director, occupying the position of a managing director, by whatever name called. The "substantial powers of management" may be conferred upon him by virtue of an agreement with the company or a resolution of the company in general meeting or by virtue of its memorandum or articles.

A managing director exercises such powers, performs such functions and discharges such duties involving substantial powers of management as are assigned to him by the Board of directors and he is required to exercise his powers subject to the superintendence, control and direction of its Board of directors.

A managing director being essentially a director must be an individual.

Disqualifications of Managing Director (Section 267) According to Section 267 of the Act, no company should appoint or continue the appointment or employment of any person as its managing director or whole-time director, who:

(a) is an undischarged insolvent or has at any time been adjudged an insolvent;

(b) suspends or has at any time suspended, payment to his creditors or makes

or has at any time made a composition with them; or

(c) is, or has been convicted by a Court of an offence involving moral turpitude.

The disqualifications provided for in Section 267 of the Act are equally applicable to the appointment of whole-time directors also. A whole-time director is a director employed to devote the whole of his time and attention in carrying on the affairs of the company. He cannot be employed elsewhere or be engaged in any other business pursuit. He can, however, be an ordinary director of other companies.

Section 267 of the Act disqualifies all persons convicted, for whatever term of imprisonment or fine, or an offence involving moral turpitude. The expression "moral turpitude" refers to anything done contrary to justice, honesty, principles or good morals.

MANAGER

As per Section 2(24) of the Act, a manager means "an individual who has the management of the whole or substantially the whole of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called". To be deemed as the manager of a company, the individual must be incharge of the whole business of the company. A mere head of a department or a branch manager is not a manager.

Only an individual can be appointed a manager of a company, whether public or private.

Disqualifications of Manager (Section 385)

Section 385 of the Act prescribes the following disqualifications for a manager:

(a) is an undischarged insolvent, or has at any time within the preceding five years been adjudged an insolvent; or

(b) suspends, or has at any time within the preceding five years suspended payment to his creditors; or

(c) is or has at any time within the preceding five years been convicted of an offence involving moral turpitude.

Tenure of Office of a Managing Director or Manager

The maximum term of appointment of a managing director or manager in a public company or a private company which is a subsidiary of public company, cannot be more than 5 years at a time. Re-appointment, however, can be made for five years at a time. The re-appointment is sanctioned not earlier than two years from the date on which it is to come into force.

SHAREHOLDERS

For carrying on its business, a company collects money from the public. The money so collected is called the capital of the company which is usually divided into different units of a fixed amount. These units are called the "shares". The persons who hold the shares of a company are called the shareholders of the company.

Joint Shareholders - The "joint shareholders" are the persons who hold the shares in a company in their joint names.

The shareholders who provide the funds for the company are commonly regarded as the "owners" of the company, its business and property. Legally they are not the owners but have been given some rights and privileges of exercising control over the affairs of the company. They exercise this control by delegating their powers and authority to their elected representatives-members of the Board of Directors. The number of shareholders is generally large. he shareholders of a company are its financial supporters; they provide finance to a company by purchasing shares in it, and through this become shareholders. This gives them certain rights as shareholders; they also have roles and duties to adhere to, which are set out in the Companies Act 2006 (or Companies Act relevant to the date that the company was formed). As shareholders of a company, they are protected from liabilities as the company is 'limited'. Shareholders may or may not be directors of the company also. Whilst directors are in charge of running the day to day business of the company and making decisions, the shareholders have a few specific roles and duties to ensure they ultimately have control over the company.

Major decisions which would have an effect on the shareholders' rights are usually required, through the Companies Act 2006, to be approved by the shareholders at a general meeting called by the directors of the company.

Only certain acts can be done by the shareholders such as; removing a director from office, changing the name of the company, or authorizing a service contract for a director which gives him job security for more than two years. In general, shareholders have little power over the directors and how they run the company, but their main role is to attend meeting and discuss what ever is on the agenda to ensure the directors do not go beyond their powers.

To fulfill the role of being a shareholder, a shareholder may require a general meeting to be called rather than simply have all decisions made through written resolutions. The directors will in fact call a general meeting, despite not being able to vote at the meeting, as this duty is solely for the shareholders. However, it is quite possible that directors will be shareholders as well and so will vote in the board meetings for directors and in the general meetings for shareholders. The directors may call a general meeting at any time for any reason and are entitled to attend and speak as are the shareholders.

There is no longer a statutory requirement to hold an annual general meeting if the company is a private company, however the shareholders may request that one is held or the directors may call an annual general meeting if desired. Commonly the date of such a meeting will be fixed from year to year. Under s.336 of the Companies Act 2006 public companies must hold an annual general meeting six months after its accounting reference date. In small companies, it is often appropriate to have an annual general meeting where the shareholders are not all directors. It provides the shareholders the opportunity to review the company accounts and confront any directors with regard to any decisions they have made.

There is a presumption that the chairman of the general meeting will usually be the same as the chairman of the board meeting. His task is to supervise the meeting and keep the general structure of it in order. The chairman will declare whether a resolution has passed or failed after voting has taken place.

Duties of Shareholders

The main duty of shareholders is to pass resolutions at general meetings by voting through their shareholder capacity. This duty is particularly important as it allows the shareholders to exercise their ultimate control over the company and how it is managed. Shareholders can vote in one of two ways: on a show of hands or through a poll vote where each vote will be proportionate to the amount of shares held by each shareholder. A show of hands is usually the preferred method of voting that takes place at general meetings.

There are two resolutions that can be voted on at a meeting: an ordinary resolution, or a special resolution.

Ordinary Resolution

An ordinary resolution is passed by the shareholders if a simple majority of the shareholders present at the meeting vote in favour of the proposal. Therefore more than 50% of the votes cast will have to be favour, usually displayed through a show of hands.

Special Resolution

For a special resolution to be passed, a 75% majority must vote in favour. A special resolution is only required if it is stated in statute or it is in the company's articles, which suggest a special resolution would have to be used for a particular vote rather than an ordinary resolution. If there is no specific mention of what type of resolution should be used, the presumption is that an ordinary resolution would be required.

The chairman's casting vote

The chairman does not have a casting vote in addition to any other vote he may have. The casting vote only operates if, without it, the number of votes for and against the resolution is equal. Where no chairman has been appointed by the company, the idea is that if there is deadlock at the voting stage, the negative will prevail and the proposed resolution will fail.

WINDING UP OF A COMPANY

Winding up (which is more commonly called liquidation in Scotland) is proceeding for the realization of the assets, the payment of creditors, and the distribution of the surplus, if any, among the shareholders, so that the company may be finally dissolved.

Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator called a liquidator is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.

Thus winding up is the last stage in the life of a company. It means a proceeding by which a company is dissolved.

Winding up should not be taken as if it is dissolution of a company. The winding up of a company precedes its dissolution. Prior to dissolution and after winding up, the legal entity of the company remains and it can be sued in a Court of law. On dissolution the company ceases to exist, its name is actually struck off from the Register of Companies by the Registrar and the fact is published in the official Gazette.
A company can be wound up in three ways:

1. Compulsory winding up by the Court;

2. Voluntary winding up : (i) Members' voluntary winding up; (ii) Creditors' voluntary winding up;

3. Voluntary winding up subject to the supervision of the Court [Sec. 425].

COMPULSORY WINDING UP BY COURT

A company may be wound up by an order of the Court. This is called compulsory winding up or winding up by the Court. Section 433 lays down the following grounds where a company may be wound up by the Court.

A petition for winding up may be presented to the Court on any of the grounds stated below:

1. Special resolution

A company may be wound up by the Court if it has, by a special resolution, resolved that it be wound up by the Court. Even in such a case it is the discretion of the Court to order for winding up or not.

2. ***Default in filing statutory report or holding statutory meeting***

If a company has made a default in delivering the statutory report to the Registrar or in holding the statutory meeting, a petition for winding up of the company may be presented to the Court by a member or Registrar (with the previous sanction of the Central Government) or a creditor

3. Failure to commence business within one year or suspension of business for a whole year

Where a company does not commence its business within one year from its incorporation or suspends its business for a whole year, a winding up petition may be presented to the Court. Even if the business is suspended for a whole year, this by itself does not entitle the petitioner to get the company wound up as a matter of right but the question whether the company should be wound up or not in such a circumstances entirely in the discretion of the Court depending upon the facts and circumstances of each case.

The suspension of the business, for this purpose, must be the entire business of the company and not a part of it.

4. Reduction of membership below the minimum

When the number of members is reduced, in the case of a public company, below 7 and in the case of a private company, below 2, a petition for winding up of the company may be presented to the Court.

5. Company's inability to pay its debts

A winding up petition may be presented if the company is unable to pay its debt. A company will be deemed to be unable to pay its loan in the following conditions (Section 434):

(a) a creditor of more than Rs. 500 has served, on the company at its registered office, a demand under his hand requiring payment and the company has for three weeks thereafter neglected to pay or secure or compound the sum to the reasonable satisfaction of the creditor ; or
(b) execution or other process issued on a judgement or order in favour of a creditor of the company is returned unsatisfied in whole or in part ; or
(c) it is proved to the satisfaction of the Court that the company is unable to pay its debts, taking into account its contingent and prospective liabilities, i.e. whether its assets are sufficient to meet its liabilities.

6. Just and Equitable [Sec. 433 (f)]

The Court may also order to wind up of a company if it is of opinion that it has just and equitable that the company should be wound up. What is 'just and equitable' depends on the facts of each case. The words 'just and equitable' are of wide connotation and it is entirely discretionary on the part of the Court to order winding up or not on this ground.

Thus the Court itself works out the principles on which the order for winding up under the section is to be made.

WINDING UP by PETITION

The Court does not choose to wind up a company at its own motion. It has to be petitioned. Section 439 of the Companies Act enumerates the persons those can file a petition to the Court for the winding up of a company. The petition for winding up may be brought by any one of the following:

1. ***Petition by Company:***
   A company can make a petition only when it has passed a special resolution to that effect. However, it has been held that where the company is found by the directors to be insolvent due to circumstances which ought to be investigated by the Court, the directors may apply to the Court for an order of winding up of the company even without obtaining the sanction of the general meeting of the company.

2. ***Petition by Creditors:***
   Before a petition for winding up of a company presented by a contingent or prospective creditors is admitted, the leave of the Court must be obtained for the admission of the petition. Such leave is not granted (a) unless, in the opinion of the Court, there is a prima facie case for winding up the company; and (b) until reasonable security for costs has been given.
   Notice that a creditor has a right to winding up order if he can prove that he claims an undisputed debt and that the company has failed to discharge it. When a creditors' petition is opposed by other creditors, the Court may ascertain the wishes of the majority of creditors.

3. ***Contributory Petition:***
   The term 'contributory' means every person who is liable to contribute to the assets of the company in the event of its being wound up.
   Section 428 makes it clear that it includes the holder of fully-paid shares. A fully-paid shareholder will not, however, be placed on the list of contributors, as he is not liable to pay any contribution to the assets, except in cases where surplus assets are likely to be available for distribution. A contributory is entitled to present a petition for winding up a company

4. ***Registrar Petition***

The Registrar can present a petition for winding up a company only on the following grounds, viz. if a default is made in delivering the statutory report to the Registrar or in holding the statutory meeting; if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year; if the number of members is reduced, in the case of a public company below seven and in the case of a private company below two; if the company is unable to pay its debts; and if the Court is of opinion that it is just and equitable that the company should be wound up.

5. ***Petition by any Person Authorised by the Central Government***

If it appears to the Central Government from any report of the inspectors appointed to investigate the affairs of the company, that it is expedient to wind up the company because its business is being conducted with intent to defraud creditors, members or any other person, or its business is being conducted for a fraudulent or unlawful purpose, or the management is guilty of fraud, misfeasance or other misconduct, the Central Government may authorize any person to present to the Court a petition for winding up of the company that is just and equitable that the company should be wound up.

Consequence of Compulsory Winding Up

(i) Where the Court makes an order for winding up of company, the Court must forthwith cause intimation thereof to be sent to the Official Liquidators and the Registrar (Section 444).

(ii) On the making of a winding up order it is the duty of the petitioner in the winding up proceedings and of the company to file with the Registrar a copy of the order of the Court within 30 days from the date of the making of the order [Section 445(1)].

(iii) The winding up order is deemed to be notice of discharge to the officers and employees of the company, except when the business of the company is continued [Section 445(3)].

(iv) When a winding up order has been made, no suit or other legal proceedings can be commenced against the company except with the leave of the Court. Suits pending at the date of the winding up order cannot be further proceeded without the leave of the Court. According to sub-section (2) of Section 446 the Court which is winding up the company has jurisdiction to entertain or dispose of (a) any suit or proceeding by or against the company; (b) any claim made by or against the company; (c) any application made under Section 391 by or in respect of the company; (d) any question of priorities or any other question whatsoever which may relate to or arise in course of the winding up of the company.

(v) An order for winding up operates in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor and of a contributory (Section 447).

(vi) According to Section 536 any disposition of the property (including actionable claims) of the company, any transfer of shares in the company or alteration in the status of its members, made after the commencement of the winding up shall be void, unless the Court otherwise orders.

Thus the Court can direct that any such disposition of property or actionable claims or transfer of shares or alteration of status of the members will be valid. But unless the Court so directs, such disposition, transfer or alteration will be void.

(vii) Section 537 declares that any attachment and sale of the estate or effects of the company, after the commencement of the winding up, will be void. In the case of winding up by the Court any attachment, distress or execution put in force, without leave of the Court, against the estate or effects of the company after the commencement of the winding up will be void. Similarly any sale held , without leave of the Court, of any of the properties or effects of the company after the commencement of the winding up will be void. With leave of the Court, attachment and sale of the properties of the company will be valid even if such attachment and sale are made after the commencement of the winding up of the company. Besides this section does not apply to any proceedings for the recovery of any tax imposed or any dues payable to the Government. Thus I.T.O. can commence assessment proceedings without leave of the Court.

(viii) It is to be noted that winding up order does not bring the business of the company to an end. The corporate existence of the company continues through winding up till the company is dissolved. Thus the company continues to have corporate personality during winding up. It's corporate existence come to an end only when it is dissolved.

(ix) An order for winding up operates in favour of all the creditors and of all the contributories of the company as if it had been made on the joint petition of a creditor and of contributory.

(x) On a winding up order being made in respect of a company, the Official Liquidator, by virtue of the office, becomes the liquidator of the company (Section 449).

Official Liquidators:

Under the present Act, the only person who is competent to act as the liquidator in a winding up is the official liquidator. For the purpose of winding up, there shall be attached to each high Court an official liquidator appointed by the Central Government, who may be either a whole time or part time officer depending upon the volume of work. In district courts the official receiver will be the official liquidator. The Central Government may appoint one or more deputy or assistant official liquidators to assist the official liquidator in the discharge of his functions. There is no provision in the Act, for the removal of the official liquidator.

VOLUNTARY WINDING UP

Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up'. In voluntary winding up, the company and its creditors are left free to settle their affairs without going to the Court, although they may apply to the Court for directions or orders if and when necessary.

A company may be wound up voluntarily under the circumstances given hereunder:

1. when the period fixed for the duration of the company by the articles has expired or the event has occurred on the occurrence of which the articles provide that the company is to be dissolved and the company in a general meeting has passed a special resolution to wind up voluntarily; or

2. the company has passed a special resolution to wind up voluntarily. Thus a company may be wound up voluntarily at any time and for any reason if a special resolution to this effect is passed in its general meeting.

When a company has passed a resolution for voluntary winding up, it must within 14 days of the passing of the resolution gives 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

A voluntary winding up is deemed to commence at the time when the resolution for winding up is passed [Sec. 486]. The date of the commencement of the winding up is important for several matters such as liability of past members and fraudulent preferences, etc.

Consequences of Voluntary Winding up

The consequences of voluntary winding up are:

1. From the commencement of voluntary winding up, the company ceases to carry on its business, except so far as may be required for the beneficial winding up thereof [Sec. 487].

2. The possession of the assets of the company vests in the liquidator for realisation and distribution among the creditors. The corporate state and powers of the company shall, however, continue until it is dissolved (Sec 456 and 487).

3. On the appointment of a liquidator, all the powers of the board of directors cease and the liquidator may exercise the powers mentioned in Sec. 512 including the power to do such things as may be necessary for winding up the affairs of the company and distributing its assets. The liquidator appointed in a members' voluntary winding up is merely an agent of the company to administer the property of the company for purposes prescribed by the statue.

WINDING UP SUBJECT TO SUPERVISION OF THE COURT

Voluntary winding up may be under the supervision of the Court. 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. The Court may give such liberty to creditors, contributories or others to apply to the Court and generally on such terms and conditions as the Court thinks just (Sec. 522).

A petition for the continuance of a voluntary winding up subject to the supervision of the Court shall be deemed to be a petition for winding up by the Court (Sec. 523).

The Court will not in general make a supervision order on the petition of a contributory, unless it is satisfied that the resolution for winding up was so obtained that the minority of members were overborne by fraud or improper or corrupt influence. Where the company is insolvent, the wishes of the creditors only are regarded or the investigation is required.

If a company is being wound up voluntarily or subject to supervision of the Court, a petition for its winding up by the Court may be presented by:

(a) any person authorised to do so under Sec. 439 (which deals with provisions as to applications for winding up), or

(b) the official liquidator [Sec. 440(1)].

Where a supervision is made, the Court may appoint an additional liquidator or liquidators, or remove any liquidator at any time and fill any vacancy. The Court may also appoint the official liquidator as an additional liquidator or to fill any vacancy. The Registrar is also given power to apply to the Court for the removal of a liquidator and the Court may do so (Sec. 524). The liquidator appointed by the Court will act as a voluntary liquidator (Sec. 525). In a voluntary liquidation brought under the Court's supervision, the liquidator's remuneration cannot be increased.

A liquidator appointed by the Court has the same powers, is subject to the same obligations, and in all respects stand in the same position, as if he had been duly appointed in accordance with the provisions of the Companies Act with respect to the appointment of liquidators in voluntary winding up (Sec. 525).

CORPORATE SOCIAL RESPONSIBILITY AND THE AVIATION INDUSTRY:

Corporate Social Responsibility (CSR) is a form of corporate self-regulation integrated into a business model. Ideally, CSR policy would function as a built-in, self-regulating mechanism whereby business would monitor and ensure their adherence to law, ethical standards, and international norms. Business would embrace responsibility for the impact of their activities on the environment, consumers, employees, communities, stakeholders and all other members of the public sphere.

Aviation industry having a massive global economic impact of approximately US $ 2,960 billion, employing 29 million people worldwide like any other industry in the market, cannot escape the discussion of corporate social responsibility. The concept of aviation as a ‘public service’ has a negative impact on good service delivery and a secure well-trained workforce. There are two major concerns for the trade unions- participation in the development of prosperous enterprises guaranteeing secure jobs and to ensure that decent wages, terms and conditions and safe working practices are provided for. On the environment front, it also a duty on part of the companies to keep the green house gas emissions in check.

Looking at the present situation, the need of CSR in the aviation sector is even more felt than before. Though global aviation has recently been a lucrative investment target, this situation is changing fast with the difficult economic circumstances in which airlines and airports are currently operating. Companies are responding to their declining profitability by seeking to recoup their losses from other stakeholders in the industry.

When investments take place in emerging markets, the investors want to be sure that not only are the capital markets or enterprises with which they are investing, run competently but they also have good corporate governance. It is the ethical framework and the moral framework under which business decisions are taken. It is not surprising to see that airlines around the world have their very own ‘code of ethics’. It is important to investigate whether the airline industry is, by and large, acting in an ethical, socially responsible manner. Or is it that, given the current wave of liberalization, airlines are only acting in their own self-interest and answerable only to their shareholder base. There have been many big airline industries which have played an active part in fulfilling the corporate social responsibility like Jet airways, Go air, Indian Airlines etc which would be dealt in the main paper in detail.

Amongst all the remarkable changes that the business world has seen since 1990s, the emergence of concept of Corporate Social Responsibility is undoubtedly one of the most noteworthy changes. “Doing well by doing good” has become popular business mantra. The World Business Council for Sustainable Development in its publication “Making Good Business Sense” by Lord Holme and Richard Watt defined Corporate Social Responsibility as below stated:

“Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large.”

The responsibility of companies apart from making profit has been given extra emphasis in recent years

An Aviation sector enterprise can also fulfill its responsibility by catering issues such as rebates being provided to old citizens, holding free training camps for its employees to update them with the latest technology, entering into healthy negotiations with the government on various debatable issues in the aviation sector and speedy redressal of claims made against the enterprise. There have also been attempts made by various aviation industry players to fulfill their responsibility by opening of various educational institutions, health care centers, sports development and social cultural activities

Aviation as a sector is booming in India today. It caters to not only the so called high class people of the society but also the middle class people. It is in need of this that the responsibility of the aviation sector has increased further. Aircraft acquisitions are happening at a pace that was unexpected even in the wildest of imagination a couple of years back. There are also incidences of cartelization of Airline Companies in India leading to price rise owing to which the MRTP Commission has been forced to enquire into the matter. It has now become the need of the hour to address issues of social responsibility attached with catering services to the consumers.

<u>Analysis of CSR Initiatives by Indian Aviation players</u>

Airlines industry in India has seen a lot of twists and turns. Hike in fuel prices were of major concern. The following are the initiatives taken by the key important players in the Indian Airlines Industry.

Jet Airways (Jet Lite): An airline that has pioneered concepts like Through-Check-in, City Check-in, Web and Kiosk check-in, SMS check-in, automated tickets at travel agency locations, e-ticketing, JetMobile and the unique five-tier frequent flier programme JetPrivilege in India. Jet Airways commenced its operations in May 1993. Jet Airways, in 1998 launched its Yellow Rose campaign . Jet Airways is involved in community service by activities like Blood Donation, relief efforts for earthquake , tsunami, Magic-Box Contribution , Eco-friendly Napkin Cords , and Flights of Fantasy Programme . Recently Jet Airways was in news for sacking 1,900 probationary and temporary workers to overcome the slowdown that hit the aviation sector as a result of which it was suffering daily losses of Rs 10 crore immediately a day after the alliance with Kingfisher. However, followed by the protests from various sectors, the decision was changed and the employees were reinstated.

Kingfisher (Kingfisher Red – formerly Deccan): It is one of the prominent Airlines in India managed and maintained by the famous conglomerate UB Group (Vijay Mallya), which has majority business of manufacturing spirit and alcohol. UB Group as a conglomerate claims to be a silent crusader in the field of community service and has over the years been endeavoring to emerge as a socially responsible corporate citizen. CSR activities by UB Group includes a super specialty hospital - Mallya Hospital at Bangalore where subsidized health care is given to the under privileged class of society by providing a general ward which is reserved for them. In the field of education, the Group has assisted in the setting up of the Mallya Aditi International School. A certain number of seats are reserved for the economically backward strata of society whose education is subsidized by the UBGroup.

Air India (Indian Airlines)

Indigo: InterGlobe Enterprises is a diversified international corporation with business interests in varied areas of tours and travels. One of its initiatives is the low-cost domestic airline services in India . There were no links available as to the company’s CSR activities.

Go Airlines: Go Airlines (India) Pvt Ltd is the aviation foray of the Wadia Group . The airline operates its services under the brand GoAir. GoAir launched its operations in November 2005. Wadia Group uses the word ‘philanthropy’ for its CSR activities. Philanthropy by Wadia group includes construction of five gardens in Mumbai between 1908 to 1956. Further there are hospitals in Mumbai and college in Pune. Sir Ness Wadia Foundation, a charitable trust set up in 1969 has worked for rehabilitation of Latur earthquake victims, and scholarship for disabled in draught relief.

SpiceJet: SpiceJet stated its operation in 2005 as a low-cost airline in India.

In the year 2006, Air India received The Galileo Express Travel World Awards Special Category (CSR) for its CSR initiatives in the areas of environmental conservation, social welfare, education and community development amongst others .

Golden Peacock

CSR Initiatives by International Aviation players

Virgin Airlines: Virgin Airlines' CEO, Sir Richard Charles Nicholas Branson, influenced by the Al Gore's explanation of consequences of climate change, 'an inconvenient truth' has pledged to plough 100% of the profits from his transport, rail and aviation companies over the next 10 years into bio-fuel research. That is around $3 billion. It has also launched a competition, the Virgin Earth Challenge for which he is offering $25 million to the person who develops, between now and 2012, an effective and sustainable process for reducing greenhouse gases .

EADS

As a global company, we share the principles of and abide by the Universal Declaration of Human Rights, the International Labour Organization Declaration on Fundamental Principles and Rights at Work, and the Rio Declaration on Environment and Development. To commit further, in 2003, we became a signatory of the UN Global Compact1, which lays down nine principles in the area of human rights, labour and the environment, and we are acting to ensure that those principles are embedded in our strategies, culture and day-to-day operations. In the future, we shall be participating in Global Compact initiatives and programmes in different countries.

MODULE II

MERGERS, ACQUISITIONS & JOINT VENTURES IN AVIATION

HISTORY OF AVIATION MERGERS AND ACQUISITIONS

Most of the mergers and acquisitions are an outcome of the favorable economic factors like the macroeconomic setting, escalation in the GDP, higher interest rates and fiscal policies. These factors not only trigger the M & A process but also play an active role in laying the mergers and acquisition strategies between bidding and target firms. The history of mergers and acquisitions can be traced back to the 19th century which has evolved in different phases mentioned as under:

From 1897 – 1904

During this period merger took place between the firms which were anti-competition and enjoyed their dominance in the market according to their productivity in sectors like electricity, railways, etc. Most of the mergers during this period were horizontal in nature and occurred between the steel, metal and construction industries.

From 1903 – 1905

Most of the mergers which took place during the first phase were considered as unsuccessful for not being efficient enough to attain the required competence. The crash was stimulated by the decelerating of the world's financial system in 1903, which was followed by a stock market collapse in 1904. During this phase the authorized structure was not encouraging either. Later the apex judiciary body issued its directive on the anti-competitive mergers stating that they could be de-merged by implementing the Sherman Act.

From 1916 – 1940

Unlike the preceding phase, this period concentrated on mergers between oligopolies, rather between anti-competitive firms. The mergers and acquisitions process was triggered by the financial boom which was seen after the World War I. The expansion further lead to developments in the fields of science and technology and the emergence of infrastructure firms which provided services for required growth in railroads and transportation by automobiles. The government strategies laid in 1920s made the corporate ambiance supportive enough for firms to work in harmony. Financial institutions like government and private banks also played a significant part in aiding the mergers and acquisitions process.

The mergers which occurred during 1916-1929 were horizontal or multinational in nature. Most of these industries were the manufacturers of metals, automobile tools, food commodities, chemicals, etc.

This phase ended in 1929 with a massive decline in stock market followed by great depression. However, the tax exemptions in 1940s encouraged the conglomerates to involve themselves in M & A activities.

From 1965 – 1970

Most of the mergers from 1965-70 were horizontal mergers and were triggered by elevating stock and interest rates, and stern implementation of anti-trust rules and regulations. During this phase the bidding companies were small in size and fiscal strength than the target companies. These kinds of mergers were sponsored by equities, thereby eliminating the roles of banks which they actively played in investment activities earlier.

In 1968, the Attorney General decided to break the multinationals which resulted in the end of merging activities after than. The decision was triggered by the inefficient performance of the multinationals. But 1970s saw the emergence of mergers which made their mark by performing effectively. Some of them were INCO merging with ESB, OTIS Elevator with United Technologies and Colt Industries with Garlock Industries.

From 1981 – 1989

This phase saw the acquisition of the companies which were much bigger in size as compared to the firms in previous phases. Industries like oil and gas, pharmaceuticals, banking, aviation combined their business with their national and international counterparts. Cross border buyouts became regular with most of them being unfriendly in nature. This phase came to an end with the introduction of anti acquisition laws, restructuring of fiscal organizations and the Gulf War.

From 1992 till present

This period was stimulated by globalization, upsurge in stock market boom and deregulation policies. Major mergers were seen taking place between telecom and banking giants out of which most were sponsored by equities.

There was a change in the attitude of the industrialists, who opted for mergers and acquisitions for long term profitability rather than short lived benefits. Promising economic trends, investments by corporate and revised government policies motivated the participation of many conglomerates to contribute in the acquisition trend.

Therefore, we can conclude that as long as business entities exist and the economic factors are favorable, the trend of mergers and acquisitions will continue.

INTRODUCTION TO MERGERS AND ACQUISITION

Introduction

An entrepreneur may grow its business either by internal expansion or by external expansion. In the case of internal expansion, a firm grows gradually over time in the normal course of the business, through acquisition of new assets, replacement of the technologically obsolete equipment and the establishment of new lines of products. But in external expansion, a firm acquires a running business and grows overnight through corporate combinations. These combinations are in the form of mergers, acquisitions, amalgamations and takeovers and have now become important features of corporate restructuring. They have been playing an important role in the external growth of a number of leading companies the world over. They have become popular because of the enhanced competition, breaking of trade barriers, free flow of capital across countries and globalization of businesses. In the wake of economic reforms, Indian industries have also started restructuring their operations around their core business activities through merger, acquisition and takeovers because of their increasing exposure to competition both domestically and internationally.

Mergers and acquisitions (M & As) have been a very important market entry strategy as well as expansion strategy. This present era is known as competition era. In this era companies, to avoid the competition, go for merger, and enjoy sometimes monopoly. Corporate India is waking up to the new millennium imperative of mergers and acquisitions in a desperate search for a panacea for facing the global competition. This is hardly surprising as stiff competition is, in a sense, implicit in any bid to integrate the national economy with the global economy. The ongoing process of liberalization has exposed the unproductive use of capital by the Indian corporate both in public and private sectors. Consolidation through mergers and acquisitions (M & As) is considered one of the best ways of restructuring structure of corporate units.

The concept of mergers and acquisitions is very much popular in the current scenario, so it is significantly popular concept, after 1990s, where India entered in to the Liberalization, Privatization and Globalization (LPG) era. The winds of LPG are blowing over all the sectors of the Indian economy but its maximum impact is seen in the industrial sector. It caused the market to become hyper-competitive. As competition increased in the economy, so to avoid unhealthy competition and to face international and multinational companies, Indian companies are going for mergers and acquisitions. Basically, a merger involves a marriage of two or more entities. Merger is defined as blending of two or more entity into a single entity. The shareholders of each blending entity will become the substantially the shareholders in the entity which is to carry on the blended entity.

Concept and Definition

Mergers

Merger is defined as combination of two or more companies into a single company where one survives and the other lose their corporate existence. The survivor acquires the assets as well as liabilities of the merged company or companies. A merger is a combination of two companies where one corporation is completely absorbed by another corporation. The less important company losses its identity and becomes part of the more important corporation, which retains its identity. A merger extinguishes the merged corporation and the surviving corporation assumes all the right, privileges, and liabilities of the merged corporation. A merger is not the same as a consolidation in which two corporations lose their separate identities and unite to form a completely new corporation.

A merger is a combination of two or more businesses into one business. Laws in India use the term 'amalgamation' for merger. The Income Tax Act,1961 [Section 2(1A)] defines amalgamation as the merger of one or more companies with another or the merger of two or more companies to form a new company, in such a way that all assets and liabilities of the amalgamating companies become assets and liabilities of the amalgamated company and shareholders not less than nine-tenths in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company.

According to the Oxford Dictionary the expression merger or amalgamation means "Combining of two commercial companies into one" and "Merging of two or more business concerns into one" respectively. A merger is just one type of acquisition. One company can acquire another in several other ways including purchasing some or all of the company's assets or buying up its outstanding share of stock.

In a merger there is usually a process of negotiation involved between the two companies prior to the combination taking place. For example, assume that Companies A and B are existing financial institutions. Company A is a high street bank with a large commercial customer base. Company B is a building society or similar organisation specializing in providing home loans for the domestic market. Both companies may consider that a merger would produce benefits as it would make the commercial and domestic customer bases available to the combined company. There will obviously be some complications and difficulties involved but there are also some obvious potential synergies available. For example, company B might be able to use its home loans experience to offer better deals to potential and existing mortgage customers of company A. The two companies may decide to initiate merger negotiations. If these are favorable, the outcome would be a merger of the two companies to form a new larger whole.

Acquisition:

Acquisition in general sense is acquiring the ownership in the property. Acquisition is the purchase by one company of controlling interest in the share capital of another existing company. This means that even after the takeover although there is change in the management of both the firms retain their separate legal identity.

Peter F Drucker gives five successful rules for Mergers and Acquisitions:

i) Think what you can contribute to the business it is buying not what the acquirer company will contribute to the acquirer.
ii) Common core of unity: The two business must have a common either markets or technology.
iii) Temperamental fit: No acquisition works unless people in the acquiring company respect the product, the markets and the customers of the company they acquire.
iv) Within a year or so the acquiring company must be able to provide top management for the company it acquires.
v) Within the first year of a merger, it is important that a large number of people in management groups of both companies receive substantial promotion across the line that is from one of the former companies to the other.

In an acquisition the negotiation process does not necessarily take place. In an acquisition company A buys company B. Company B becomes wholly owned by company A. Company B might be totally absorbed and cease to exist as a separate entity, or company A might retain company B in its pre-acquired form. This limited absorption is often practiced where it is the intention of company A to sell off company B at a profit at some later date. In acquisitions the dominant company is usually referred to as the **acquirer** and the lesser company is known as the **acquired**. The lesser company is often referred to as the **target** up to the point where it becomes acquired. In most cases the acquirer acquires the target by buying its **shares**. The acquirer buys shares from the target's shareholders up to a point where it becomes the owner. Achieving ownership may require purchase of all of the target shares or a **majority** of them. Different countries have different laws and regulations on what defines target ownership.

Acquisitions can be **friendly** or **hostile**. In the case of a friendly acquisition the target is willing to be acquired. The target may view the acquisition as an opportunity to develop into new areas and use the resources offered by the acquirer. This happens particularly in the case of small successful companies that wish to develop and expand but are held back by a lack of capital. The smaller company may actively seek out a larger partner willing to provide the necessary investment. In this scenario the acquisition is sometimes referred to as a **friendly** or **agreed** acquisition. Alternatively, the acquisition may be **hostile**. In this case the target is opposed to the acquisition. Hostile acquisitions are sometimes referred to as **hostile takeovers**.

One tactic for avoiding a hostile takeover is for the target to seek another company with which it would rather merge or be acquired by. This third company, if it agrees, is sometimes referred to as a **white knight**, as it 'comes to the rescue' of the threatened target.

In hostile takeovers the acquirer may attempt to buy large amounts of the target's shares on the open market. The problem with this action is that the target's share price will tend to increase in value as soon as any large-scale purchases are detected. In order to minimize share price rises, the acquirer may attempt to buy as much stock as possible in the shortest possible time, preferably as soon as the markets open. This practice is sometimes referred to as a **dawn raid**, as it attempts to take the market (insofar as is possible) 'by surprise'. In both friendly and hostile takeovers the decision on whether or not to sell shares in the target lies with the shareholders. If all or a large proportion of target shareholders agree to sell their shares, ownership will be transferred to the acquirer. Shareholders generally will agree to a merger if they are recommended to do so by the board of directors and if they stand to make a profit on the deal. The acquirer may offer either cash or its own shares in exchange for target shares. Cash transactions offer shareholders an immediate potential profit, whereas shares offer a longer-term investment. Share transactions tend to be more attractive to shareholders in a buoyant market as the value of the shares is likely to increase more rapidly than in a stagnant market.

Amalgamation

Halsbury's laws of England describe amalgamation as a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertaking.

Consolidation

Consolidation is known as the fusion of two existing companies into a new entity in which both the existing companies extinguish. Thus, consolidation is mixing up of the two companies to make them into a new one in which both the existing companies lose their identity and cease to exist. The mixes up assets of the two companies are known by a new name and the share holders of two companies become shareholders of the new company. . For example, merger 8of Hindustan Computers Ltd, Hindustan Instruments Ltd, Indian Software Company Ltd and Indian Reprographics Ltd into an entirely new company called HCL Ltd.

Takeover

A takeover generally involves the acquisition of a certain block of equity capital of a company which enables the acquirer to exercise control over the affairs of the company. Normally merger, amalgamation, acquisition, takeover are used interchangeably.

Rationale behind Mergers and Acquisitions

There are numerous reasons why one company chooses to merge with or acquire another.

Strategic Rationale:

The strategic rationale makes use of the merger or acquisition in achieving a set of strategic objectives. Mergers and acquisitions are usually not central in the achievement of strategic objectives, and there are usually other alternatives available. For example, company A might want to gain a foothold in a lucrative new expanding market but lacks any experience or expertise in the area. One way of over- coming this may be to acquire a company that already has a track record of success in the new market. The alternative might be to develop a research and development division in the new market products in an attempt to catch up and overtake the more established players.

Speculative Rationale:

The speculative rationale arises where the acquirer views the acquired company as a commodity. The acquired company may be a player in a new and developing field. The acquiring company might want to share in the potential profitability of this field without committing itself to a major strategic realignment. One way to achieve this is to buy established companies, develop them, and then sell them for a substantial profit at a later date. This approach is clearly high risk, even if the targets are analyzed and selected very carefully.

Management Failure Rationale:

Mergers or acquisitions can sometimes be forced on a company because of management failures. Strategies may be assembled with errors in alignment, or market conditions may change significantly during the implementation timescale.

Financial Needs Rationale:

Mergers and acquisitions are sometimes required for reasons of financial necessity. A company could misalign its strategy and suddenly find that it is losing value because shareholders have lost confidence. In some cases the only way to address this problem is to merge with a more successful company or to acquire smaller more successful companies

Political Rationale

The impact of political influences is becoming increasingly significant in mergers and acquisitions. In the UK between 1997 and 2002, the government instructed the merger of a number of large government departments in order to rationalize their operations and reduce operating costs. Government policy also encouraged some large public sector organizations to consider and execute mergers. These policies resulted in the merger of several large health trusts (hospitals financed by central government but under their own management control).

Difference between Mergers and Acquisitions:

Difference between Merger and Acquisition is subtle. It is true that the terms Mergers and Acquisitions are used in a way that it seems, both are synonymous. But, the fact is that, there is a slight difference in the two concepts.

In case of a Merger, two firms, together, form a new company. After merger, the separately owned companies become jointly owned and get a new single identity. When two firms get merged, stocks of both the concerns are surrendered and new stocks in the name of new merged company are issued.

Generally, Mergers take place between two companies of more or less of same size. In these cases, the process is called Merger of Equals. But, in case of Acquisition, one firm takes over another and establishes its power as the single owner. Here, generally, the firm which takes over is the bigger and stronger one. The relatively less powerful smaller firm loses its existence after Acquisition and the firm which takes over, runs the whole business by its' own identity. Unlike Merger, in case of Acquisition, the stocks of the acquired firm are not surrendered. The stocks of the firm that are bought by the public earlier continue to be traded in the stock market. But, often Mergers and Acquisitions become synonymous, because in many cases, the big firm may buy out a relatively less powerful one and thus compels the acquired firm to announce the process as a Merger. Although, in reality an Acquisition takes place, the firms declare it as a Merger to avoid any negative impression.

Another difference between Merger and Acquisition is that, when a deal is made between two companies in friendly terms, it is proclaimed as Merger, even in case of a buy out. But, if it is an unfriendly deal, where the stronger firm swallows the target firm, even when the target company is not willing to be purchased, then it is called an Acquisition.

Types of Mergers:

There are mainly four types of mergers based on the competitive relationships between the merging parties:

- Horizontal Mergers
- Vertical Mergers
- Conglomerate Mergers
- Reverse Mergers

Horizontal Mergers

Horizontal Mergers is a combination of two or more firms in the same area of business. Horizontal merger is a merger of two companies which are essentially operating in the same business. The main purpose of this merger is to obtain economy of scale in production by eliminating duplication of facilities, reducing of competition, reduction of cost, increase in share price and market segments. For example, the merger of ICICI Bank and Bank of Madura is a horizontal merger. But the merger of ICICI bank and Mahindra Tractor it is not a horizontal merger.

Horizontal mergers raise three basic competitive issues. The first is the elimination of competition between the merging firms, which, depending on their size, may be significant. The second is that the unification of the merging firm's operations may create substantial market power and could enable the merged entity to raise prices by reducing output unilaterally. The third problem is that by increasing concentration in the relevant market, the transaction may strengthen the ability of the markets remaining participants to co-ordinate their pricing and output decisions. The fear is not that the entities will engage in secret collaboration but that the reduction in the number of industry members will enhance co-ordination of behavior.6

Vertical Mergers

Vertical merger is a combination of two or more firms involved in different stages of production or distribution of the same product. It is a merger of one company with another having different stages of production / distribution process of the same product / service. In short the merging companies are engaged in different stages of production or distribution. The main objective is to increase profitability by the previous distributors. For example, ICICI Ltd With ICICI Bank is an example of vertical merger with backward linkage as far as ICICI Bank is concerned. 10

Vertical merger may take the form of forward or backward merger. When a company combines with the supplier of material, it is called backward merger and when it combines with the customer, it is known as forward merger. And their two benefits: first, the vertical merger internalizes all transactions between manufacturer and its supplier or dealer thus converting a potentially adversarial relationship into something more like a partnership. Second, internalization can give the management more effective ways to monitor and improve performance. Vertical mergers may also be anticompetitive because their entrenched market power may impede new business from entering the market.

Vertical integration by merger does not reduce the total number of economic entities operating at one level of the market, but it may change patterns of industrial behavior. Whether a forward or backward integration, the newly acquired firm may decide to deal only with the acquiring firm, thereby altering competition among the acquiring firm's suppliers, customers, or competitors. Suppliers may lose a market for their goods, retail outlets may be deprived of supplies, or competitors may find that both supplies and outlets are blocked. This raises the concern that vertical integration will foreclose competitors by limiting their access to sources of supply or to customers.

Vertical mergers may also be anticompetitive because their entrenched market power may impede new businesses from entering the market.

Conglomerate Merger

Conglomerate merger is an amalgamation of two companies engaged in different line of business, in other words, the merging companies are engaged in diverse business activities.6 For example, ICICI Ltd merger with Mahindra tractor and Reliance Industries Ltd. merged with Reliance Petroleum Ltd.

Conglomerate transactions take many forms, ranging from short term joint ventures to complete mergers. Whether a conglomerate merger is pure, geographical or a product line extension it involves firms that operate in 11 separate market. Conglomerate transactions ordinarily have no direct effect on competition. Conglomerate merger can supply a market or demand for firms thus giving entrepreneurs liquidity at an open market price and with a key inducement to form new enterprises. Conglomerate merger also provide opportunity for firms to reduce capital cost and overhead and achieve other efficiencies.

This type of merger may also reduce the number of smaller firms and increase the merged firm's political power, thereby impairing the social and political goal of retaining independent decision making centre guaranteeing small business opportunities and preserving democratic processes.

Reverse Merger

Reverse merger is a merger of an ordinary merger, achieved the same general industry but in the same line of business. In case of a reverse merger a healthy company merges into a financially weak company and the former company is dissolved. For example the merger of machine tool manufacturer with the manufacturer of industrial conveyor system.

The principal change the name of the company to the name of their company and elect their nominees to the board of directors. A private company merged with an existing public company or a subsidiary of a public company. In a reverse merger an operating private company merges with a public company which has no assets or known liabilities.

CHAPTER III: MERGERS AND ACQUISITION: PROCEDURES

Merger and Acquisition Process is a great concern for all the companies who intend to go for a merger or an acquisition. This is so because, the process of merger and acquisition can heavily affect the benefits derived out of the merger or acquisition. So, the Merger and Acquisition Process should be such that it would maximize the benefits of a merger or acquisition deal. The Merger and Acquisition Process can be divided in to some steps. The stepwise implementation of any merger process ensures its profitability.

Notifying the Competition Authority:

In accordance with section 18(1) of the Competition Act 2002, each of the undertakings involved in a proposed merger or acquisition shall notify the Authority in writing within 1 month of the conclusion of the agreement or the making of the public bid.
Notifications are made on the Authority's Notification Form Undertakings are encouraged to make a joint notification, though they are not obliged to do so. Where undertakings do make separate notifications, the "appropriate date" from which the merger review procedure commences, as defined in section 19(6) of the Act, shall be the date of receipt of the last notification (Section 19(8) of the Act). In the situation where one of the parties, which should have notified, fails to notify, the appropriate date is the latest date by which the non-notifying party could have notified on time, i.e. a month after the agreement was concluded. For the purposes of establishing the "appropriate date" referred above, the authority should receive a notification within the reasonable

working hours. In addition to the hard copy, the Notification Form and as many of the other notification documents as are capable of being supplied electronically should be so supplied.
A notification unaccompanied by the prescribed fee will be invalid, and the notifying parties will be so informed as soon as possible. The filing fee may also be paid in electronic format. In such cases, the furnishing of the fee will render the notification valid and the “appropriate date” will be the date of receipt of the fee.

Preliminary Assessment:

This step deals with assessing the market value of the target company. In this process of assessment not only the current financial performance of the company is examined but also the estimated future market value is considered. The company which intends to acquire the target firm engages itself in a thorough analysis of the target firm's business history. The products of the firm, its' capital requirement, organizational structure, brand value everything are reviewed strictly.

Upon its receipt by the Authority, the notification will be assessed to ensure that

- it is a merger or acquisition within the meaning of section 16 of the Act,
- to consider, where appropriate, whether it is a media merger within the meaning of section 23(10) of the Act and
- to confirm that all requisite information has been furnished.

Where the Authority considers that the notified transaction is not a merger or acquisition within the meaning of the Act, it will so inform the notifying parties as soon as possible. Where a notified transaction does not amount to a merger or acquisition, then it and the filing fee will be returned to the undertakings involved.

In addition to the requirement to notify the Authority in writing, section 18(1) and (3) of the Act require the undertakings involved to provide “full details” of the proposed merger or acquisition. Where full details are not provided, the Authority will reject the notification. The appropriate date shall be the date that the undertakings involved submit full details to the Authority.

Where the Authority considers that the notified merger is a media merger, it will within 5 days of receipt of the notification forward a copy to the Minister and inform the undertakings involved that it considers the merger to be a media merger.

Publication

Within 7 days from the date of receipt of the notification stating the name of the undertaking involved and the reference number of the transaction, contact details, business activities and third party notices, if any, the Authority will publish notice of it on its website barring certain exceptions under Section 18 of the Competition Act 2002.

The Authority may make a written requirement upon any one or more of the undertakings involved to provide further specified information within a specified time period.

Proposal

Before the expiry of 1 month from the appropriate date (as defined in the Act), the Authority may enter into discussions and the undertakings involved may make proposals to the Authority with regard to the manner in which the merger may be put into effect or to the taking, in relation to the merger or acquisition, of measures which would ameliorate any effects of the merger on competition.

Determination to Put the Mergers & Acquisitions into Effect:

Having considered the information provided and all submissions received, the Authority, if it forms the opinion that the result of the merger or acquisition will not be to substantially lessen competition in markets for goods and services in the State, will determine that it may be put into effect. The Authority will then, within 1 month after the appropriate date (as defined in the Act), or within 45 days inform the undertakings involved and any other undertakings or third parties who have made submissions, that it has so determined. On the date of the determination, the Authority, in addition to informing the undertakings involved, will publish notice of the making of the determination on its website. The Authority will publish the text of its determination on its website at the earliest possible date thereafter (and in any event, no later than two months from the date of the determination), after allowing the undertakings involved a number of days to indicate whether certain information in the determination should be redacted on the grounds of constituting a business secret.

Investigation Phase:

Where, having considered the information provided and all submissions received, the Authority is unable on the basis of the information before it to form the view that the result of the merger or acquisition will not be to substantially lessen competition in markets for goods and services in the State, the Authority will make a determination to carry out a full investigation. The Authority, within 1 month after the appropriate date will inform the undertakings involved and any other undertakings or third parties who have made submissions that it intends to carry out a full investigation. Submissions must be received in writing within 21 days of the date of the determination to carry out a full investigation. Submissions should clearly indicate any information which should be treated as confidential.

If the Authority, within 8 weeks of the date of the determination to conduct a full investigation, is satisfied that the result of the merger will not be to substantially lessen competition, it will, without proceeding to make an assessment of the proposed merger or acquisition (“the Assessment”), determine that the merger may be put into effect, or may be put into effect subject to conditions. The Authority will inform the undertakings involved, on the same date, of its Determination.

Assessment of Investigation Submissions

If, having considered all submissions, the Authority is not satisfied that the result of the merger will not be to substantially lessen competition, it will, within 8 weeks of the date of the determination to conduct a full investigation, furnish its Assessment to the undertakings involved. This time period may be adjusted following consultation and agreement between the undertakings involved and the Authority. The Assessment will set out clearly the Authority's concerns regarding the effect of the proposed merger on competition in the relevant markets.

After the Assessment has issued, the undertakings involved will be afforded the opportunity to access the file in accordance with the criteria set out in its Procedures for Access to the File in Merger Cases.

Within 3 weeks of the delivery of the Assessment, the undertakings involved may respond in writing thereto.

During the phase 2 review period, but no later than 3 weeks after the furnishing of the Assessment, the Authority may enter into discussion and the undertakings involved may make proposals to the Authority Mergers and Acquisitions Procedures with regard to the manner in which the merger may be put into effect or to the taking, in relation to the merger or acquisition, of measures which would ameliorate any effects of the merger on competition.

Final Determinations

On completion of the phase 2 review period, the Authority shall make one of the following determinations:-

(i) that the merger or acquisition may be put into effect,
(ii) that the merger or acquisition may not be put into effect,
(iii) that the merger or acquisition may be put into effect subject to conditions specified by the Authority being complied with, including a condition requiring the merger or acquisition to be put into effect within 12 months after the making of the determination and will furnish to the notifying parties the written determination within 4 months after the appropriate date (as defined in the Act).

Contents of Authority's written determination

In every case, the Authority's final determination in regard to the proposed merger or acquisition will include a statement of the facts, a summary of the information, evidence and submissions considered by the Authority and the reasons grounding the determination.

Publication of the Authority's determination

The Authority will publish notice of its determination on its website on the same day as the determination is made. The Authority will publish the written determination on its website after allowing the undertakings involved an appropriate period to indicate whether certain information in the written determination should be redacted on the grounds of constituting a business secret.

MERGERS AND ACQUISITIONS IN INDIAN AVIATION INDUSTRY

In the present era of liberalization and globalization, questions relating to the impact of mergers and takeovers on the economy of a country, warrant our immediate attention. During the past few years, India has followed the worldwide trends in consolidation amongst companies through mergers and acquisitions. Mergers and industrial restructuring have raised important issues both for business decisions and for public policy information. The daily newspapers are filled with case studies of mergers and acquisitions, tender offers (both friendly and hostile), spin-offs and corporate restructuring, changes in ownership structures, units being hived off and struggles for corporate control.

Mergers are like a marriage in the romantic jargon. Usually there is a period of courtship leading to the joining of two or more separate entities into one, after which the parties hope to live happily ever after, i.e., to say a Merger is said to occur when two or more companies combine to form a new company Mergers in aviation industry are also very relevant to the present economy because it affects directly the life of large number of people who frequently use airway for commuting from once place to the other place. The direct affect involves the frequency of the number of flights being operated by different airlines in a specific route and the cost that has to be paid by the customer to avail such facility. Mergers in aviation industry would definitely affect both these concerns of the prospective or frequent customer.

Airline mergers and alliances can allow airlines to lower cost and enhance demand by rationalizing the combined networks, and expanding the scope of seamless service. On the other hand, airline mergers and alliances can reduce competition and enhance market power, especially on non-stop routes to and from hub airports. The relative balance of the efficiency benefits and the competition effects depends on a number of factors, including the degree of overlap in the airlines' networks prior to the merger.

The promotion and protection of competition in the airline industry requires attention to both competition and regulatory issues. In particular, competition in the airline industry could be preserved and enhanced through:

- Further liberalization of regulatory constraints on competition, especially at the international level, including for example, the application of international trade principles of transparency and non-discrimination within multilateral context;
- Attention to the mechanisms for investment in and allocation of scarce airport capacity including investment in new airports, expansion of existing airports and mechanisms for ensuring that facilities are available to entrants at key times;
- Careful review of proposals for mergers and alliances, careful use of remedies to offset anticompetitive effects and consideration of divestiture or separation in cases of dominance;
- Close review to frequent- flyer programs and other loyalty schemes;
- Careful control over predatory behaviour and other anti competitive practices.

Jet-Sahara Merger: Heralding the Consolidation in Civil Aviation Industry:

It seek to examine the significance of Jet–Sahara merger against the backdrop of liberalization and privatization of civil aviation sector. Having witnessed a tumultuous journey interspersed with legal hurdles owing to which it was held in abeyance, the resurrected merger has triggered the market driven consolidation of aviation industry. Secondly, it uncover the ramifications of this merger on the health of low cost carrier in the proposed paper. The Jet–Sahara combine will re-assert the leading private airline's supremacy in the Indian skies and empower it to fight the low fares offered by low cost carriers. This deal has erected a conspicuous entry barrier as evidenced by the changing dynamics of low cost carriers with Jet acquiring dominant market share and enhanced airport infrastructure.

Thirdly, it made an attempt to explore the legal underpinnings of this deal to understand the role of mergers and acquisitions in the aviation sector. This deal is saddled with monopolistic traces making Jet the largest player in Indian airspace and the sole private airline to possess international flying rights. (In the current scenario, Kingfisher has attained clearance from the civil aviation ministry to operate international flights courtesy the Kingfisher-Deccan deal). The MRTP Commission gave the green signal to deal silencing all analysts claiming abuse of dominance. The probe was in a way restricted as clauses relating to monopoly, mergers and acquisitions in the MRTP act had been deleted in 1991. With establishment of the new competition regime addressing legal concerns exhaustively, the aviation industry can expect stricter vigilance in future consolidation advances.

Fourthly, it undertakes an analysis of regulatory obstacles that have been exposed through this deal. The transfer of assets such as parking and landing slots were being governed by land lease agreements and couldn't change hands through merger. The civil aviation ministry settled the dust by charting guidelines regulating transfer of airport infrastructure in all merger schemes.

Project Finance in Airlines

In the last few years major structural and organizational changes have been occurring within the air transport industry. Major airlines have been consolidating their services by forming international alliances whilst a new generation of low cost carriers has entered the market. At the same time, a growing number of airports have been privatized which has allowed airport groups, which control a number of airports in different countries, to develop. In the era of globalization, the aviation industry is booming very much and low cost operating airlines are coming up and project financing or we can say that financing in the airlines or like mergers or take over of major carriers in aviation are taking place. If we take the example Kingfisher is a major airline and it took over the small and budget carrier Deccan airways, so many low cost airlines are coming up and investment in this field is very much as we have seen the changes in the recent decade that the purchasing power parity of a common man has increased many times folded, so for increasing demand in the aviation industry so many low cost airlines or we can say budget airlines came up and huge money is being invested in this field, if we look at the past few years only few airlines were there and they were even not permitted by the aviation ministry to fly internationally but now many private airlines are there which are flying internationally. Now financing of the airlines or venturing up the capital in starting the new airlines is booming up, every day we hear of some or the other airline coming up in the market, competition is so high that financing in the aviation sector or like in airlines is a new phenomenon which has been seen in the recent days. Project financing involves various aspects like, first of all the attention required as such the latest techniques in airport traffic forecasting, revenue and cost projection, airport charges regulation, project finance and risk assessment. Key market trends will be evaluated, including the growth in global airline alliances, low cost airlines and increasing concern over environmental issues, together with their potential implications for future airport growth. In the same decade airports have transformed from a public service to a value creator in a transport network. Deregulation of air transport markets has shown that the introduction of competition may have drastic impacts on network configurations of airlines, because of free route entry and exit; airlines will use their route networks to achieve traffic economies and maintain spatial monopolies in a competitive environment, so the major thing is that project finance in airlines is increasing day by day, economy is growing, as the number of growth of airports is also growing, so financing projects related to the aviation industry is seen as a profitable venture. Predatory Pricing is assumed, when an incumbent airline responds to market entry by greatly expanding capacity and low-fare seats. Summing up project finance in airlines is now a seen as a profitable venture as the market trends are changing in the developing country like India, so financing the airlines is also seen as a new phenomenon.

Air France and KLM Merger:

In September 2004, the boards of directors of KLM and Air France announced the merger of the two airlines forming Air France-KLM, the biggest airline in the world in terms of revenues. This paper investigates the effect of the merger on the stock price and operational performance of the merging firms, using three different methods outlined later. An analysis of mergers and acquisitions (M&A) in the airline industry is done to examine the effect that M&A generally has in this industry. While mergers and acquisitions are widely discussed in the economic literature, M&A in the airline industry are generally overlooked, despite their relevance for finance and their big impact on stakeholders of the airlines.

Factors that influence the success of the Air France-KLM merger

Firm size

The firm size has a negative impact on short-term and long-term AR, according to Moeller et al. (2004) and Franks et al. (1991). Dickerson et al. (1997) find the same results for operational performance, although they find that the firms in the 1st quintile (the smallest firms) perform worse than those in the 2nd and 3rd quintile. Although these papers do not directly provide an explanation for the negative correlation between firm size and AR, it is reasonable to assume this is due to the 'firm size effect'; the larger the firm, the harder it is to find investment opportunities that improve overall company performance significantly. Because Air France-KLM is in the 5th quintile when all airlines are ranked from small to big, the firm size might have a negative influence on the success of the merger in all 3 methods.

Method of financing

In many studies on the effect of mergers, a distinction is made between stock-financed M&A and cash-financed M&A. Healy et al. (1992), Fuller et al. (2002) and Heron and Lie (2002), among others, analyzed the difference in CAR and operational performance between these two ways of financing. On this subject, the literature does not seem to reach a single conclusion. Looking at the short-term stock price effect, Healy et al. (1992) find that cash-financed M&A outperform stock-financed M&A in terms of short-term CAR, especially when looking at the acquiring firms. An explanation could be that acquirers using cash take on more debt, for which they are rewarded by shareholders. Heron and Lie (2002) reach the same conclusion. Fuller et al. (2002), however, find that stock-financed M&A outperform cash-financed M&A.
Looking at the long-term stock price effect, significantly better results for cash-financed M&A are found by Abhyankar et al. (2005). The explanation they offer is that when an M&A is financed with stock, this is a signal that the stock price is too high. This explanation is consistent with the findings of Myers and Majluf (1984). Opposed to the Abhyankar et al. results, Franks et al. (1991) find no significant difference between the two methods of financing.
Two studies expand on the impact of the method of financing on long-term operational performance. Heron and Lie (2002) find that stock-financed M&A outperform cash-financed M&A, even though they find opposite returns when looking at the short-term CAR. Unfortunately,

they do not provide the reader with possible explanations. A different conclusion is reached by Ghosh (2001), who finds evidence that cash-financed M&A outperform stock-financed M&A, and uses the same reasoning as Abhyankar et al (2005).
Air France acquired KLM by offering 11 Air France shares and 10 Air France call options for 10 KLM shares. According to the majority of the studied literature, this might have a negative impact on the CAR and the operational performance of Air France-KLM.
However, since there is no unanimous conclusion, it is a weaker expectation than was the case for both CARs.

Mergers and Acquisitions in the airline industry

In 1978, deregulation of the airline industry started in the US to spread to the rest of the world in the following years. One consequence of this deregulation was the rise of low-cost carriers (LCCs) and increased competition. This triggered many airlines to merge in order to achieve economies of scale. This consolidation is thought to be crucial in an industry that is still fractioned. Notably, the top five European airlines had a combined market share of only 31% in 2008, four years after the Air France-KLM merger (Buettner and Burger, 2008).

It is surprising how little attention the specific area of airline mergers has received, especially compared to the number of studies addressing effects of M&A in general. Whereas most studies that do address this topic focus on problems related to Industrial Organization, especially market power and price levels, this paper focuses on financial performance. The papers that did focus on financial performance are discussed in the next section. How the possible factors of success relate to the Air France-KLM merger is discussed later.

Short-term stock price effect

As with M&A in general, the literature is fairly conclusive regarding the short-term stock price effect. Singal (1996), Knapp (1990), Slovin et al. (1991) and others report significant AR for target airlines and zero to slightly positive AR for acquiring airlines. Factors that are discussed include firm size, method of payment and overlap of cities serviced by the merging airlines.
Since mergers in the airline industry did not occur frequently before 1978, there was not enough data to analyze airline M&A until the end of the 1980s. One of the first to dive deeper into the airline industry from this point of view was Knapp (1990). Taking the period between 20 days before and 10 days after the merger announcement, he finds significant CARs for target firms of around 25% and significant CARs for acquiring firms between 6% and 12%. The author suggests that a possible explanation is the network overlap between acquirers and targets, but provides no evidence to support this.
An article that partly reaches the same conclusion when looking at the short-term stock price effects is Singal (1996). He finds significant CAR for target airlines of up to 22% when using a

period between 5 days before and 1 day after the merger announcement, and insignificant AR for acquiring airlines. This seems to confirm the research findings on M&A in general. Singal (1996), too, suggests that a high overlap in the airlines' network results to higher gains, and shows that the coefficient on route overlap is in fact positive, confirming the suggestions made by Kim and Singal (1993).

Slovin, Sushka and Hudson (1991) have the same expectations regarding the explanations for excess returns to target and acquiring airlines around merger announcements, which is that they are significantly positive for both but higher for target firms, and that market power is an important determining factor. While the former seems to be confirmed by their empirical analysis, the latter is not. The authors do indeed find significant CARs of 10.8% for target airlines and 5% for acquirers in the period from 4 days before the merger announcement to the day of the merger announcement itself. A satisfactory reason is not provided. Their tests on the influence of market power (of which overlap of network is a strong indicator) show that this does not have a significant impact on the AR. This could be due to the small sample size that is used and/or the fact that very small mergers are included. In the case of very small mergers, the market power of both parties is unlikely to change even when their networks overlap well, but this overlap could still have a positive effect on the AR. The effect of overlapping networks will in this case be neglected.

Long-term stock price effect

Unfortunately, there is no research done yet on the long-term stock price effect of mergers in the airline industry. The authors that researched the stock price effect looked only at the short-term effect. A predicted effect can still be derived from the existing literature, however, by combining the conclusions of various papers. Singal (1993) draws the important conclusion that the stock price and the operational performance are correlated in the short term. Based on this it can be assumed the long-term stock price is also correlated with the long-term operational performance. The literature on the long-term operational performance is discussed in the next paragraph and is used to support hypotheses that involve both the long-term operational performance and the long-term stock price.

Operational performance effect

Investigating the effect of mergers on the operational performance of the companies, researchers often focus on the higher market concentration caused by the mergers. The general theory is that a higher market concentration results in higher prices and higher profit margins, and thus higher returns on assets (RoA) and returns on equity (RoE). The effect of mergers on the RoA and RoE of airlines is not studied in the existing literature. However, market power is assumed to have a strong correlation with both metrics (Bruner, 2000). Therefore the outcomes found by the studies on the effect of mergers on the market power are used as an indication. Several papers, for example Jordan (1988), Slovin et al. (1991) and Kim and Singal (1993) study the effect of mergers in the airline industry on the market power of the merging companies and the profit margin.

Jordan (1988) finds that market concentration and market power of the merging airlines does not increase after the merger. A reason for this is that merging airlines terminate part of the created overlap on existing routes. However, Jordan does find that operating costs are lower after the merger, which is an indicator for increasing RoA and RoE, and that prices are also lower after the merger, which is an indicator for decreasing RoA and RoE.

As does Jordan (1988), Carlton et al. (1980) find that mergers in the airline industry do not have a significant effect on the market power of the merging airlines, and thus do not impact the long-term operational performance from this point of view. Their theory is that the higher a firm's market power, the higher the price level is and the higher the profit margin. They find that the product is superior after the M&A but that the price level remains the same.

An author that does find significant average improvement in profit margins is Merkert (2012). An important conclusion from his study is that the success of M&A in the airline industry is strongly influenced by firm size. This relationship seems to be stronger than is the case in mergers in other industries. Merkert (2012) argues that there is an optimal firm size, and that a merger hurts the profit margins if the merged firm becomes too big. The firm size is measured in terms of available seat kilometres (ASK) and the optimal firm size is 34-52 billion ASK.

Kim and Singal (1993) find that market power of merging airlines does increase after M&A. They provide evidence in the form of a significant increase in fares as a result of increased market power. A separate study by Singal (1993) supports these findings and shows that the stock price reaction anticipates on this increase in fares (see above). The increased market power and fares is considered to be an argument for airlines to merge. Possible determinants of the degree of increase are not discussed.

Factors that influence the success of the Air France-KLM merger

The literature on mergers in the airline industry provides little explanation around the drivers of success. Consensus is reached on the influence of market power, but not on firm size and overlap of network. All three factors are discussed in the following section.

Market power

All studies that are discussed above see market power as a critical determinant of success of M&A. They argue that increased market power leads to higher prices and higher profit margins, thus higher RoA and RoE. A possible weakness of the literature is that it does not explain if this relationship is linear, which is probably is not, and what the optimal market share is. It is obvious that the market share and the market power of Air France-KLM was greater than that of Air France and KLM separately. Because no optimal market share is given, the increased market share is considered to have a positive effect on the AR and the operational performance of Air France-KLM.

Firm size

As shown by Merkert (2012), firm size is an important factor for the success of an M&A in the airline industry. He argues that the optimal firm size is 34-52 billion ASK, and that airlines with a capacity of more than 200 billion ASK are too large to operate efficiently. Because Air France-KLM had a capacity of 201 billion ASK in 2004 and 215 billion ASK in 2005, the merger is expected to generate diseconomies of scale.

Overlap of network

There is a big overlap of the network of Air France and KLM. One reason for this is that the hubs of both airlines, Paris and Amsterdam respectively, are only 400 kilometres apart. Before as well as after the merger both airlines serviced many cities in Europe, North America and Asia, which creates an overlap and thus market power and higher profits (Singal, 1993). Termination of a big part of the overlap as suggested by Jordan (1988) is not applicable to Air France-KLM. The overlap of the network is expected to have a positive effect on both the CARs and the operational performance of Air France-KLM.

The Air France-KLM merger

Short-term stock price effect

For the short-term stock price effect for the Air France-KLM merger, the expectation was that the abnormal return (AR) of Air France would not have been influenced significantly by the merger. The expectation was that the AR of KLM would have risen significantly in the 5 days surrounding the announcement of the merger. As can be seen in table 2, the two parts of the first hypothesis are accepted based on the empirical research conducted. The AR on the stock price of Air France was on average 0.007% in the control period before the merger and - 0.875% in the (-2,+2) period, but the test statistic is -0.621 > -1.64. Because -1.64 (or 1.64) is the critical value for the two-sided test with a significance level of 10%, it can be concluded that the change was negative but not significant. The average AR on the stock price of KLM was 0.025% in the control period and 3.056% in the (-2,+2) period with a test statistic of 2.759, which makes the change significantly positive at the 1%-level. The combined effect, where the stock price of both firms is weighted by the value of the total assets, shows a positive effect on the average AR of 0.331%, which is small but significant at the 5%-level.

JOINT VENTURE IN CIVIL AVIATION SECTOR: EMERGING LEGAL ISSUES

The Indian Civil Aviation Sector is in for a major overhaul over the next few years. Major policy changes are taking place because of a shift in the mindset of the government from considering air travel as elitist to making it available for the common man. This has led to the liberalization of air travel services. The airport industry is going through an exceptional transformation that has driven the market towards increasing levels of competition. Additionally, major investment programs are required to meet the expected growth in air travel demand (particularly in some emerging regions, such as India). Nevertheless, governments and city airport authorities are becoming more reluctant to support airport projects, since they have major budgetary constraints.

The New Economic policy Reforms 1991 has paved way for almost all Indian industries to undergo a radical change. The traditional and restrictive Aviation industry is no doubt a part of it. In fact, Indian civil aviation had to immediately nod to liberalization due to its poor and pathetic financial numbers. Airline, being a service industry is facing intense competition after liberalization. As a result, the various airlines are engaged in consolidation, strategic alliance and privatization, with an aim of improving their competitive positions.

KEY PLAYERS IN INDIAN INDUSTRY

Airlines on International Routes

Air India is the national flag carrier airline of India with a network of passenger and cargo services worldwide. It is one of the two state-owned airlines in the country, the other being Indian Airlines. Air India has 44 world-wide destinations. The airline has been profitable in most years since its inception. In the financial year ending March 31, 2006, Air India has made a net profit of Rs.97 million; earned a revenue of Rs.87, 480 million - representing a growth of almost 15 per cent over the previous year.

Air Sahara is a privately owned airline operating scheduled services1 connecting all metropolitan centres in India. The airline was established on 20 September 1991 and began operations on 3 December 1993 with two Boeing 737-200 aircraft as Sahara Airlines. The uncertainty over the airline's fare has caused its share of the domestic Indian air transport market, from approximately 11% in January 2006 to a reported 8.5% in April. Sahara Airlines was rebranded as Air Sahara on 2 October 2000.

Indian is India's state owned primarily domestic airline, under the federal Union Ministry of Civil Aviation The Company was formerly known as Indian Airlines. On December 7, 2005 the company was rebranded as Indian as a part of a program to revamp the company image in preparation for an IPO. Former Indian Civil Aviation Minister, Praful Patel, announced Government of India's plan to merge Air India and Indian into one giant airline consisting of 130-140 aircraft.

Airlines that provide normal scheduled air transport of passengers and freight Jet Airways a "regular" airline which offers normal economy and business class seats. Jet Airways, along with Air Sahara, is the only airline which survived the dismal period of 1990 when many private airlines in India were forced to close down. Jet Airways operates both in domestic and international routes. The airline operates over 300 flights to 43 destinations across the world. It currently controls about 32% of India's aviation market.

Airlines on Domestic Routes

Spice Jet is a low-cost airline. Their marketing theme is "offering low", "everyday spicy fares" and "great guest services to price conscious travelers". Their aim is to compete with the Indian Railways passengers travelling in AC coaches.

Air Deccan is an airline based in Bangalore, India. It was India's first LCC (low-cost carrier)/no-frill airlines2, and as of May 2006, it connects 55 cities within India. Air Deccan has grown rapidly since it first started air operations in 2003, and despite its almost disastrous maiden inaugural flight (which caught fire), it continued to grow. The growing Indian economy and the increasing number of middle-class people in India have greatly helped its growth.

GoAir or the People's Airline, a low cost carrier promoted by The Wadia Group is a domestic budget airline based in Mumbai, India established in June 2004. It's a relatively small player as compared to other low cost airlines.

Kingfisher Airlines is an airline based in Bangalore, India. Services started on 9 May 2005, following the lease of 4 Airbus A320 aircraft. It initially operates only on domestic routes. The airline promises to suit the needs of air travellers and to provide reasonable air fares. Kingfisher are pushing for an amendment of the present Indian government rule which requires an airline to fly a minimum of five years on domestic routes before it can start flying overseas.

IndiGo Airlines is a new and a private domestic airline based in India. IndiGo placed an order for 100 Airbus A320 aircraft during the 2005 Paris Air Show. The total order was worth US $6 billion; one of the highest by any domestic carrier during the show. The new low-fare carrier has started operations from August 4, 2006.

LCCs are mostly no-frill airlines i.e. they not provide food, beverages or other amenities to passengers

Growth Potential of Aviation Industry

What drives the aviation dream is the growth potential, estimated to be 25 percent with domestic players like Indian Airlines, Jet Airways, Kingfisher Airlines, SpiceJet, Air Deccan, GoAir and Air Sahara carrying 25million passengers every year. In spite of the downturn, key players are ramping up to fight the battle.

Growth in aviation industry can also viewed from macro economic perspective. A study by NCAER3 pointed out that one per cent increase in GDP required one per cent increase in air passenger traffic and 1.3 per cent increase in air cargo traffic. In the first three years of the Tenth plan, the air transport has grown at an average rate of 7 per cent per annum as against the planned estimate of 5 per cent. During the year 2004-05, air transport witnessed a very high growth of 22 per cent in passenger traffic and 20 per cent in air cargo.

Growth in India's civil aviation sector, for many years stunted by bureaucracy and political interference, is now booming at an estimated 25 percent per year. The intense competition ushered in by new entrants — and the strategic response by existing players — will drive further market growth. This expansion is being fuelled by annual economic growth of about 8 percent, rising incomes, cash-rich middle class, a reformist government and an ambitious plan to modernize the country's aviation infrastructure.

The Indian aviation industry is growing at a rapid pace, thanks to air transport deregulation, emergence of new operators, lower fares and large untapped demand for air travel.

The New Delhi office of the Center for Asia Pacific Aviation (CAPA), a Sydney-based aviation consultancy, says airlines in India may be selling about 50 million tickets a year by 2010, compared with around 19 million now. Another study conducted by KPMG suggests that the air passenger traffic is likely to reach 100 million in 2009-10.

As per the National Council for Applied Economic Research, the main drivers of air traffic are economic upswing, concentration of population, industries and liberalization leading to higher propensity to travel. The spike in air passenger traffic is largely triggered by the emergence of low-cost carriers in the domestic sector. The penetration of low-cost carriers in small towns, coupled with exceptionally low airfares comparable with railway AC fares has raised the competition to a new level. India is the only country where the number of air travellers a year equals the number of rail passengers in a day.

The growth potential in this sector is further leveraged by the first-time flyers queuing up to fly.

The Government has also come up with some initiatives in the right direction which aids the growth of aviation industry such as strong political will and improved policy environment:

Electricity Act, Draft Maritime Policy, Draft Civil Aviation policy, ring fencing of funds earmarked for infrastructure, nomination of implementation authorities, urgency to bring about commercial viability, momentum of private participation, innovative financing concepts like
'Public Private Partnerships' and 'Viability Gap Funding'4 etc.

The aviation industry is almost an under penetrated market with total passenger traffic being only 50 million as on 31st Dec 2005 amounting to only 0.05 trips per annum as compared to developed nations like United States have 2.02 trips per annum. Air Cargo has not yet been fully taped in the Indian markets and is expected that in the coming years large no of players would have dedicated fleets The key challenge for Indian aviation companies is to convert strong traffic and revenue growth to profits for which yields need to stabilize.

<u>Civil Aviation: Before and After Liberalization</u>

Before Liberalization:-

The cost of travel in India was amongst the highest in the world. The two state-owned domestic and international carriers, Indian Airlines (IA) and Air India (AI) dominated the market until recently. Built on huge cost and as full-service providers they justified these high airfares.

Viability Gap Funding' – A scheme which is meant to reduce capital cost of projects by credit enhancement and to make them viable and attractive for private investments through supplementary grant funding.

With no competition from any front, the state-run airlines enjoyed a monopoly. From their position of strength, they pressurized the state machinery to obstruct foreign airlines from expanding flights to India and also to restrain the growth of private sector players. As a retaliatory measure foreign players hindered the growth of Indian airlines by not accommodating any deals with them. In the early 1990s, steps were taken to liberalise the aviation sector and the rest what we witness today is history.

After Liberalisation

From the consumers perspective; choice of airlines have increased, fares have reduced significantly, and increased routes is another big major advantages. From the airline perspective; Commercial freedom is the biggest advantage along with increased foreign investment. From the airport perspective; increased number of air passengers and aircraft contributing to increased revenue in form of landing charges and consumer spending at airport is the great advantage. All these factors have directly and indirectly contributed to the economy in form of increased tax revenues, increased employment opportunities and increased inflow of FDI, increased tourism etc.

Problems in Indian Civil Aviation

The most restricted industry faces serious setbacks even after liberalization and privatization. Infact such initiatives have caused new problems.

a. Infrastructure bottlenecks: There is hardly an airport with more than one runway. Also, none of the runways can handle wide bodies like the A380. There is serious shortage of parking bays. Ground facilities are hardly sufficient to process the current passenger volume. While the offer of cheap tickets and the convenience of choosing between different airlines and flight timings are luring domestic flyers, there are other issues that need attention. If one talks to regular flyers today one will come across endless tales of how flights circle above airports, waiting to land, or they are made to wait endlessly in aircraft because of the long queues of planes either waiting to take off or land.

b. Traffic Jam: Airport privatization is facing rough weather. The ground infrastructure of metro-airports is very poor. Delhi and Mumbai together handle around 60 percent of India's passenger traffic. It typically takes 10 to 15 minutes for any flight to land in Delhi or Mumbai airports. Under foggy conditions, it may go up to 40 to 45 minutes. It may be noted that each minute of flying over the airport burns around fuel worth Rs.1000

c. Taxation policy: The taxation policies of the Indian government are also adversely affecting airlines operations. The aviation turbine fuel (ATF) price in India, which is reportedly subject to 8 per cent excise duty, and a high sales tax averaging well above 25 per cent, is on the high side. Airlines in India have to spend 30 per cent of their operating costs on ATF while the international average is 10 to 15 per cent.

d. Productivity: The legacy carriers are replacing their high-cost labour with new blood which would result in lower wages as less senior people means lower wages. At the same time, low cost carriers will be maturing and with older work force comes higher salaries. The most difficult problem facing the legacy carriers will be the transition to higher productivity. Senior workers will be hesitant and it will be difficult tot change the culture. The low-cost carriers will face aircraft that are older. Older aircraft requires more maintenance and more time out of service as the longer maintenance cycles are more intense.

Reasons for Alliances & Joint Venture in Civil Aviation

The salient features that favored the alliances and joint ventures in airlines are as follows: Capital intensity, service orientation, Limited manufacturers, High level of regulation, low margins and tendency to consolidate and outsource.

a. Capital intensity: The modern jet aircraft are products of intensive research and commercial application and are hence very costly. This implies that airlines companies should have the ability to mobilise enormous resources for acquisition and maintenance of their fleets.

b. Service Orientation: As the basic aircraft gives little scope for product differentiation, airlines are harping on high level of on-time performance, wide network that offers better connectivity, better in-flight services, attractive frequent flyer's programme, superior lounge facilities etc. to attract passengers. Airlines are, thus, dependent on the skills of the flying crew and pleasant behavior of the cabin crew for attracting and retaining passengers.
   Legacy carrier - An airline revolving around a hub & spoke network and a corporate structure. Legacy Carriers mainly include:: First Class/Business Class , Lounges , Frequent Flyer Programs , Alliances Frills/Perks throughout the cabin (food, beverage, better service)

c. Limited manufacturers: Most of the aircraft are manufactured by two manufacturers: Airbus Industries and The Boeing Company. As a result, basic features like carrying capacity, speed, range and facilities offered are likely to be similar for same type of aircraft operated by different airlines.
d. High level of regulation: Operations of the air transport industry are governed by the agreements entered into between countries in which the aircraft are registered. These agreements prescribe the names of the carriers that can operate between the countries, the frequency, seating capacity and rights to pick up and discharge passengers. Countries have to enter into bilateral agreements for these rights. Government support is, therefore, essential for the survival of the airline industry.

e. High level of concentration: Although there were more than 700 airlines in the world, the top seven (in terms of revenue) accounted for 33% of the total tonne kilometre performed in 1996. Again, approximately 35% of the total volume of scheduled passenger, freight and mail traffic was accounted for by the airlines of the United States. On international services, about 18% of all traffic was carried by the airlines of United States.

f. Low Margins: Almost all the airlines are running under losses. If at all any airlines showed profits, it is only marginal. Generally any capital intensive industry would book low or negligible profits.

g. Tendency to consolidate: Faced with intense competition and falling yields, the major players in the industry are moving towards consolidation through block space arrangements, code sharing alliances and joint ventures. In 1996, six major alliances controlled 59% of the revenue, 56% of the fleet, 55% of employees and 60% of total tonne kilometer for the top 100 airlines in the world.

   Through alliances, the partners attempt to edge out marginal players on different routes.

   Adding to the salient features, the following reasons contributed for consolidation in Indian airline industry: Weak financials, high cost of operation, poor brand image, lower fleet capacity and inability for differentiation.

h. Block space arrangement - reservation of certain number of seats in oneairlines’ flight is reserved for sale of another airline
i. Code sharing - seats can be sold by two airlines bearing codes allotted to more than one airlines
j. Weak Financials: The Laws of supply and demand in economics were not working for civil aviation business. “In the law of economics, lower prices lead to increase in demand and in turn lead to higher revenues. In the airline business, there has been a reduction in fares resulting in an increase in demand for seats. But the industry does not experience a corresponding increase in revenues; in fact, the reverse is happening.” Cumulatively, the losses reported by various airlines exceeded Rs.2000 crores in 2006.

k. Declining Yield: Intense competition is leading to falling yields. This issue got compounded by the very high prices of aviation turbine fuel (ATF). Airlines are not able make up for the frequent and steep increase in prices of ATF through price adjustments. It is noteworthy to mention that ATF prices account for around 30 - 45% of an airline’s operating cost. Hefty taxes imposed by Central and State government is another reason for low margins. The additional service tax imposed on business class and first class passengers also affected custom from a sector that have been paying handsome prices.

l. High cost of Operation: The steep decline in fleet strength and the ageing fleet make cost of operations still costlier for Indian Airlines. Today, the average age of the Indian Airlines fleets over 17 years; these include fuel guzzlers like A 300 and B 737. With the new order by IA for 43 aircraft, the average age would fall to less than 8 years.

m. Poor Infrastructure: Air transport follows road transport case in India. Development of road infrastructure was not matching the production of cars. Similarly Airport infrastructure is far behind the acquisition of aircraft. Presently, there is increase in demand for air travel and this has stimulated the investments in airport infrastructure. Upgradations with huge investment are carried out at Delhi, Mumbai, Bangalore, Hyderabad, Cochin airport. Due consideration is given to smaller airports.

n. Poor brand image: Customer service and network are the main aspects of the product offered by airlines. Since it is a service industry, only the quality of service will ensure success in business. AI's product has suffered on these counts in the recent past due to which it has lost its business to other airlines.

o. Lower fleet capacity: AI's fleet size is only 26, which is significantly less when compared with other international airlines. British Airways has 256 aircraft while Singapore Airlines is having aircraft. Even after the merger between Air India and Indian, there will be only 112 flights in total. All other private carriers also don't have commendable fleet size to meet the growing demand. But almost all the airlines have ordered for aircrafts in big numbers. Fleet acquisition will be a successful only if there is access to adequate capital.

p. Inability for differentiation: Being a capital intensive industry, it is difficult for the airlines to differentiate in the aircrafts they run. Hence the differentiation has to be in service – with frills or no-frill service.

Strategic Alliance – The modern airline trend

Strategic alliances have been one of the most visible responses of airlines to the intense competition of recent years. The main objective of these alliances is to create competitive advantage for the partners by enabling them to complement each other's services and achieve substantial economies of scale, particularly in marketing and maintenance costs and largely retailing and corporate independence. Inter-airline alliances lead to many competitive advantages:

- Merging of commercial activities in terms of sale and passenger service
- Pooling of intercontinental routes and linking domestic routes
- Providing high quality services
- Giving preferential access to a long haul hub8 for feeder airline partners
- Joint ground handling and maintenance at airports
- Capturing market share
- Joint investments and operating expenditure agreements
- Merging of reservation systems
- Joint fare policy

- Code sharing
- Advantage of global status and transcontinental distribution on partners
- Generate economies and new opportunities
- Risk sharing

Hub –An airport or city in which an airline has a major presence and many flights to other destinations. Many carriers use the hub and spoke system to maximize profits by keeping the aircraft in the air as much as possible. Flights to the hub are many, and from there flights to many other destinations are scheduled.
Such alliances enable the airlines to break regional barriers and explore vast and hitherto untapped business opportunities. In the international front, the first major alliance was established in 1989 between KLM and North West Airlines. The 'Star' alliance was initiated in
1993 between Lufthansa and United Airlines. In 1996, British airlines and American airlines formed the 'One World' alliance. Airline merger permits airline that may be constrained by bilateral regulations to offer a global coverage (Agusdinata and de klein 2002).
In the domestic front, such alliances are going to shape the outlook of entire aviation industry. Jet airways and Air Sahara has set the prelude for alliance and mergers. In years to come there would be one or two alliances formed by merging or amalgamating small airlines like Air Deccan, Go Air, Indigo etc. and one national airline (merged entity between Air India and Indian). Kingfisher airlines is looking forward eagerly for such opportunities.

Strategic Initiatives in Civil Aviation
The Ministry of Civil Aviation has taken some serious steps after privatization which was actually pending for a long duration.
Revenue from Real Estate: All most all the airports, be it be Bangalore International Airport
(BIAl), Cochin international airport (CIAL) or Hyderabad International airport (HIAL) – all of them have unanimous decision to earn diversified revenue from their huge real estate land with them. The promoters of BIAL are planning to lease out a 300-acre corridor along the access road. CIAL expects to attract Rs.3, 500 crore of investment in real estate. It will lease some of its land, enter into joint ventures, and may even pick up equity in some projects. It is the same story for HIAL. All this flows from civil aviation ministry policies on airport infrastructure of 1997 and 2002.

Joint venture for support services: IA's joint venture on maintenance, repairs and overhaul is also being extended to take of the maintenance of air frame and other engineering services. IA has been offering a lot of ground handling operations for other airlines. In all 23 foreign airlines, including British Airways and Lufthansa, are provided ground handling services by IA in 1 stations. Some 25,000 third party flights are covered by these stations.
Alliance with low-cost carrier: Jet airways have acquired Air Sahara for $500 million. It is also trying for an alliance with Air Deccan - the largest low-cost carrier in the country. The alliance

would be on various fronts – sharing of engineering infrastructure, exchange of passengers when flights are cancelled, and combination offers and so on.
Merger by authoritative bodies: The Airports Authority of India (AAI) was formed after the merger of the International Airports Authority of India and the National Airports Authority by way of the Airports Authority Act (No.55 of 1994). It came into existence on April 1, 1995. The AAI is keen on establishing world-class airports in the country.

Consolidation approach: Despite competition, there seems to be camaraderie between the private airlines. Air Deccan has given one of its Airbuses to Kingfisher so that its pilots can train.
Also there are strategic alliances especially in sharing infrastructure at airports and inventory.
There are also reports about joint bidding for aircraft manufacturers so as to get a good deal.
Indian Airlines and Air India have decided to jointly tender for ground handling at the GMR Hyderabad International Airport (GHIAL). Singapore air terminal service (SATS) was selected by GMR as the JV partner with 49% share holding, while Air India and Indian Airlines both jointly hold the remaining 51%.
Perhaps one of the most published deals is stopping poaching of pilots from one other's airlines. As airlines in India find their niches (at home and abroad) the advantages of code-sharing and other joint market approaches will become clearer.

<u>Opportunities in 2007</u>
Indian aviation industry is optimistic to take up pleasant journey in 2007. Though almost airlines have exhibited losses in the past few years, still the industry seems lucrative both for the players and for the changing Indian consumers.

Reduction in Fuel bill: ATF accounts for 35-40% of the cost of an aviation company. Any drop in prices will spare losses. Oil prices have declined from the peak of US$ 78 per barrel. Now it is around US$ 76 per barrel.
More disposable income with the Indian population: IT revolution and earning youth in India are left with high disposable income. Also the LCC have targeted at the first class train travelers who don't mind paying a little extra thereby reducing journey time.
Funds pouring into the sector: Aviation is a capital-intensive business with long gestation. Both domestic and international carriers are in the full swing of expansion to meet the growing demand.
Unlike earlier days, investors are willing to pour in their funds in to this loss making but still but still optimistic sector. The players are adopting different funding strategies. For instance, SpiceJet announced it would raise about US$118.5 million by offering stake to potential investors which include Tata group companies, Texas pacific group ventures, Istithmar PJSC and Goldman Sachs.
In August 2006, Spice jet and Babcock & Brown Aircraft management (BBAM), along with a long term strategic partner Nomura Babcock & Brown Co (NBB), signed a sale-and –lease back agreement covering 16 brand-new Boeing 737-800/-900 ER aircraft valued at over US$ 1.1 bn based on the manufacturer's list prices.

Similarly Air Deccan had announced that it had entered into financial structure with a consortium of European banks for US$ 100 mn to be received in four tranches against the assignment of aircraft purchase contract through a special purpose company funded by consortium of European banks. Air Deccan has also issued equity shares to Investec bank (UK) on a preferential basis. Jet airways has successfully launched its IPO and several other airlines are to follow this route.

Own MRO units: Global players like Boeing and Airbus are collaborating to set up MRO units and aeronautical flight training centre in Nagpur with estimated investment of $ 185 mn. Not only airline carriers are pitching in this space. Even infrastructure developers like GMR group have business plans to set up MRO units. There is strong trend of outsourcing in this space. For instance two decades ago, about 85 percent of global engine maintenance was done in-house.
Now, this is reduced to 30 per cent. Locating MRO units in India saves time and resources.
Globally 25 percent of flight delays are maintenance related. A research by Hamco reveals that in India these are as high as 60 per cent.

Case of Air-India Limited

Air-India (AI) was set up on October 15, 1932, as Tata Airlines, the first scheduled airmail service in India. In July 1946, the company was converted into a public limited company and renamed as Air-India. By the end of 1947, Air-India International was launched for international services, with the participation of the Government of India. In 1952, the Planning Commission recommended nationalization of the air transport industry. Nationalization was effected on August 1, 1953 with the creation of two corporations, viz. Air-India for international services (as the nation's flag carrier) and Indian Airlines for domestic services.
The paid up share capital of AI as on 31st March, 1997 was Rs. 153.8crores and is wholly owned by Government of India.

Air India and Lufthansa Sign Strategic Alliance

Lufthansa and Air India have significantly improved their market leadership positions on India-Europe-USA routes with the Strategic Alliance agreement signed between Lufthansa & Air India. From 1st October 2004, Air India has been a partner of Lufthansa. Within the scope of an extensive agreement covering a far-reaching bilateral cooperation, Wolfgang Mayrhuber, Chairman of the Executive Board of Deutsche Lufthansa AG, and V. Thulasidas, Chairman & Managing Director of Air India, signed a Strategic Alliance agreement in Mumbai. The objective of the partnership is expansion of the offer of flights between Germany and India. All flights between the two countries are operated by the two airlines in code-sharing. New routes are added.
Through the cooperation in the area of frequent flyer programs, customers on flights of both airlines can collect and redeem miles for the respective programmes - Miles & More and Flying Returns.
Air India has been accorded the IOSA Audit Certificate by IATA which puts it in the league of a dozen Airlines conforming to quality standards required for joining Global Alliances.

India - Germany/ Europe and India-USA are very important markets for Air India which it plans to serve over Frankfurt in 10. IOSA (International Civil Aviation Organisation) – A specialized agency of the United Nations whose objective is to develop the principles and techniques of international air navigation.

IATA (International Air Transport Association) –

A trade association serving airlines, passengers, shippers, travel agents alliance with Lufthansa. In addition to the code-sharing between Germany and India, the code of Air India will also be bookable on Lufthansa connecting flights from Frankfurt to Berlin, Munich, Stuttgart and Düsseldorf to Amsterdam, Geneva, Zurich and Lyon as well as to Washington, Denver, Detroit, Chicago and Los Angeles.

This cooperation agreement results from a memorandum of understanding which the two carriers signed on 26th August 2003. In it, cooperation in the area of sales and marketing is also foreseen as well as cooperation in the medium term in other areas, for example, in the area of IT.

Lufthansa which was flying from Frankfurt to Delhi (once daily), Mumbai (once daily),
Chennai (once daily) and Bangalore (five times a week) as well as from Munich to Delhi (three times a week.) would fly further six weekly flights between Frankfurt and Mumbai as well as three weekly flights between Frankfurt and Delhi which are operated by Air India and can be booked with a Lufthansa code.

Air India served up to 33 destinations from Mumbai and Delhi, including, among others, Frankfurt, Chicago and New York. The fleet of Air India consists of 33 wide bodied aircraft and it had planned to add more to make its Los Angeles & Chicago flights daily. It has also planned to operate daily services between London and Mumbai & London and Delhi and link Bangalore with Frankfurt four times a week from March 2005.

The Lufthansa - Air India pact paves the way for joint development of air services on India-Europe-USA route.

Air India – Indian Airlines Merger

The Indian government has cleared the merger of two state-run carriers Air-India and Indian (Indian Airlines Ltd).Government will continue to be the sole owner of the merger entity and has made it clear that the public sector character of the merged airline would be maintained.

But the Government may look for IPO after getting approval of a committee consisting of Finance Ministry.

The merger of the two airlines would enable them to leverage their combined assets and capital better and build a strong and sustainable business. The potential synergies are expected to enhance the new combined airline’s profitability by over US$133 million per annum, or about four per cent, of their current combined assets. By 2010-11, when all the new aircraft ordered by the two carriers are inducted into the fleet, the merged entity’s employee-aircraft ratio would come be about 200:1, comparable with any major global airline. While Air-India has ordered 68
Boeing planes, Indian has finalized the acquisition of 43 Airbus aircraft.

According to the report submitted by Accenture, there will be no manpower rationalization as the consultancy has suggested ‘careful integration’ of manpower at various levels. It has also suggested a top-to bottom integration of the employees. It is proposed that the pay-scales be revised to bring parity in promotion procedures.

The merged entity of state-owned international and domestic carriers Air India and Indian - National Aviation Company Ltd - is now in the process of drafting the Scheme of Amalgamation under Section 391-94 of the Companies Act. This would pave the way for the integration of the two national airlines and their subsidiaries — Air India Express (Air India) and Alliance Air (Indian).

MODULE III

COMPETITION ISSUES IN AVIATION

OVERVIEW OF THE COMPETITION ACT 2002

What is Competition?

It is a situation in a market, in which sellers independently strive for buyer's patronage to achieve business objectives such as profits, sales or market share. It is the foundation of an efficiently working market system. Competition and liberalization, together unleash the entrepreneurial forces in the economy. Competition offers wide array of choices to consumers at reasonable prices, stimulates innovation and productivity, and leads to optimum allocation of resources.

Competition is not defined in law but is generally understood to mean the process of rivalry to attract more customers or enhance profit or both. Competition law deals with market failures on account of restrictive business practices in the market. Restrictive business practices can be of many kinds and include inter-alia agreements to restrict competition, cartelization, predatory pricing, tie-in sales, re-sale price maintenance, abuse of dominance etc.

The history of competition law is usually traced back to the enactment of Sherman Act in 1890 in the US. This act was directed against the power and predations of the large trusts formed in the wake of the Industrial Revolution where a small control group acquired and held the stock of competitors, usually in asset, and controlled their business. Gradually, competition law came to be recognized as one of the key pillars of a market economy. This recognition led to enactment of competition law in many countries, including developing countries, and the number now stands at around 105.

Need for Competition Law

Competition Policy

The past few years have been challenging for the economy and for businesses world over, making the task of policy makers even more daunting. India, in the pursuit of globalization responded by opening up its economy by removing controls and resorting to liberalization. In the light of this, the obvious need of the hour was that the Indian market be geared to face competition from within the country and outside. The financial crisis which gripped world strengthened the need and highlighted the importance of a strong and effective competition policy, a policy which would encourage markets to work well for the benefit of business and consumers, thereby increasing the country's economic fitness: markets characterized by effective competition makes firms innovate more, keep prices down for consumers and improved total factor productivity drives economic growth. These factors are all the more relevant given the financial challenges faced by the country. It is clear that ultimately, the way out of this crisis – for the financial sector and the wider economy – lies with competitive markets, backed up by a robust competition policy.

Competition policy is defined as those government measures that affect the behavior of enterprises and structure of the industry with a view to promoting efficiency and maximizing consumer/

social welfare. There are two components of a comprehensive competition policy. The first involves putting in place a set of policies that enhance competition or competitive outcomes in the markets, such as relaxed industrial policy, liberalized trade policy, convenient entry and exit conditions, reduced controls and greater reliance on market forces. The other component of competition policy is a law and its effective implementation to prohibit anti competitive behavior by businesses, to prohibit abusive conduct by dominant enterprise, to regulate potentially anti competitive mergers and to minimize unwarranted government/regulatory controls.

In the wake of economic liberalization and wide spread economic reforms introduced by India since 1991 and in conformity with the commitments made at the WTO, in October 1999, the Government of India appointed a High Level Committee (Raghavan Committee) on Competition Policy and Competition Law to advise a modern competition law for the country in line with international developments and to suggest a legislative framework, which may entail a new law or appropriate amendments to the MRTP Act. The Committee submitted its report to the Central government. The Central Government consulted all concerned including the trade and industry associations and the general public. The Central Government after considering the suggestions of the trade and industry and the general public decided to enact a law on Competition to replace the then existing competition law namely, the Monopolies and Restrictive Practices Act (1969) (the MRTP Act) which was primarily designed to restrict growth of monopolies in the market with a modern competition law in sync with the established competition law principles. As the first step towards this transformation, a new Competition Act, 2002 was enacted which received Presidential assent on January 13, 2003

Background to Indian Competition Act 2002

Government of India (GOI) had appointed a committee under the Chairmanship of Shri S.V.S. Raghavan in October, 1999 to examine The Monopolies and Restrictive Trade Practices Act, 1969 for shifting the focus of the law from curbing monopolies to promoting competition and to suggest a modern competition law. Competition Bill, 2001 was introduced in the Lok Sabha on 6 August, 2001 and was referred to Parliamentary Standing Committee for its recommendation. Pursuant to the recommendations of the committee, the Competition Act, 2002 [Competition Act] was enacted.

In an open market economy, some enterprises may undermine the market by resorting to anti-competitive practices for short-term gains. These practices can completely nullify the benefits of competition. It is for this reason that, while countries across the globe are increasingly embracing market economy, they are also re-enforcing their economies through the enactment of competition law and setting up competition regulatory authority.

In line with the international trend and to cope up with the changing realities India, consequently, enacted the Competition Act, 2002. Designed as an omnibus code to deal with matters relating to the existence and regulation of competition and monopolies, the Act is intended to supersede and replace the MRTP Act. It is procedure intensive and is structured in an uncomplicated manner that renders it more flexible and compliance-oriented. Though the Act is not exclusivist and operates in tandem with other laws, the provisions shall have effect notwithstanding anything inconsistent therewith contained in any other law.

Departure from the MRTP Act

In a significant departure from the letter and spirit of the MRTP Act, the Act hinges on the "Effect Theory" and does not categorically decry or condemn the existence of a monopoly in the relevant market, rather the use of the monopoly status such that it operates to the detriment of the potential and actual competitors is sought to be curbed.

- The earlier legislation, considered draconian in the changed scenario, was based on size as a factor, while the new law is based on structure as a factor, aimed at bringing relief to the players in the market.

- The Act empowers CCI to impose penalty on delinquent enterprises, whereas in the MRTP Act there were no provisions regarding such enterprises

- MRTP Act could only pass "cease and desist" orders and did not have any other powers to prevent or punish while the new law contains punitive provisions.

- MRTP Act was applicable to Private and Public sector undertakings only, whereas, the new Act extends its reach to governmental departments engaged in business activities.

- As regards agreements, compulsory registration has been done away with.

- The most path-breaking chapter in the Act has been the emphasis on Competition Advocacy that was not at all contemplated by the MRTP Act.

Objectives of the Act

I. To check anti-competitive practices
II. To prohibit abuse of dominance
III. Regulation of combinations.
IV. To provide for the establishment of CCI, **a quasi-judicial body** to perform below mentioned duties:

- Prevent practices having adverse impact on competition
- Promote and sustain competition in the market
- Protect consumer interests at large
- Ensure freedom of trade carried on by other participants in the market
- Look into matters connected therewith or incidental thereto.

ELEMENTS OF COMPETITION LAW

Typically, a modern competition law has three major elements:

- anti-competitive agreements
- abuse of dominance
- merger control

Anti-competitive agreements

Anti-competitive agreements are those, as the name suggests agreements that restrict competition. Usually, an agreement need not be formal or in writing or justifiable in a court of law necessarily to be dealt with under a competition law. Thus, an informal agreement to fix prices will be hit by provisions of competition law. Agreement between rivals or competitors is termed horizontal agreement. The most pernicious form of anti-competitive agreement is cartelization. When rivals or competitors agree to fix prices or share consumers or do both, the agreements are termed as cartel. Competition laws across the global take cartelization very seriously and there seems to be a convergence in law on dealing strictly with this scourge of competition.

Besides horizontal agreements, there can be anti-competitive agreements between producers and suppliers or between producers and distributors. These are referred to as vertical agreements. By an agreement with the supplier of the most important source of raw material or by having an agreement with the largest distribution channel, the producer forecloses the market to its rivals. Hence, vertical agreements too can undermine competition in the market.

The Competition Act, 2002, deals with anti-competitive agreements in section 3.The provisions specifically deal with cartels and distinguish between horizontal and vertical agreements. While horizontal agreements are dealt with under presumptive rule, i.e. appreciable adverse effect on competition is presumed, vertical agreements are dealt with on a rule of reason basis, i.e. appreciable adverse effect on competition needs to be proved by the Competition Commission of India.

In the US, anti-competitive agreements are dealt with in section 1 of the Sherman Act. In the UK, anti-competitive agreement is covered in Chapter I section 2. In the EU, these are controlled by re-numbered Article 81 of the Treaty of Rome. In Australia, anti-competitive agreements are covered in Part IV of the Trade Practices Act, 1974. In the Canada, Part VI Sec 45 covers anti-competitive agreements.

In the competition laws, anti-competitive agreements are declared to be void. While this is true in the US (where it is illegal), the same is true in the UK, Australia, Canada and also in India.

Most competition authorities rely heavily on leniency or amnesty programmes for detection of the cartels. A member of a cartel is usually granted immunity from criminal sanction (wherever it exists like in the US) and/or the penalty is either waived or reduced. Practically every major industrialized country has some kind of leniency programme and there seems to be a move towards having criminal sanctions for this offence. In India, the leniency programme is contained in section 46 and does empower the Commission to reduce the penalty. However, there are no criminal sanctions for cartelization in the Competition Act, 2002.

Monetary fines seem to be common in the competition laws of major countries.
Both in India and in UK, the fines can be upto 10% of the turnover. In the US, the fine is fixed at US$ 10 million for a company and US $ 350000 for a person under the Sherman Act, 1890!
In modern competition laws, in order to establish abuse of dominance or dominant position, it is first necessary to establish the dominance itself. Ever since the enforcement of section 2 of the Sherman Act in US began, economic analysis came to play an important role. This led to the development of certain key concepts in competition economics namely, market definitions. An enterprise's dominance can be in the relevant market which can be demarcate on the basis of the relevant product market and the relevant geographic market.
The relevant product market is the market constituted by substitute products or services. The relevant geographic market consists of neighboring areas or territories from which products can be supplied profitably at little above the current prices to the area under inquiry. For example, a major supplier of bananas with a large market share of, say, around 50% can be in a dominant position only if the other fruits are not substitutes. As a matter of fact, in one of the landmark cases in the European Union, a banana supplier claimed 6% market share in the fruit market but was found to have market share of 46% among banana suppliers. The European Court of Justice held that banana constituted the relevant product market on account of its non- substitutability by the toothless i.e. infants and old people.

Abuse of Dominance

Dominance is also referred to as market power which is defined as the ability of the firm to raise prices or reduce output or does both independently of its rivals, customers and consumers. The definition of dominance is broadly similar in the competition laws of several countries. When a firm acquires market powers, it can, and usually will, increase prices and reap monopoly profits since it has no fear of rivals or consumers. As and when price is increased or output is reduced by a firm having market power in a non-transitory manner, it is said to abuse its power. Since economists loathe monopoly for its failure to provide any benefits but certainty of its leading to loss of consumer welfare, competition laws also treat abuse of dominance as a restrictive business practice.
The laws of various countries show a lesser convergence while dealing wit abuse of dominance. One major difference seems to be in the need for proving the harm and injury on account of the abuse. There is also variation in what constitutes an abuse.
In the Competition Act, 2002, abuse of dominant position is dealt with in section 4 and the law presumes 5 kinds of abuses including, inter-alia, discriminatory pricing, unfair pricing, predatory pricing, denial of market access, etc. and prohibits such behaviour. Injury or harm is not required to be proved while dominance needs to be proved using rule of reason test after considering 27 4factors (including factors to be taken into account for market definition), economic as well as non-economic, stated in the law itself. This is in line with other jurisdictions. Once dominance is established and the dominant firm is found to be indulging in any of the five kinds of behaviour, law presumes such behaviour to be an abuse.

Some of the vertical agreements, namely, tie-in-sales, resale price maintenance etc. are treated under the provisions dealing with abuse of dominance in some jurisdictions since these can only be effective if resorted to by dominant firms.

: Indian Civil Aviation in the past seventy or so years has witnessed three different phases, starting from the initial private regime followed by years of nationalization and the recent era of deregulation. The current de- regularized system, with its inherent competition, has succeeded in providing better consumer services. On the other hand, this has posed several challenges to the competition policy framework, calling for a need to strike a balance between protecting the interests of consumers and hence ensuring free and fair competition.

Areas which need the attention of legal fraternity and policy makers include measures to combat abuse of dominant position, encompassing:

- Predatory pricing
- Denial of market access
- Loyalty Programmes
- frequent flyer programmes
- corporate discount schemes
- travel agents commission

At the first level the paper will focus on the issues relating to abuse of dominant position by airline operators and air navigation service providers. At the next stage an attempt will be made by the authors to examine certain practices adopted by the airlines such as predatory pricing, denial of market access and loyalty programmes which have an adverse effect on the competition in the industry.

This paper will analyze the position of law in India and the existing infirmities to it in this regard. The paper will draw insights from various international instruments like Chicago Convention, 1944, the International Civil Aviation Organization (ICAO) and International Air Transport Association (IATA) and de-regulation laws of various jurisdictions like USA, Australia, Mexico, Canada and European Union which are in consonance with the international law regime and the applicability of the same in the Indian scenario will be examined in detail.

Based on the above appraisal of the current scenario the paper will draw conclusions on the need of a comprehensive policy or the substitution of draft Civil Aviation Policy, 2000 that can assure a conducive competitive regulatory framework for encouraging entry and participation of private airlines and privately run airports with special reference to update policies, guidelines and other regulatory instruments to address recent changes

Merger Control

The third element of modern competition law is merger control. The Indian law uses the word combinations to cover acquisition of control, shares, voting rights and assets, and mergers and amalgamations. This is universally done ex-ant in all jurisdictions. The underlying logic is that it is much easier to stop a combination that is likely to undermine competition than to deal with the situation ex-post, after the damage has been done (which could have been prevented in the first place) and facing the possibility of de-merging, which can be cumbersome. The combinations are stopped or modified (including divestiture) to prevent unilateral action or collusive action. If the combining parties compete in substitute products, and the combination is likely to provide them with market power, it is likely that they will abuse such power. Therefore, such combinations can not be allowed to go ahead by the competition authorities. It is also likely that combination can result into fewer players in the market which can facilitate collusion that can seriously undermine competition. Therefore, even such combinations will not be allowed.

Combinations are usually divided into three categories. The first are horizontal combinations, which are between producers of substitute products and often raise serious competition concerns for obvious reasons. The second category is vertical combinations where the combining parties are at different stages or levels of production e.g. producer of cars merging with distributors. Such combination can in some cases lead to anti-competitive situation and will get a hard look by the competition authorities. The third category is conglomerate combinations where the combining parties are in unrelated businesses and usually do not raise competition concerns. Most of the jurisdictions that have merger control are similar in this regard.

One major difference in handling combinations is the requirement of notifications and having thresholds. Most of the jurisdictions in the world have mandatory merger control where the combining parties are compulsorily required to notify the competition authority. The list of countries having compulsory notification includes Argentina, Brazil, South Korea, Canada, France, Germany, Israel, Japan, South Africa, EU and US. Few countries have voluntary filing regimes where it is left to the discretion of the combining parties whether to notify the competition agency. According to the International Bar Association, the list of such countries in 2006 includes Australia, Chile, Costa Rica, Indonesia, New Zealand, Norway, Panama, UK and Venezuela. Since compulsory notification brings in greater certainty and reduces business risks associated with combining, most countries in the world have opted for compulsory notification.

Since compulsory notification tends to increase the workload of the competition authorities, most of the jurisdictions have sought to reduce their workload by having threshold limits, either in terms of value of assets or value of turnover or both. The Competition Act, 2002 also provides thresholds both in terms of assets as well as turnover. The threshold limits in the Indian law are relatively higher than most jurisdictions.

Under a compulsory notification regime, combinations taking place outside the jurisdiction also need to notify. If the combining parties do not have any effect on competition in markets within the concerned jurisdiction, the burden of imposing notification requirements would not be appropriate. Therefore, most of the jurisdictions having compulsory notification provide for further threshold limit in terms of domestic revenue generated by the combining parties. In effect, domestic nexus provides second level of threshold which would reduce the burden of both the combining parties as well as the competition agency.

The fourth element is competition advocacy. At the outset, it may be noted that advocacy is not always provided in the statute even in mature jurisdictions. And yet, all the mature jurisdictions display a singular focus on competition advocacy. Competition advocacy has been defined to "include all activities of a competition agency that are intended to promote competition apart from

those that involved enforcement of the competition law". The Competition Act, 2002 mandates the Competition Commission to promote competition advocacy, create awareness
and impart training on competition issues.

While enforcement of competition law is targeted towards commercial activities of private and public players, advocacy is targeted more towards the policy making powers of the government besides creating awareness. Therefore, it is often said, the law enforcement and competition advocacy complement each other.

The Indian competition law enables the government to seek non-binding opinion of the Competition Commission on competition policy. In the UK, all government offices are obliged since 2002 to assess the impact of legislation on competition.

The Office of Fair Trading, the UK competition authority, advises the regulators and the government on their regulatory impact assessments. In the US, the Federal Trade Commission has a competition advocacy programme since 1980s and has actively intervened in a number of sectors including on legislations.

<u>Competition Commission of India</u>

CCI, entrusted with eliminating prohibited practices, is a body corporate and independent entity possessing a common seal with the power to enter into contracts and to sue in its name. It is to consist of a chairperson, who is to be assisted by a minimum of two, and a maximum of ten, other members.

<u>Acts taking place outside India</u>

CCI has the power to enquire into unfair agreements or abuse of dominant position or combinations taking place outside India but having adverse effect on competition in India, provided that any of the below mentioned circumstances exists:

- An agreement has been executed outside India
- Any contracting party resides outside India
- Any enterprise abusing dominant position is outside India
- A combination has been established outside India
- A party to a combination is located abroad.
- Any other matter or practice or action arising out of such agreement or dominant position or combination is outside India.

To deal with cross border issues, CCI is empowered to enter into any Memorandum of Understanding or arrangement with any foreign agency of any foreign country with the prior approval of Central Government.

Benches

For the execution of duties, the Act contemplates the exercise of the jurisdiction, powers and authority of CCI by number of **Benches**. If necessary, a Bench would be constituted by the chairperson of at least two members; it being mandated that at least one member of each Bench would be a "Judicial Member". The Bench over which the chairperson presides is to be known as the **Principal Bench** and the other Benches known as **Additional Benches**. However, the Act further empowers the chairperson to further constitute one or more Benches known as **Mergers Benches** exclusively to deal with combination and the regulation of combinations.

Extension of the executive powers

The Act contemplates the extension of the executive powers of CCI by the appointment of a **Director General** and as many other persons for the purpose of assisting it in conducting enquiries into contraventions of the provisions of the Act as well as conducting cases before the Commission.

CCI is empowered to conduct enquiries into:

1. "Certain agreements and dominant position of enterprise"
2. "Combinations"

CCI, either on its own motion, on receipt of a complaint or on a reference made to it by the Centre or State Government may enquire into any alleged contravention regarding the nature of the agreement, which is suspected to be inherently anti-competitive, or the abuse of dominant position. Any person, consumer, consumer association or trade association can make a complaint.

An enquiry into a combination, existing or proposed, may be initiated upon the knowledge or information in the possession of CCI or upon notice of the person or entity proposing to enter into a combination or upon a reference made by a statutory authority. Limitation of time for initiation of enquiry is one year from the date on which the combination has taken effect when CCI conducts such enquiry.

Jurisdiction

An enquiry or complaint could be initiated or filed before the Bench of CCI if within the local limits of its jurisdiction the respondent\s actually or voluntarily resides, carries on business or works for personal gain, or where the cause of action wholly or in part arises.

CCI has been vested with the powers of a civil court including those provided under sections 240 and 240A of the Companies Act, 1956 on an "Inspector of Investigation" while trying a suit, including the power to summon and examine any person on oath, requiring the discovery and production of documents and receiving evidence on affidavits. CCI is also vested with **certain powers of affirmative action** to act in an expedited manner. Civil courts or any other equivalent authority will not have any jurisdiction to entertain any suit or proceeding or provide injunction with regard to any matter which would ordinarily fall within the ambit of CCI.

Procedure Of Investigation And Order Thereof

If a prima facie case exists with respect to **anti-competitive agreements and abuse of dominant position**, CCI is empowered to direct the Director General to conduct an investigation in the matter.

In determining the nature of agreements, the following factors are to be taken into account:

- Barriers to new entrants in the market
- Driving existing competitors out of the market
- Foreclosure of competition by hindering entry into the market
- Accrual of benefits of consumers
- Improvements in production or distribution of goods or provision of services
- Promotion of technical, scientific and economic development.

In determining the nature of the dominant position enjoyed by an enterprise, following factors are to taken into account:

- Market share of the enterprise and market structure and size
- Size and resources of the enterprise
- Economic power of the enterprise including commercial advantages over the competitors
- Size and importance of the competitors
- Dependence of consumers on the enterprise
- The extent of vertical integration and consumer dependence
- Whether the monopoly was gained by reason of statute or otherwise
- Entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, market entry barriers, technical entry barriers, economies of scale
- "Countervailing buying power" and "social obligations and costs"
- Any other factor which CCI may consider relevant for the enquiry.

The Director General would submit his report with recommendations. If CCI is of the view that there are no merits to the case, the complaint would be dismissed, with costs. However, during the course of enquiry, CCI may grant **interim relief by way of temporary injunctions** restraining a party from continuing with the ant-competitive agreements or abuse of dominant position.

An order of CCI subsequent to an enquiry, could consist of:

- Directing the persons or entities ruled against to desist from abusing a dominant position or discontinuing acting upon anti-competitive agreements
- Imposing penalty to the maximum extent of ten percent of the average turnover for the last preceding three financial years upon each person or entity party to the abuse
- Award compensation
- Modify agreements
- Recommend the division of the dominant enterprise to the Centre, which has the ultimate authority to decide the fate of a dominant enterprise
- Recovery of compensation from any enterprise for any loss or damage shown to have suffered by the other party.

The procedure for investigation of combinations is somewhat different, as the Act contemplates direct investigation to be conducted by CCI rather than by resorting to the via media of the Directorate General. It may call upon any party to furnish all relevant information with regard to their business operation to come to a conclusion as to the nature of the combination.

While the factors to be taken into account are similar to the parameters to be applied while examining anti-competitive agreements and abuse of dominant position the CCI shall also have due regard to the following factors:

- Actual and potential level of competition through imports in the market
- Extent of effective competition likely to sustain in the market
- Likelihood that the competition would result in the removal of a vigorous and effective competitor or competitors in the market.
- Possibility of a failing business
- Nature and extent of innovation
- Relative advantage, by way of the contribution to the economic development
- Whether the benefits of the combination outweigh the adverse impact of the combination if any

In case of combination, CCI may pass following **orders**:

- Approval of the combination if no appreciable adverse effect on competition is found
- Disapproval of the combination in case of adverse effect
- It may propose suitable modification as accepted by the parties
- During enquiry grant interim relief by way of temporary injunctions
- Award compensation

Penalties

In case of failure to comply with the directions of CCI and Director General or false representation of facts by parties, penalties ranging from Rs 1lac to Rs 1 crore may be imposed as the case may be.

Execution of the order

So far the execution of the order is concerned, it is the responsibility CCI. However, in the event of its inability to execute it, CCI may send such order for execution to the High Court or the principal civil court, as the case may be.

Post-Decisional Options

The aggrieved person may apply to CCI for **review of the order** within thirty days from the date of the order, provided that the below mentioned conditions are fulfilled:

- An appeal is allowed by this Act
- No appeal has been preferred

Provision has been made for an **appeal against any order** or decision of CCI by any aggrieved person. An application for this purpose has to be made to the Supreme Court within sixty days from the date of communication of the decision or order.

Competition Advocacy

Perhaps one of **the most crucial components of the Act** is **competition advocacy.** Intention is to help evolve competition law through review of policy, promotion of competition advocacy, creating awareness and imparting training about competition issues. For this purpose Government may, in its discretion, make a reference to CCI for its opinion thereon but is not bound by it. The power of the Centre to issue directions to CCI is inherent, and such directions would bind it.

COMPETITION ACT AMENDMENT IN 2009

By the end of 2009, India is expected to finally begin enforcing its 2002 Competition Act which, while introducing a new paradigm of merger review, will enhance India's prior regulation of cartels, anticompetitive agreements, and abuses of dominant positions.
Soon after the enactment of the Competition Act 2002, the Supreme Court of India issued interpretations (also known as "rules") of the 2002 Competition Act. But those rules were not adopted as amendments to the Act until October 2007 (the "Amendments"). As a result, the

"complete notification" of the 2002 law (which, under Indian law, is necessary prior to implementation) was delayed and, during the interim period, the Competition Commission was unable to engage in any actual investigations. The Commission, however, was not idle and spent the intervening years focused on administrative functions, including competition advocacy, organizational capacity-building, and developing a professional network for future enforcement activities.

Notwithstanding the adoption of the 2007 Amendments, there remain several steps that must be completed before the Act can be fully implemented—and enforcement activities initiated—including the appointment of the Chair and other members of the Commission, the hiring and training the Commission's professional staff, and the issuance of the Act's implementing regulations. Drafts of these regulations were published in 2008 and circulated to other global competition authorities, lawyers, and academics for comment; the appointment of the commissioners was announced in early March 2009. It is expected that the commissioners shortly will undertake the required recruitment and training of the full professional staff, and that this process will be complete, and enforcement will begin in earnest, by the end of the year.

Overview of Competition Act Provisions

The amended Competition Act covers four primary competition concerns:

- prohibition of cartels and anticompetitive agreements,
- Abuses of dominant positions (including predatory pricing, tying, etc.),
- regulation of horizontal and vertical mergers, and
- Competition advocacy — which is defined as raising private sector awareness of the Commission and its intended role.

COMPETITION LAW AND AVIATION

Colluding To Remain Airborne: Competition Issues In The Aviation Sector

The liberalization of the airline industry in the 1990s led to a notable increase in the role of the private sector. No longer were the Indian skies dominated by the state run carrier and the exclusive monopoly of the state carrier came crashing down. Many reasons have been attributed to such crash, which include unplanned expansion as well as interference of government in key policies despite deregulation and ironically deregulation itself has been blamed as a cause.

It is important in the context of a developing country like India to keep two posits in mind. The first, no air passenger wishes to return to the days of state dominated control in the aviation airline sector. Second, anti competition behavior on the part of the private players is going to defeat the purpose of deregulation. These two posits are often at conflict with each other. While a remedy against anti competitive behavior is necessary, it must be balanced with the concern to keep the private sector alive and thriving. Price appears to be most important factor for the consumer followed by service provided and flight schedules. So, the astounding reason for air passengers not favouring state dominated control is the price-effective outcome of the open-sky policy of deregulation. Other reasons attributable for consumer's preference over deregulation is the constructive mode of service and schedule-friendly approach.

Further, the regulatory structure inhibits competition in many ways. It can prevent or deter entry, constrain capacity, and limit the potential for airlines to win market share. A problem in assessing regulatory impacts is the structure of aviation markets. The problem arising out of the structure is again attributable to the anti-competitive or collusive behaviour of private players defeating the very purpose of deregulation. However, things have not really been going the consumers' way. The market opening for private players has not brought the desirable stage for the aviation sector.

Pre-Liberalization Era

The early years of Indian aviation industry and especially 1949-1950, witnessed soaring prices of aviation fuel, mounting salary bills and disproportionately large fleets. The result was shown in the declining financial health of the airline companies inspite of a slightly favourable and liberal patronage by the government and an increasing trend in air passenger traffic. Further in 1953, the government nationalized the airlines via. The Air Corporations Act, 1953, giving rise to Indian Airlines and Air India. The Act also gave monopoly power to Indian Airlines to operate on domestic scheduled services to the exclusion of any other operator. Air India became the only Indian carrier to operate on international routes except for some routes to the neighboring countries which were given to Indian Airlines.

Air India had the reputation of a boutique airline till 1970s with all its gracious Indian service. But it was unable to sustain this image as it slowly adopted many of the insensitivities of Indian public sector enterprises and appeared to be driven more by the priorities of its large workforce than its paying customers. On the other hand Indian Airlines became unpopular due to its delayed flights, indifferent service, patchy safety record, and high fares.

The period before liberalization of Indian economy was predominantly exposed to higher levels of state control over most of the sectors of the economy. The Airline industry being one of the most important sectors of the economy was no exception. The industry was monopolized by state-run carriers, disallowing private and foreign players from entering Indian market and these state-run carriers which dominated the market were built on huge costs. The monopoly by state carriers led to hindrance of growth in the airline sector. One of the most disadvantageous consequences of such monopoly was the retaliatory measure by foreign players. The foreign airline companies were hesitant in entering into deals with Indian companies due to the monopolistic lock created by state-run carriers resulting in an unwelcoming aviation market.

The cost of air travel in India was amongst the highest in the world owing to rising fuel costs. Further, the monopoly of the state-run carriers restricted the entry of no-frill airlines into the market. No- frill airlines are those low cost airlines which do not provide food, beverages or other amenities to passengers, reducing the cost of travel. But the monopoly of the two airlines had created a dead-lock restricting entry of private players, low-cost airlines, foreign players, etc., resulting in hindrance in the growth of aviation sector. All these factors and features of the era of liberalization resulted in the "open skies" policy of the government.

Reasons for Deregulation

The monopoly of state-run airlines and their deteriorating performance was one of the most important reasons for deregulation in the aviation sector. The rising costs of travel and dissatisfaction amongst consumers and various reasons demanded deregulation of the aviation sector. The restriction on entry of private players disallowing competition and reduced prices was a clear disadvantage for the passengers.

Since the 80s, popular opinion began shifting towards privatization and deregulation of the air transport sector. Many forces including growth in demand for air services, technical changes, emphasis on safety, and changing perceptions of limited Government intervention in commercial activities contributed to the shift. The burgeoning growth in air traffic also put additional strains on the aviation system and its regulatory structure. Increasing passenger demand was not meted out by satisfactory services to cater to the demand. It was not only a trend with increasing passenger demand but the passengers demanded variety and options in aviation services, such as low- cost and no-frill airline services. This need for variety in services fostered the entry of such services into the market post deregulation.

Moreover during the 1980s and 1990s, most of the developing countries witnessed rapid economic development, and this was also reflected in the dynamism of the airline industry. Air traffic witnessed a major boost, both on domestic and on international routes. The development in turn necessitated important reforms in the role of the State. It needed loosening up of the regulations. The divergent needs of business travelers, tourists, shippers of cargo, and the airlines themselves put considerable strain on the regulatory structure.

Liberalization of the sector entailed a combination of both privatization initiatives as well as deregulation as a whole. Privatization of the airlines from Government control would enable the airlines to operate on economic principles, fostering competition and improved efficiency. Worldwide experience showed that privatization of ownership improved efficiency in operations, as the parameters that govern the operations are no more non-economic. Excessive Government control had been one of the weak links of the sector. Private ownership would also facilitate resource mobilization. It was deemed to prove important especially for developing countries because it was perhaps the best way of bringing in financial discipline in the aviation sector.

Therefore, decline in performance as well as profitability of both Air India and Indian Airlines and increased passenger demand from 1990 onwards, necessitated additional capacity creation in the domestic market leading to deregulation. Apart from the reasons related to the monopolistic state carriers, other reasons such as rising fuel prices and the zeal of privatization demanded deregulation of the aviation sector.

Post Liberalization

India reverted back towards an 'open sky' policy in the nineties conforming to the worldwide trends in the aviation sector. As a part of this policy, various reforms were brought about in the aviation sector. Private operators were allowed to operate scheduled and non-scheduled services thus removing entry and exit barriers. Since the repeal of the Air Corporations Act and the entry of private operators, seven private airlines were assigned 'scheduled' status and were allowed to operate on all domestic routes alongside Indian Airlines. Apart from these there were 27 non-scheduled operators. However there were no private operators on international routes.

The choice of the aircraft type and size were left to the operator to decide. The foreign equity up to 40 per cent and NRI/OCB investment up to 100 per cent was permissible in the domestic air transport services. The deregulation reforms also brought about open sky policy for cargo operators on a permanent basis. Constructions of private airports both for international and domestic operations were being permitted. Private participation including full foreign equity in the development of existing airports was allowed.

One of the most important features of deregulation was that the control over fares had been withdrawn and left to the market forces. This led to a rapid boom in the demand for air transport services. Further, entry of low-cost and no-frill airlines enhanced this demand.

For the systematic development of air transport services, four categories of operator services were defined—Scheduled Airlines, Regional Airlines, Nonscheduled (Air Taxi) Charter Services and Air Cargo Services for transportation of cargo and mail. Scheduled airlines were to operate on routes according to a published timetable each flight being open to use by members of the general public. Regional airlines were to operate between state headquarters and other cities and towns in the region. Nonscheduled services were to cover specialized traffic like business tours, executive flights and special flights to destinations without scheduled flights. Air cargo services were either on a scheduled or a non-scheduled basis but could not carry passengers.

Hence, deregulation brought about rapid developments in the civil aviation sector and revolutionalised the erstwhile industry which was pawned by the government. But gradually, the developmental objectives which were sought to be brought about in the sector began to be defeated by various factors. Firstly, the immediate factors like uneconomic fares and rising fuel costs defeated the developmental objectives of deregulation. Further, in the recent times, strategic alliances by airlines and corresponding anti-competitive behaviour on their part have also started defeating the purpose of deregulation.

Factors Defeating The Purpose Of Deregulation:

At the dawn of deregulation, there was a lot of enthusiasm and optimism that accompanied the entry of private operators in the Indian domestic market. However, the private operators could not sustain their operations for long and soon turned sick. There are several factors that contributed towards such a down-turn. Setting up an airline operation required substantial capital investment, and so the number of aircrafts that each of these operators had was limited. Further, the operators had to adhere to the route categorization laid down by the government, or in other words they were forced to ply in certain economically unviable routes. All these factors made the operations uneconomical.

The private operators could not afford to maintain separate aircrafts for flights on category II/III routes. Overall, the private airlines failed to provide a regime of regular, stable and professionally run air transport services in the country. They had also been involved in various disputes relating to lease agreements, payment of dues, lack of schedule integrity, frequent shifting of routes and operations, etc. Gradually, most of the airlines turned sick.

Thus despite liberalization and deregulation of the civil aviation sector, the domestic air transport sector had not grown on expected lines. The private airlines, which had to close down, blamed their sickness on reasons such as :

• Lack of transparent and consistent government policy
• Route Dispersal Guidelines – Operations on uneconomic routes
• High Cost of Aviation Turbine Fuel
• Inland Air Travel tax and Income Tax on leasing of aircraft
• High rates of airport charges
• Lack of adequate airport facilities and limited watch hour problem at minor airports
• Uneconomic fares

All these reasons contributed to the downfall of private airlines. Therefore, the very purpose of deregulation was defeated due to such a downfall. Another important factor was the decline in airfares which triggered losses for the airline companies. The losses worsened the existing deterioration of the private airline companies. Moreover, the rising fuel costs also deteriorated the situation.

Further, there was gradual decrease in the number of passengers, both business and leisure, contributing to the losses suffered by these companies. Due to all these factors, the airline companies faced an inability to meet breakeven and continued to suffer losses. The initial freedom resulting from deregulation, led to competition in the market place following new entry in the business leading to lowering of prices in the markets that put further pressures on the bottom lines of the airlines companies' balance sheets. Subsequently, the focus shifted on economizing the operations so as to reduce the costs and arrest the price increases so as to boost the margins and keep the airlines in business.

As a measure to improve their situation, the airlines brought about an uncontrolled rise in fares with a new break up of the total fare.

- Earlier, Basic Fare = 999 + Tax = 225 , Total = Rs. 1224
- Now, Basic Fare = 99 + Tax = 3250 , Total = Rs. 3349

The new break up of airfare with a deceitful increase in the tax rate is one of the few measures taken up by the airlines to improve its profits and meet breakeven. The amount charged as tax is majorly pocketed by the airlines and only a small amount is actually the tax collected by the government. The break up of the tax includes fuel surcharge, service charge, congestion charge amongst others and these are adjusted according to the rising input costs. This practice had knocked down the aim of deregulation to a great extent but the players in the industry defend themselves by saying that they have no other option if they have to survive. The era of post liberalization has observed the airline industry undergoing constant revision of strategies for growth and to encounter competition. One of the key factors driving this industry is survival since prosperity in this sector is only secondary.

Therefore, the general law of supply and demand has not been applicable to the civil aviation sector, according to which lower prices lead to increase in demand resulting in increasing revenues. Lower fares have led to an increase in demand for seats but at the same time there was an increase in input costs because of which industry did not experience increasing profits. Increasing losses, inability to meet breakeven, constantly rising ATF (Aviation Turbine Fuel), poor infrastructure have forced the airline companies to come up with various strategies to cope up with the situation along with the driving force of survival. One such solution arising as part of such a deliberate action by the airline companies was strategic alliances amongst airlines. This involved alliances between arch rivals to minimise costs and maximise profits, who agreed on various terms and levels of air transport service carried out by alliance agreements.

The most relevant Indian illustration to such an alliance is the recent Jet-Kingfisher alliance. The two airlines who own more than 50% of the market share are rival companies who signed an alliance for the purposes of maximizing profits and minimizing costs. But these alliances are under scrutiny by the competition authorities as they are opposed to competition in the market having an adverse impact on competition.

Anti- Competition Law

In common terms, competition refers to a situation of the market wherein sellers strive for buyer's investment in order to maximize their profits. Competition makes an enterprise more efficient and offers wider choice to consumers at lower price. Fair competition is beneficial for the Consumers, Producers / Sellers and finally for the whole society since it induces economic growth. In order to realize this objective to competition in the economy, the Competition Act, 2002 was passed which replaced MRTP Act, 1969. The objective of Competition Act is to prevent anti-competitive practices, promote and sustain competition, protect the interest of the consumers and ensure freedom of trade. The objectives of this Act are to be achieved through the instrumentality of the Competition Commission of India (CCI).

A restrictive trade practice as per section 2(o), MRTP Act , 1969, means a trade practice which has or may have, the effect of preventing, distorting or restricting competition in any manner and in particular

- (i) which tends to obstruct the flow of capital or resources into the stream of production or
- (ii) which tends to bring about manipulation of prices, or conditions of delivery or to affect the flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs or restriction.

The Competition Act, 2002, on the other hand prohibits anti-competitive agreements and abuse of dominance and regulates combinations (mergers amalgamations or acquisition) through a process of inquiry. Alliances which exceed limits specified in the Act in terms of assets and turnover which causes or is likely to cause substantial adverse effect on competition with in the relevant market in India can be scrutinized by the Commission. As per Section 3 of the Act, an agreement entered into between enterprises, associations of enterprises or person or association of persons in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse affect on competition within India, shall not be entered into.

When Is An Agreement Anti Competitive? – The Threefold Step

For the purposes of scrutinizing an airlines-alliance agreement regarding its appreciable adverse effect on competition, a watchful inquiry into the terms of the agreement is imperative. The European Community jurisprudence suggests a threefold step to examine whether an agreement is anti competitive.

The first step is to identify a relevant market. As defined by Section 2 of Competition Act, 2002 Relevant product Market is defined as a market comprising of all those products and services which are regarded as interchangeable or substitutable by the consumer , by reason of characteristics of the products or services; their price & intended use. According to the "Origin and Destination approach", every route between the origin and the destination is a separate and independent market. For Eg., In a flight route from Mumbai to New Delhi, the relevant market refers to the single route between Mumbai (origin) and New Delhi (destination). Therefore, this route between the two cities is a separate and independent relevant market.

The second step is to establish whether any restriction or distortion in the relevant market has been caused by such an agreement. The agreement might have caused restriction or distortion either by object or by effect.

The third step is to rebut an assertion that the tests of Article 81(3) of the EC Treaty are met. Article 81(3) of the EC Treaty lays down the following kinds of agreements, which are opposed to competition law:

- Efficiency Gains
- Indispensability
- Fair share for Consumers
- No elimination of Competition in respect of a substantial part of the product in question

Therefore, to hold an agreement as anti-competitive in nature, the agreement cannot be of such nature as mentioned in Article 81(3) of the EC Treaty. Thereby, identifying the relevant market, establishing whether the agreement places a restriction or leads to distortion in the relevant market and rebutting an assertion arising out of Article 81(3) clearly assists in ascertaining the nature of an alliance agreement between airlines.

Further, the European Community Jurisprudence in the case of Air France (also known as Alitalia Case) has laid down certain guiding principles regarding anti-competitive agreements between airlines. The Commission looks at various factors, while ascertaining an agreement as anti-competitive in nature, like:

- Direct flights between Airports concerned
- Airports whose respective catchment areas overlap
- Indirect flights which are substitutable with direct flights
- Alternative Transport – Car / Trains
- Consideration of time sensitive and flexible customers

Jet-Kingfisher Alliance

When two principal competitors come as collaborators, this could mean and indicate a medium of survival. Earlier Jet had acquired the ailing Air Sahara, while Kingfisher had taken over Air Deccan. Kingfisher and Jet, currently with a combined domestic market share of nearly 60 per cent have a code-sharing arrangement on domestic and international routes. Under the terms of the alliance, they have common ground-handling facilities, a joint fuel management strategy to trim expenses and will strive for reciprocity in their frequent-flyer programmes. The alliance will help the two airlines prune their combined daily losses which were estimated in the region of Rs 15-20 crore. Rising aviation turbine fuel prices have hit them hard with each of the entity losing about Rs 10 crore a day.
The scope of the alliance will include the following areas:

- Code-shares on both domestic and international flights subject to Directorate General of Civil Aviation (DGCA) approval.
- Interline/Special Prorate agreements to leverage the joint network deploying 189 aircraft offering 927 domestic and 82 international flights daily.
- Joint fuel management to reduce fuel expenses.
- Common ground handling of the highest quality.
- Cross selling of flight inventories using the common global distribution system platform.
- Joint network rationalisation and synergies.
- Cross-utilisation of crew on similar aircraft types and commonality of training as also of the technical resources, subject to DGCA approval.
- Reciprocity in Jet Privilege and King Club frequent flier programmes.

Code-sharing is a commercial agreement between airlines, under which they can mutually use their two-letter identification code to represent each other's flights on computerized reservation systems. Consequently, the airlines get a larger network using fewer flights and potentially fly different legs of a journey by issuing a single ticket. Code-sharing and network rationalization were two key objectives before Jet and Kingfisher when they proposed the alliance in October 2008.

The Monopolies and Restrictive Trade Practices Commission (MRTPC) had ordered its investigating arm, Director-General of Investigation and Registration (DGIR) to investigate the high profile alliance of Jet Airways and Kingfisher Airlines. The investigation was brought on to see whether the formation of alliance would turn into a monopoly. Officials of the Monopolies and Restrictive Trade Practices Commission (MRTPC) have started looking into reports about the alliance to seek more information from the companies about possible anti-competitive nature of some parts of the agreement.

Although provisions of the competition law requiring prior approval from the competition regulator for mergers are yet to be notified, the arrangement announced by Jet-Kingfisher could still come under the scrutiny. Unlike mergers, such agreements are usually examined after they come into force. The Competition Commission of India (CCI), which has come into effect with April 1, 2009, could also look into the agreement once it gets enforcement and adjudication powers. As of now, the CCI lacks the teeth since it does not have a chairman or members and its powers have not been notified. In such cases involving an arrangement leading to a virtual integration of operations and a high market share, the agreement requires close professional examination by the Competition Commission of India to ensure that it does not adversely affect consumers and the economy. Regrettably, in our country, the Competition Commission has still to be made fully functional by the government, and it is not therefore in a position to take legal cognizance of such transactions.

Alliances have become fairly common among global airlines. Star Alliance is the world's largest, with 21 full and three regional members. Sky Team has 11 members and three associate airlines, and One World Alliance comprises of 10 airline members. But there hasn't been a monopolistic scenario emerging from any of these because the members come from different markets. When the Star Alliance was created, the idea was that the strengths of United Airlines in the US would become accessible to German Lufthansa, and the advantage that, Singapore Airlines has in Asia would become advantageous to another carrier in the alliance.

Moreover, each carrier does not have to invest and develop a base, facility, terminal area and lounge in every geography; it can access those of a partner that has already been invested in these facilities there. But the Jet and Kingfisher alliance cannot be compared to such alliances since the concept and purpose of the alliance between Jet and Kingfisher is very different from the above alliances. Hence the Jet-Kingfisher alliance could be viewed as anti-competitive and would come under the scrutiny of regulators.

Conclusion

Airlines like Jet and Kingfisher propose that the alliance will benefit customers as it will deliver the most-comprehensive integration in the industry. They have also made efforts time and again to assert that this alliance is not a cartel but it is essentially meant to save costs due to the heavy losses sustained by both the parties. It is not only unfair but impractical to blame the current economic situation and the rising fuel costs for such an alliance, since such economy related factors have always existed.

Therefore, presently, it is for the MRTPC and the CCI to be extremely vigilant about such alliances in the civil aviation sector. The task vested in these authorities is not only to be vigilant but also to examine the anti-competitive nature of such agreements and condemn the same in the light of consumer interests. The anti-competitive aspects of the alliance agreements have to be brought out and its corresponding adverse impact on competition in Indian economy has to be analysed.

The strategic alliances between airlines have not only diluted the purpose of deregulation of the sector, but would also cause inconveniences to the consumers in terms of prices and variety. Therefore, such anti-competitive behaviour has to be condemned by the competition authorities in furtherance of the inconvenience caused to the consumers and the economy on the whole. The purpose of deregulating the sector and benefiting the consumer and the industry seems to be lost with the colluding and anti competitive behaviour benefiting only the latter. The rail passenger, who tried to hop on the flight in the same amount of money, is still dreaming for fair and reasonable airfares... as one of the private airlines puts it “flying for everyone”.

CONCERNS OF CARTELISATION AMONG AIRLINE COMPANIES IN INDIA: LEGAL ISSUES

> *People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.*
>
> – Adam Smith

‘Cartelisation’ is a process where enterprises collude to fix prices, limit or control production, share the market or customers, or indulge in collusive bidding. Cartels usually operate in secrecy due to which these are hard to detect, or successfully, investigate and prosecute and because of this competition laws across the globe reserve their most severe treatment for cartels. Almost all the sectors, including the aviation sector are prone to Cartelisation.

Cartelization is when enterprises collude to fix prices, indulge in bid rigging, or share customers. Cartels have the capacity to adversely affect consumer welfare and the economy of a country. The most common activity undertaken by cartels is price-fixing which eventually results into artificial increase in prices.

Chapter IV of the Constitution directs the State policy in matter of concentration of wealth, welfare of consumers' vis-à-vis Fundamental Rights (under chapter III). It is in pursuance of this that the State enacted the Monopolies and Restrictive Trade Practices Act, 1969. This Act has now been replaced by the Competition Act, 2005. But critics opine that this Act is riddled with loopholes that might condone hard-core cartels and predatory pricing. Section 19 of the Competition Act, 2002 provides that Competition Commission of India may inquire into any alleged cartel (anti-competitive agreement) on receipt of any information from any person, consumer or their association or trade associate.

The aviation industry in India has undergone a sea change from the times when it was the domain of the public sector. Today, the aviation sector is predominantly about the oligopolistic competition among privately owned firms vying for maximum profits.

Two years ago, the privately owned firms decided to reduce fares so as to increase the catchment area and include the common man in their customer base. This cutthroat competition forced the

companies to decrease their fares to such an extent that they ended up incurring losses.
In such a scenario it is but obvious that the airline companies would devise plans to pull themselves out of this rut, and since the lack of innovative ideas plague the aviation industry, the firms would come out with methods which have been tried and tested through the course of history. Cartelization is one such method which the Indian private airlines seem to be following. Several economic studies and legal decisions of antitrust authorities have found that the median price increase achieved by cartels in the last 200 years is around 25%.
The result of this cartelization is the increase in air fares among all the privately owned airlines along with other measures, with "route rationalization" being one of them. This increase in air fares across the board has been a lot in the news lately with Jet airways and Kingfisher being accused of forming a cartel and increasing air fares which both the firms have vehemently denied blaming losses being incurred by them due to market forces and also the rise in price of Aviation Turbine Fuel (ATF), thus justifying the increase in fares.
According to Sections 33 (i) (d) and (j) of the MRTPC Act, 1969, the privately owned airline firms have violated the law if they have formed a cartel and involved themselves in a restrictive trade practice.

EMERGING LEGAL ISSUES IN SLOT ALLOCATION: IS COMPETITION LAW COMPETENT?

Civil Aviation plays an integral role in development of an economy. It helps in realizing the socio-economic objective of providing connectivity to foster travel & trade. As per International Civil Aviation Organizations' estimates, every 100 $ spent on air travel produces benefits worth 325 $ to the Economy. The Indian Aviation Sector has witnessed tremendous growth in the recent past which is driven by sound demographic, macroeconomic, government aided reforms & market dynamics. The three fold increase in consumerism, rising disposable income; booming aviation sector; burgeoning middle class; increasing business travel; government reforms; entry of low cost carriers; increasing competition etc. have positioned the Indian Aviation

Sector in a high growth trajectory

In order to maintain this high growth trajectory, it is very important that competitive forces must continue to operate with in this sector. In this report my focus shall be on the competition related issues surrounding Airlines with special emphasis on M&A in light of Competition Act, 2002.
In common parlance competition in the market means sellers striving independently for buyer's patronage to maximize profit or other business objectives. A buyer prefers to buy a product at a price that maximizes his benefits whereas seller prefers to sell the product at a price that maximizes his profit. Competition makes an enterprise more efficient and offers wider choice to consumers at lower price. Fair competition is beneficial for the Consumers, Producers / Sellers and finally for the whole society since it induces economic growth. In order to realize this

objective to competition in the economy, the Competition Act, 2002 was passed which replaced MRTP Act, 1969.The objective of Competition Act is to prevent anti-competitive practices, promote and sustain competition, protect the interest of the consumers and ensure freedom of trade. The objectives of this Act are to be achieved through the instrumentality of the Competition Commission of India (CCI) which has been established by the Central Govt. w.e.f 14th October, 2003.

Areas focused under the MRTP Act, 1969:

i. Prohibition of concentration of economic power to the common detriment;

ii. Control of monopolies; and

iii. Prohibition of monopolistic, restrictive & unfair trade practices.

Where as the theme areas for the Competition Act, 2002 are as follows:

i. Prohibition of anti-competitive agreements;

ii. Prohibition of abuse of dominant position;

iii. Regulation of combinations;

iv. Competition Advocacy;

Competition Act, 2002 shall prohibit anti-competitive agreements and abuse of dominance and regulate combinations (mergers amalgamations or acquisition) through a process of inquiry. It shall give opinion on competition issues on reference received and is also mandated to undertake competition advocacy, create awareness and impart training on competition issues.

Going by simple rule of demand & supply, if demand for one good is rising then supply correspondingly is increased to match the demand. However, this is not possible for the Aviation sector as capacity cannot be augmented in response to demand. Airports have a fixed capacity and in terms of their ability to handle traffic. In absence of alternate airports, the major metropolitan airports are becoming congested and are constrained in terms of capacity. Now this may act as a barrier to entry for new entrants as there is acute shortage of slots, ground handling and others. This might act as an entry barrier in the current regime where slots' allocation is based upon grand fathered rights. Slots are rights to take off or land at particular time of the time. The issue of slots is important as the existent carriers may shoo away competition by taking advantage of the capacity constrained airports.

LOW COST AIR CARRIERS - A GLOBAL PERSPECTIVE

Overview

The low cost carriers in Europe almost captured a 25% share as of now. While the first time air travelers continue to contribute to the growth of LCC, the full services conventional carriers (legacy) do not suffer any appreciable market share.

In general, what we observe in the air travel market today is a fare war ignited by low cost carriers. There is an impression fast gaining momentum that low cost carrier (LCC) means, substandard services, low in performance, low in serviceability and low even in safety standards, and the tickets are sold for a very low price or even 'zero' as the hidden surcharges and taxes are unknown to the traveling public, particularly the 'first time travelers' who in any case are the target population. It is time that the LCC re- looked at their advertising campaigns to correct the wrong impressions. First time travelers must know the clear difference between a 'full service' conventional airline like Emirates Airline and the LCC like Air Arabia. Travelers should be aware that low cost carrier means it will not have certain facilities or full services on board like Emirates and that is why they are low in prices, and not low in service quality. Once this clear message is communicated, then the traveling public should be able to choose the right airline. It is important to create the right impression from the very beginning, otherwise it will create a wrong impression in the mind of a first time traveler and that will spread by word of mouth. It is critical to inculcate the right perspective, as the LCC is growing fast and have a good potential to grow fast in India too.

What is a Low-Cost carrier (LCC)

In airline business, we have a traditional model referred to as 'Legacy Carrier/Conventional' and the Low-Cost Carrier. It is essentially a 'business module' also known as 'no frills' or discount carrier, is an airline that offers low fares but eliminates most traditional services. Legacy carriers operate with multi-class (First, Business and Economy) configuration with 'complimentary in-flight services.

'No-frills' is the term used to describe any service or product for which the non-essential features (or frills) have been removed. Common products and services for which no-frills brands exist include airlines, supermarkets, holidays, automobiles etc. They operate on the principle that if you take away the frills, you get lower prices/fares. No-frills supermarkets are recognizable by their store design and business model. They work on the principle that in most supermarkets,20% of products on sale account for 80% of what people buy and therefore, they stock the most commonly sold product, and they often do not serve branded items.

A typical Low-Cost Carrier business model practices include:

- a single type of aircraft (say, Airbus320 or 'Boeing 737)
- a single passenger class
- a simple fare scheme(typically fare increases as the aircraft fills up, which rewards early reservations-Yield Management)
- unreserved seating (encouraging passengers to board early and quickly)
- short flights and fast turnaround times (allowing maximum utilization of aircraft)
- flying to cheaper/less congested airports
- simplified routes, mostly point-to-point

- emphasis on direct sales of tickets(on line)
- employees working in multiple roles and simple dress code
- 'Free' in flight catering and other 'complimentary' services are eliminated, and replaced by optional paid-for in-flight food and drink

LCC seek to price their fares well below those of traditional airlines to increase demand and encourage consumers to switch to the low -cost carriers. By taking advantage of their lower average seat mile costs and using the increased demand to fill a large percentage of their flights, the low-cost carriers seek to maintain profitability despite offering lower rates.

The first successful low cost carrier was Pacific South West Airlines in the US who pioneered the concept when the first flight took off on 06 May 1949. Often, this credit has been incorrectly given to South West Airlines which began service in 1971 and it has been profitable every year since 1973.. With the advent of aviation deregulation, the model spread in Europe and the most notable one being Ireland's Ryanair which began the low cost operations in 1991 and Easy Jet followed it in 1995. Malaysia's Air Asia and Australia's Virgin Blue came in 2004.

Many traditional carriers tried to introduce the low cost concept by introducing an 'airline within an airline' where in the traditional airlines tried to follow the low cost concept just by introducing no frills such as KLM's Buzz, British Airways' GO Fly, and United's Ted, and most of them found it difficult to establish the low cost model. British Midland's low Cost rival bmi baby has however, successfully operated alongside its full-service counterpart. In Canada, Air Canada found it difficult to compete with low-cost rivals such as Westjet, Canjet and Jetsgo despite its prominent position in the market. Air Canada tried to operate two low cost subsidiaries, Tango and Zip, and both were discontinued. Whereas, Malaysia's Air Asia and Australia's Virgin Blue are some of the good models of growing LCC.

The clear message is that fare alone can not drive an airline, though it could be one of the drivers, there has to be other factors that should join the drivers to make LCC in real terms, 'low in fares but high in service'. Look at airlines like 'Emirates', they are high on fares, superior in service quality, and doing well.

It is also wrong to presume that people look only for food and entertainment on board, more so, on short routes, the main customer concern is service with a smile and from the word go customers should have a feeling of goodwill- a hassle free environment.

As the Government policy is now aimed to encourage Regional Carriers, it is obvious that more and more LCC will take off, while many more are waiting on the wings, some hesitant and frightful whether they can gain the market and be profitable. Why this uncertainty?

The objective of LCC are to woo the rail/road travelers to air travel and create a new environment for this segment of travelers so that more and more such travelers will move over creating a new wave of mass transportation- nothing but an Air Taxi operation. The carriers, planners, and airport operators should accept this concept and mutually assist each other so that air taxi operations (LCC) gain the required momentum.

It is said “strategy with out tactics is the slowest route to victory.” There is a need for LCC to re-look at their present strategy to ensure that the model stays on track and sustains with adequate profit margin, with out indulging in fare war, and without coming on the contrails of full service model carriers. What is the way forward?

LCC- New Thrust Areas

Low-cost carriers pose a threat to traditional 'full service' airlines,since the high-cost structure of full-service carriers prevents them from competing effectively on price. Notwithstanding, LCC are to focus on new thrust areas to stay ahead.

There is a need to find a path that the low cost carriers can follow as it seeks out new markets, ways and means to attract and maintain its customers and how to compete with the market rivals. Sustained excellent performance records of LCC like SouthWest and JetBlue in US and Ryanair and EasyJet in the UK are good case studies that will help our existing LCC and the potential low cost carriers to carry out a transformational intervention. Some of the key issues that merit attention are:

Differential Strategy- Uniqueness, Features, Appearance and Perceived Customer Value are some of the factors that help to provide distinguishable marks for which the customer is willing to pay a premium. You have to be something different from your competitors. To gain such a differential strategy, you need to know the market you want to serve, the market segments, customer type, nature of customers, customer needs and their choice and the geographical area and the product niche. You have to constantly work through the customers by way of customer surveys, close scrutiny of customer preferences, their behaviour patterns and the regional characteristics including the cultural bias. Capture these very features and introduce something new and something very different. Though it can be copied by your competitor, but you have the advantage of introducing it for the first time and thereby making it easy for you to market it, and also to bring about quick changes at frequent intervals. Pleasing, unique interiors and appearance, seating configuration, leather upholstery, soft skills of cabin crew and above all, on time performance are some of the features that can differentiate you from your competitors. You may not need to add any tangible value to the product as long as the customer perceives that the product is superior. It is the perception that matters. Perception value is more important than actual value.

Competitive Strategy- It means that a low cost model is doing something different, deliberately choosing a different set of activities than its competitors. Full service carriers serve a large number of destinations on a hub-and-spoke method, clustering around peak hours at hub airports which require coordination of schedules, interlining, extensive screening of baggage etc. Where as, low cost operators should stay away from large, congested airports and offer only short point-to-point services between mid size cities and only to secondary airports in large cities, strategy being- keep fares low and frequency high- so that you are able to attract people who might otherwise travel by car or train.

While introducing hopping flights to attract rail/road users, it should be ensured that they do not waste their time in procedural aspects, instead, it should be straight in and they should gain an impression that air travel really saves time, it is comfortable and convenient, and at an affordable cost.

Popularise the secondary airport/low cost airports concept. They are to be different to achieve the quick turn around time with simplified security/check in procedures; one can even scrutinise the credentials of frequent fliers and high value travelers, and issue them with laminated boarding pass/e-gate facility to reduce the dwell time.

Airport operators and aviation security bureau should be able to come forward with less stringent and quicker ways to screen and even provide an exclusive area for low cost operators. Passengers can be indoctrinated to carry less baggage or just hand baggage only so as to reduce the turn around time. Passengers with only hand baggage can even be encouraged with some incentives so that the practice gets developed. Focus on high frequency and least dwelling time.

Selection of aircraft is crucial. The tendency to go in for the easily available old aircraft or cheaper lease terms should be avoided as it can be costly in due course as they would be less fuel efficient and costly on maintenance, training of air and ground crew. Use of standard aircraft, say a fleet of Air Bus 320 or B737-800 contribute to lowering the operating costs and therefore selection of aircraft is key to the whole issue. In 2006, the cost per available seat mile for full services carrier US Airways was 12.5 cents and 9.6 cents for Continental, where as, it was 7.0 cents for South West and 6.2 cents for Jet Blue, the low cost operators.

Operational Effectiveness- It means performing better than your competitors by keeping the operating cost lower than your competitors by performing the same activities in different ways. A strategic management approach of establishing a corporate Vision, Mission, Objectives, strategic alternatives, implementation of the set out strategies and periodical evaluation, and corrective action wherever necessary will be an effective tool to achieve the operational effectiveness. Vision or Mission says it all. Virgin Atlantic's Mission, "to grow a profitable airline, that people love to fly and where people love to work" has indeed helped the airline to market it very well.

Awareness Build Up- Most of the traveling public, particularly the first time fliers, at least 10 to 20% at any given time are ignorant of the difference between conventional full services airlines except that they are induced by the fare driving advertisements. Best fare does not always explain consumer choice in air transportation. There is a segmentation here one segment is leisure passengers and the other business passengers. While price may rank high in the case of leisure passengers where elasticity of demand is high, when it comes to business travel, demand level is inelastic and depends mostly on convenient schedule than fare. Another factor is passengers may end up paying a higher fare than they would probably because they use a medium to make their reservation that does not have an account to the lowest possible fare. Use of inter net and on-line booking makes it cheaper than booking through a travel agent or direct booking over a telephone. One may choose an airline due to pre-conceived perception of preferred ground services, or safety record or on time performance, or cultural preferences, and therefore, understanding the consumer behaviour is extremely important in establishing a competitive position.

Low Cost Leadership- A low cost leader has two options one, to provide a service at lower fare than its competitors and thereby gaining a large share of market place. In this, the low cost leader is undercutting the competition. If the buyer is cost sensitive, then the buyer will choose the low cost leader. The second option for the low cost leader is to offer the same fares as that of the competitors. In this case, the leader reaps the benefit of a greater profit margin. The leader by virtue of being the leader has been able to keep the cost lower than rivals, and as the costs are lower, the profit is better than rival. However, to be a leader, you should be able to provide customers with a workable schedule as well. In a price sensitive environment, the customers should also know who offers the lowest fare and convenient schedules and then choice will be the leader.

When buyers are price sensitive, low cost leadership position will have a very strong competitive position in the market. The aim is to contain the cost to the lowest, relative to industry rivals and in course to create a sustainable cost advantage over the competitor. Remember, cost is not equal to price. So, one has to gain cost advantage in a manner that is very difficult for the rival carriers to copy. Cost advantage is based totally on the relative ease or difficulty it takes to imitate the product and this is the key to sustainability of competitive edge.

Core Competence – What is your core competence, how to identify them and how to develop them are some of the questions that you need to answer. May be it is better for you to try and identify a competency or set of competencies that helped you to do well in your business, and then it would be easy to exploit them.. We need to recognise that the competitive advantage and core competencies come from within the airline itself. It must also be borne in mind that it is not easy to identify or figure out what exactly is your core competence. It may be skills, process, and corporate identity, combination of skills and knowledge that is embedded in the organisation; because it exists you are able to reach new heights. This helps to initiate value creating activities that can make unique value added contributions to the business. The aim is that your airline should be better at the competencies than all others or at least the vast majority of your competitors. Rareness of the competency makes it difficult for your competitors to imitate you. Competency to meet your customer needs is the key. Being better than your competitor is not enough to have a sustainable competitive advantage, but the reality is to fit and focus is necessary. What make an airline in one market, may not work in another market. Your success in one market segment does not guarantee success in another market segment. It is important for you to focus on your core activities in which you want to excel. This is the reason why the introduction of 'airline with in an airline' tried by some of the major traditional airlines did not succeed. Continental tried to copy South West unsuccessfully, similarly, many others. So copying is not easy.

When the activities are incompatible, it can become confusing to customer if another type of service or value is offered, when the brand is known for one type of service or value. The new image can undermine the reputation of the parent airline (Air India Vs Air India Express). A new activity requires different skills, different equipment, management systems/style and employee attitudes. Use of same travel agents, lack of training on the part of employees while switching from legacy carrier to low cost or even after training, inertia or mind set can affect the brand image. Lack of internal coordination and control can also result out of change of roles.

Sustainability Strategy

- Optimize operating efficiency of facilities
- Pursue cost cutting measures through procedural control
- Avoid or minimize marginal cost activities
- Maintain a close watch on the cost drivers
- Continuous innovation in areas where cost cutting can be achieved. Even the crew uniforms can be made simpler and cheaper. Introduce something to go by the regional accent and smart casuals are optional choices.
- Adaptability to market condition, where inventory can be adjusted rapidly, keeping demand and supply equation
- Quick and efficient on time performance- flexibility to respond quickly and pro-actively to changing needs of the customers
- Out source as much as possible in areas such as finance& accounting, back office functions, reservation process, baggage screening, and resort to e-marketing, snap express reporting and build committed employees.
- Seating and all other services based on what the customers can afford to pay, what ever strategy that can boost the first time travelers' choice and cut down the costs to ensure no seat goes unoccupied and that no space that goes vacant, it should be filled with additional seats.
- Improved revenue management system- some of the airlines have a complex fare structure. Make it user friendly and more manageable, and keep the unfamiliar first time travelers in mind.
- Function exactly as air taxi operations with e-commerce strategy.

Follow what Mr. Roller King, the founder of South West Airline, the most successful low cost carrier said "if you get your passenger to their destination when they want to get there, on time, at the lowest possible fares, and make damn sure that they have a good time doing it, people will fly your airline"

<u>TAXATION OF AVIATION TURBINE FUEL: MOUNTING CONCERNS</u>

The beginning of this decade witnessed the boom of no-frills carriers which gave a new thrust to the privatization of aviation sector in the country. At this junction the high prices of Aviation Turbine Fuel (ATF) has become a thorny issue as ATF currently constitutes about 30-45% of the total operating costs. The same has especially become a burning issue for this budget with the rise of cut-throat competition with frequent entries of new players. The same not only attracts accelerating custom and excise duties but varying sales tax at the level of state government. This is because aviation turbine fuel is not yet notified as a 'declared good' and hence does not attract the uniform VAT rate of 4%.

Sadly the budget has failed to address the issue despite cries from various sections of the industry. The finance minister has overlooked the ensuing repercussions. The high tax rate structure while coupled with shooting oil prices worldwide has made it increasingly tough for the private players to cope with the competition. ATF prices in India are 60-100 per cent higher than in other countries. This means that the domestic players are even losing out to international competition. The effect on aviation sector has certain indirect effects as well. It affects the tourism industry which witnessed a boom with the entry of private air carriers. It also discourages the carriers to fly in states with high sales tax. Ultimately it has a negative multiplier effect on the employment and the economy as such.

This paper seeks to analyze why the ATF, has through various budgets consistently evaded the treatment as being a 'declared good' and generally seeks to advocate a decline in the overall tax rates applicable to ATF which is an essential factor in the civil aviation sector. This would help reap the true benefits of privatization and ultimately ease the burden of the common man.

<u>Taxation of civil aviation; emerging issues</u>

"There is cut-throat competition in this sector and airlines are losing money, mainly because of competition and high taxes."[1]

This paper seeks to impress upon the authorities the urgent need for uniformity and rationalization of taxes. The Central Government has the power to issue Orders regarding rates, tariffs, and the like under section 5 of the Aircraft Act, 1934 and Rules 134, 13of the Aircraft Rules, 1935.

The various taxes being imposed in the aviation sector include Service Tax, Luxury Tax, transport taxes, and excise duty.

The prominent amongst these is the state sales tax levied on Aviation Turbine Fuel (**ATF**) which differs from state to state and ranges from 4 to 34 per cent. ATF comprises 35-40 per cent of domestic airlines' total operating costs. There is a demand to notify ATF as a declared good so that

[1] Mr. Praful Patel, Hon'ble Minister for Civil Aviation, Government of India at the First National Civil Aviation Conference, New Delhi, January 18. 2008.

it attracts a uniform 4% duty all over the country as under section 15 of the Sales Tax Act, 1956. The current ATF prices are 60% higher than the average ATF prices globally. Besides, there is also a levy of 8% excise duty on ATF.

A recent circular issued by the finance ministry to airlines operating international flights out of India has called for a levy of 12.36% service tax on the fuel surcharge on every business class and first class ticket. Such a surcharge was previously not under the ambit of service tax. Non-Economy class international journey has been subjected to service tax vide the Finance Act 1994 as amended vide Finance Act 2006 with effect from 1st May 2006. It must be noted that fuel surcharge is levied at the same rate irrespective of the distance covered by the air journey. Hence, if a fight travels from Bombay to Goa or Bombay to Srinagar the fuel surcharge is levied at the same rate.

Due to the high tax rate there have been instances of airline operators attempting to evade tax; Lufthansa and British Airways are two popular illustrations. Consumers have also filed cases against the hike in airfare due to taxes, surcharge, transaction fees and congestion fees which are prima facie irrational.

Rationalization of taxes, particularly state sales tax, would encourage more airlines to fly into a state, leading to creation of aviation as well as tourism infrastructure that would in turn create jobs and income and have a multiplier effect. Through this paper the student author has attempted to bring out an ideal tax structure so that neither the airline operators nor the passengers are burdened.

Apart from the tax structure emphasis has been laid on improving the standards of the Government operated airlines and a suggestion of privatizing the same as are Air France, British Airways and many more.

THE EMERGENCE OF CODE-SHARING AGREEMENTS: A LEGAL PERSPECTIVE

The liberalization of the aviation industry in India has precipitated the boom for domestic and international air carriers. With the concept of code-sharing becoming popular among Indian carriers especially now that the domestic private carriers can fly overseas once they complete five years of domestic operations in addition to other mandatory requirements, legal liabilities are bound to increase and become complicated.

Code sharing involves one airline advertising and selling the services of another airline as its own and the transportation of passengers and cargo on an airline other than the one identified in the travel documents. The carrier performing the flight is usually referred to as the operating carrier while the other airline is typically identified as the marketing or contracting carrier. Code-Share agreements enable airlines to increase their traffic and revenues thereby profits, network size, service frequency, offering more destinations through its frequent flyer programmes and coordination of operations.

In order to identify the proper defendant claim arising from a code-shared flight, the Guadalajara Convention, which was adopted in 1961, applies to which India is a party. It ensures that a carrier performing carriage without having entered into a contract with the passenger will be liable according to the Warsaw Convention as modified by the Guadalajara Convention. This convention has formally introduced the distinction between a contracting and an actual carrier. As per this convention, both carriers will be jointly liable and the plaintiff is released from the difficulty in proving which carrier caused the damage which could be due to lost baggage, delay in the flight taking off, diversion of the flight due to unavoidable circumstances, passengers been offloaded due to overbooking .etc. especially in congested airports. Jet Airways already has a code-share agreement with Brussels Airlines in order to give its passengers wider destinations in Europe to choose from.

Thus the role of the Guadalajara Convention will increase and become more important with a steadily growing number of flights under Code-Sharing agreements.

Frequent Flyer Programs and Code Sharing Alliances: Competition Concerns:

There are certain factors intrinsic to airline industry that are anti-competitive such as 'Frequent Flyer Programs' ("FFP's") operated by various airlines that is a form of unfair pricing practice and can have adverse effect on competition. Also, the airlines alliances in the industry that inter alia include 'Code Sharing Agreements' tend to restrain competition in the market. The object of the paper is to study nature and impact of Code Sharing Alliances and FFP's on competition.In India, many airlines such as Indian Airlines, Kingfisher, and Jet Airways operate FFP's for its customers and provides various benefits in relation to same. FFP's are basically loyalty inducing programs offered by airlines which rewards customers with free travel on the basis of build up miles and gained points on each travel by that airline. Through these FFP's, the airline tends to enhance the value of subsequent flights on its airline by increasing opportunity for free travel, once the customer flies on FFP.

Such rewarding tends to induce future loyalty among customers and not only strengthens airline's market position, but also tends to fetter competition in market by making it difficult for new entrants to enter market and expand. Such loyalty inducing pricing and rebates programs become abusive when they lead to foreclosure effects. Section 4 of the Competition Act, 2002 ("the Act") prohibits abuse of such dominant position by an enterprise by way of imposition of unfair or discriminatory price in provision of services or by limiting or restricting market. Such loyalty programs also prevent customers from accruing most advantageous offer at a given time thereby denying market access. Further, airlines by way of FFP's raise the switching costs between various airlines –they make traveller keen to continue its services such that, if they switch to another they would not be able to gain points and thus free travel. Switching costs act as barrier for entrants to gain market share and are detrimental to competition in market. Also, the inducement caused by way of FFP to customer by the airline has the effect of stipulation to purchase exclusively from that airline and is related to the law prohibiting exclusive purchasing agreements. FFP's are basically targeted for business class travellers who have less price elasticity demand and therefore treat customers in discriminatory manner over other leisure travellers. Such discriminatory pricing is prohibited under the Act.

In the air industry, alliances constitute a framework for cooperation between airlines such as Code Sharing Alliances that allows one airline to sell seats under its own name and code on another airline's flight. However when two main competitors in the market enter into such code share agreement on overlapping networks, it dampens competition which may also lead to price collusion and rise by the two airlines. For example in 2006, Air Deccan signed an alliance with Jet Airways for code sharing and pooling engineering resources. This Jet-Sahara-Air Deccan alliance can have severe impact on competition as both of them have a very heavy domestic presence and overlapping networks with a combined market share of over 50 per cent, which may lead to monopoly on some routes.

Further, if Computer Reservation System displays each alliance partner's flight under each partner codes, independents or entrants shall have more difficulty in getting their flights listed prominently. Also, considering the issue that customers may be unaware of code sharing when purchasing ticket and may find themselves on carrier which they consider to offer low quality of service and would not have been willing to choose, it can be said that code sharing operations act as detrimental to fundamental issue of transparency in consumer information and interests.

To conclude, competition in airline industry could be preserved and enhanced through, inter alia, close and careful review of FFP's and such alliances and careful use of remedies to offset such anti-competitive effects. Remedies such as, requiring incumbent airlines to grant new entrants access to their FFP and control on merging airlines to keep their FFP separate and in case of code share alliances, to assess such alliances on the basis of increase in fares and elimination of competition on the basis of market power or network effects, that should be discouraged and also pro competitive effects of economic efficiencies that can outweigh potential competitive harm.

MODULE IV

BUSINESS OPPORTUNITES IN AVIATION SECTOR: RECENT DEVELOPMENTS

The Aviation Industry is facing the challenges on account of the global economic recession. The industry has undergone paradigm shift over a period of time in the Asia Pacific Region including India. Indian Aviation has recorded over 23% growth just prior to the economic meltdown. There is no doubt that the present setback is only a pro-tempore phase and there is ample evidence that industry is regaining its momentum and bouncing back at a higher rate where it was left. Whenever there is a slight demonstrated decline in the air traffic and loss of revenue, unfortunately the first casualty is training budget and when the industry bounce backs there is acute shortage of professionals and a visible gap between the trained manpower and the required manpower. Here again unfortunately there is no worthwhile aviation education institutions/ universities who could meet the projected deficiencies of the industry. The industry by itself cannot meet their own training requirement due to financial constraints and displace priorities. Per se, it is for the leaning universities/ educational institutions to come to rescue of the industry.

In India, so far, much of the Aviation related programmes were confined to IATA Travel and Tourism, and hardly any courses covering the core areas of Aviation Management. Airline sectors is in need of Airline Managers, Business Development Managers, Marketing Managers, Safety and Security Managers, Operations Managers, Air Transport Managers, Human Relations Managers, Finance Managers, Environmentalists etc. similarly Airport and Aerospace sectors, we need hundreds of such Professional Managers to meet the day to day Managerial Activities. Air Transport Industry is one of the unique business entity providing direct, indirect and induced employment opportunities. While every direct employment creates an additional thirteen indirect employment induces another nearly 100 in the induced sector thereby providing the largest employment opportunity in the global aviation market.

Projected Aviation growth in India, Asia Pacific and Middle East Region opens up equally challenging opportunities for the lawyers who were hitherto ignorant of the immense job opportunities in the aviation sector where not in a position to acquire a specialization in the aviation law. With the rapid expansion of airport, airline, aerospace sector, the global aviation market has opened up plethora of aviation opportunities for legal professionals. Aviation Law which essentially related to the international law and specific aspects related to the aviation industry is generally identified as aviation law. It is a fact that barely two or three universities across the globe the much desired qualification in aviation law. Legal Professionals with specialization in air law would easily be able to enter into the much coveted aviation industry in the managerial areas as well as in the legal departments. Legal professionals with specializing in aviation law would be in a much better position to enter into legal consultancy, legal advising, litigation, for drafting contracts, negotiating bilateral and multilateral treaties, handling of traffic rights and other and regulatory functions. Now hundreds of job vacancies are also waiting for air law experts because of Globalization, Liberalization and Privatization of aviation industry in India and abroad.

CHOOSING BETWEEN BILATERALISM AND MULTILATERALISM: APPROACHES FOR IMPROVING MARKET ACCESS IN THE INDIAN CIVIL AVIATION INDUSTRY

The air transport industry in India is not in its nascent stage, though it is in its nascent stage of liberalization. India is pursuing phased liberalization as recommended by the Naresh Chandra Committee Report and is in the second phase, negotiating for more liberal bilateral agreements and vying for full access to wider markets by entering into regional and multilateral agreements with countries with similar liberalization agendas. However, there have been major limitations, which have created distaste for the newer airline companies from entering the Indian Civil Aviation industry. According to recent reports, newer airlines, which choose to fly out of the major hubs of Delhi and Mumbai, have to park their aircraft overnight at nearby airports like Lucknow or Pune, leading to higher costs and misalignment with the peak traffic. Blame in this regard, has been attributed to the bilateral system of negotiations for market access. This paper deals with reconciling the conflict between the bilateral and multilateral approaches for entering the Indian civil aviation regime in the light of the air transport annex of the General Agreement on Trade in Services.

In the present contextual matrix, air traffic rights of scheduled air services are negotiated and exchanged on a strict quid pro quo basis under the framework of the Convention on International Civil Aviation, notwithstanding the presence of a multilateral framework under the Convention. It appears that the model of bilateralism has so far been a more widely and successfully used tool of gaining market access through the exchange of traffic rights vis-à-vis the multilateral avenues available for the same under the Chicago Convention framework. Taking this as the core argument, the paper shall argue upon the outcome of providing trading access rights through the GATS route in the form of a multilateral convention and its effects upon India.
However, at this stage the factors affecting market access should be taken into account. A nation while choosing between a bilateral model (bilateral air traffic agreement) and multilateral model (commitment to be made under the GATS Annex on Air Transport Services) will have to consider certain shortcomings of both of these, in the form of onerous cabotage restrictions, debilitating ownership and control clauses, debilitating state aid programs, vexatious slot allocations; and environmental restrictions, which may restrict market access. Elaborating upon these, the paper shall weigh the adequacy of both the models and establish as to which one be the best one for India.

In conclusion, it should be noted that acceding to GATS-specific commitments relating to a market access regime now might not seem such a distant dream, but it is still a difficult one to realize because India shows reluctance to end its protection of flag carriers. It seeks to encourage and nurture the growth of private enterprise, but not at the cost of allowing its flag carriers to fall to stiff competition from India and road. Further, India's aviation market is hobbled by third-world realities such as the dismal state of its infrastructure, policy rigidities, and protectionist tendencies towards its flag carriers. The few bold steps taken in the past to increase market access will prove to be inconsequential if India does not adequately address its infrastructural and policy rigidities.

Therefore, unless India confronts these realities soon, it will also be difficult for it to benefit from entering into liberal, bilateral or multilateral arrangements with other nations.

AVIATION INSURANCE: HAVE A SAFE FLIGHT

Insurance in the aviation sector has become an area of much review particularly when the magnitude of the problem was demonstrated in the 9/11 attacks. The insurers covering those aircrafts faced the prospect of claims for loss of hulls, liability for passengers and crew, and last but not the least, liability for on-the-ground third-party fatalities. Thus the risk and liability may rise up to mammoth proportion. Therefore it is obvious that the general principles of insurance laws in rating of premiums are insufficient in the case of the aviation sector because of the presence of high risk and liability.

Aviation Insurance in India: Aviation insurance is a very specialized branch of insurance. This unique class of business is characterized by high risk, high values and sophisticated technology. Aviation technology has developed rapidly during the last few decades. As a result, air travel these days had grown to be significantly safer than was the case a few decades ago. Emerging complexities in finance and lese arrangements, coupled with the criticality of optimum management of finances in this capital-intensive field, lend more challengers to the Aviation Insurer than ever before. This field of insurance has turned truly global in view of its inherent nature and characteristics.

Aviation insurance policies offer a wide variety of cover ages to take care of almost every conceivable situation that may bear an adverse financial impact. The aviation portfolio encompasses cover normally availed of by airline operators which includes (1) Aircraft Hull All Risks; (2) Aircraft Liabilities; (3) Aircraft Hull War Risks; (4) Spare Risks; (5) Personal Accident Cover for Crew; and (6) Loss of Licence cover for Pilots. There also exist cost effective insurance covers that are available to agencies allied to aviation industry.

Since nationalization of General Insurance Business in India, Aviation business has been under-written by the General Insurance Corporation of India (GIC) and its four Subsidiary Companies—National insurance Co. Ltd., Calcutta, New India Assurance Co. Ltd., Bombay, Oriental Insurance Co. Ltd., New Delhi, and United India Insurance Co. Ltd., Madras. While GIC writes the aviation insurance business of Air India Ltd., Indian Airlines Ltd., Vayudoot Ltd., all the divisions of the Hindustan Aeronautics Ltd., (HAL), and the Airport Liability Cover of the Airports Authority of India (AAI), the four subsidiary companies write aviation business pertaining to all other aircraft operators and Allied Agencies including Pawan Hans Ltd., and other private operators.

GIC has insured the national flag carriers since their infancy from the time they operated with small sized fleets and has seen them through their growth and acquisition of the modern and technologically advanced fly-by-wire aircraft. During this period, GIC had gained considerable technical expertise and have a proven track record tested by time and circumstances in this class of business.

The Global Connections: Aviation is a technology that has grown by leaps and bounds during the past few decades and aircrafts today are highly sophisticated. In addition, Lease and Finance arrangements involved in procurement of aircraft have grown in complexity and bear international implications. Considering fact that aircraft operations involve heavy outlays both on capital as well as on working finance, aircraft operators justifiably demand and expect more and more from insurers. Further, with new operators having tight cash flows and critical break-even operations, insurance outlays assume even greater significance. Aviation insurance has, all through, kept pace with the changing scenario and has today emerged as a very specialized and technical branch of General Insurance.

Insurance companies have constantly strived to attain one of the prime objectives of nationalization byway of maximization of retentions. Aviation insurance, however, being a high exposure and high risk branch, increasing aircraft values and limited financial risk bearing capacities have left insurance companies with no option but to share large portions of the risks with several reinsures world wide in a large number of cases.

This process of reinsurance on a global basis also insures adequate and much needed spread of the risks and is one of the fundamental principles of insurance. Lloyd's at London is one of the larges Aviation Reinsurance Markets. Relatively large markets also exist in France, elsewhere in the European Continent and in the USA. Terms in respect of major Aviation Operators/Agencies in India are, therefore, negotiated by the GIC and its subsidiary companies with Underwriters at London and other Aviation Insurance Markets.

The world Aviation Market has reeled from recurrent losses since 1985, despite hikes in premiums. For example, in 1994 losses touched a peak of US dollars 2.4 billion. These losses have eroded the reserves of Aviation Insurance and Reinsurance worldwide. As a result, several syndicates and companies have wither gone into liquidation or merely ceased writing aviation insurance business or merged with other entities. Underwriting capacity of aviation insurance stands considerably reduced. The aviation insurance market has hardened considerably leading to large increases in premium rates during the last few years. Selective underwriting practices with due recognition for good loss records and good growth potentials remain underwriting keys.

The aviation insurance portfolio in India has, in a manner of speaking, really taken off since 1991 with the introduction of the Government's Open Sky Policy and with the consequent liberalization in National Economic policies. The scenario today points to sustained growth of aircraft operators in India in the coming years.

GIC has on number of occasions lived up to their reputation as judicious insurers sensitive to the needs of the operators by way to timely interventions in expeditious claim settlements and their pragmatic approach in this regard. As a part its diversified activities, GIC also aids operators in their loss minimization, risk assessment and management programmes and also propagates effective client awareness. With this objective in mind, GIC has, during the recent past, organizes seminars of officials of Air India dealing with cargo claims. These efforts have been well received.

The expertise gained centers around various technical and related aspects of the acquisition, administration, development and management of healthy aviation insurance portfolio. These strengths are available to the subsidiary companies for the overall advantage of the Indian market as a whole. The Indian market has come of age and has presently developed substantial expertise in this effective management of this class of business with their tackling of complicated financial and technical issues. These features have put the Indian aviation insurance industry on the world map.

The adept and efficient handling of situations, including in adverse circumstance like operation to the Gulf Areas during war, and more recently the September 11th terrorists attack in the United States of America, flexibility and practical approach have earned GIC an enviable reputation in aviation circles. Constant interaction and prolonged exposures with the world markets have enabled sensitization of operations and transformed Indian aviation insurance operators and agencies into the Global Aviation Insurance Market. Several fruitful business relationships have been established where good faith, reliability and long-term relations remain key parameters.

The Indian aviation insurers, in their continued pursuit of customer satisfaction, have intertwined their business handling with educating the buyers of aviation insurance in India. Besides human resource development interventions, several client seminars and training sessions are extensively used to enhance awareness and take the aviation insurance product to where it belongs- the customer.

India is often said to be a at the threshold of a aviation revolution, but for the wings to fly high, and more importantly safe much needs to be done to improve the insurance of the aircraft. If once this is secured, India's aviation market, one of the fastest in the world, will be all set to take wings.

TRAIN THE PILOTS – BRAIN THE ECONOMY

With the air and the land going into the private hands, the dotted link between the two needs to be submitted to the safe carriers. The paper talks about, how the establishing of the new flying schools within India can strengthen our economy. The need of the hour is grooming sharper pilots with sound skills. Its for everyone to see the aviation boom and its expanding grasp over the expanding population of our country, this very India. It certainly calls for more pilots to enter the arena and in a way pilots who receive better training facilities. What can be more jubilant for us than the fact that we have an unexplored bracket to bank upon in a way to brain our economy. This in turn will boost the economy of our country to the core. What India needs after business schools, technical schools and law schools phase is the phase of flying schools (with world class flying facilities). Why we need them can best be explained with the fact that so many aspiring pilots leave the shore to gain advantage. If we are able to check this drain, we can certainly brain our economy with virtuous inflows .This can be supported by the strong and astounding technical hold India has on the markets of the world. Why not make ourselves self-potent even on the front of pilot training imparting hubs ? The creeping in of the LPG (model) which takes into account the liberalization, privatization and globalization spheres .We must also base ourselves on these .At present there are only two flying schools that hold the national status, i.e. IGRUA and Ragiv Gandhi Flying School.Better flight simulators need to find a place to catapult the over-growing needs and fill up the deficiency .Having a say at the (technical know-how) field will provide the best platform to the aviation industry. A green flag will be the sign for the new day.

3. Shortage of Pilots in India: What Steps We Need

Due to the era of Globalization, Liberalization and Mergers and Acquisitions of several medium and small sizes aviation companies like Sahara- Jet airways, Air Deccan and Kingfisher Airlines the size of Indian Aviation sector become multi times; simultaneously there are several other foreign players like Lufthansa, British Airways, and Singapore Airways who wants to trap the huge Indian aviation industry.

On the other hand India has only one government sponsored flying school and its tuition fee is not within the reach of every person. The entire Indian Aviation Industry is struggling from the acute shortage of Skilled and experienced pilots. With the aviation boom underway, and an estimated shortage of 450 pilots, many feel the Directorate General of Civil Aviation (DGCA) must facilitate an easier licensing process. The DGCA, however, insists that students must have maths and physics as subjects in Class 12; 200 hours of flying, including 25 hours of multi-engine flying; and strong theoretical knowledge of aircraft, aviation, and aerodynamics.

The DGCA says it is aware of the changing needs and is planning to phase out certain portions of the syllabus. “The profiles of commercial pilots are changing, and so is the business of aviation and the technology of aircraft: we are trying to update study material accordingly. But this won’t happen overnight. About the DGCA exams being the toughest to clear, well, that’s because we maintain quality.

To curb the problem of shortage of pilots, India should open at least 10 to 15 Flying schools and simultaneously also attract the foreign trained pilots, who have enough flying experience. The Government should sponsor financially to the students pursuing the Student Pilot License and Commercial Pilot License. On the patterns of United States of America and Canada, Government should promote more and more private players in the pilot training institutions.

Indian flying schools don’t have the foreign collaborations with the countries like Russia, USA and Canada. The problem of flying of bulky size jets by Indian Pilots can only be curbed by the introduction of new multiple engine trainers.

Shortage Of Pilots: What Steps Do We Need

With aviation industry occupying a prime position in the Indian transport sector and having a crucial role to play in India's march to emerge as global economic hub, it is incumbent upon the civil aviation to play a proactive role. One of the several problems which it is facing is the acute and continuous shortage of pilots in the country which will tarnish the industry with the associated costs.

A lot of hue and cry is what can be witnessed in the Indian aviation industry. The dire need now is to take immediate steps so as to counter the crisis of shortage of pilots and hence putting a halt on the consequential problems like dwindling expansion rate of aviation market. This has to be rectified immediately because the rolling Indian economy at this crucial hour has to expand its flying base and meet the burgeoning demand of the aviation industry and its consumer palette.

Over the past several years the growth of air traffic in the Middle East and Asia and the proliferation of budget airlines in Europe and the United States have created a drastic shortage of airline pilots. With global air traffic predicted to grow by 5 to 6 per cent annually over the next two decades, the shortage will only become more acute, especially in country like India.

The situation demands urgent reforms in the sector with rising demand for pilots, cabin crew and maintenance staff . The cut throat competition which has arisen with private players coming into picture cannot afford abrupt flight cancellations and indiscriminate poaching activities. Hence, significance of this topic cannot be ignored. Though the government has taken measures to combat the shortage, there is a need to go beyond the conventional measures and reform the procedural and substantive laws in place.

- Ameliorate Infrastructure- The Government should implement the recommendations of M.K. Kaw Committee report on reorganising the DGCA. The report had favoured setting up a central air university, State air universities, a DGCA training academy, and better supervision over flying clubs. The DGCA be given a sufficient budget and administrative and financial autonomy. The flying clubs in existence need to be open to privatisation at a faster pace. The fresh talents from the flying clubs have to be targeted upon coupled with restructuring the 17 defunct flying schools in the country levelling it to the international standards. The mushrooming private flying schools have to be given proper assistance and lucrative tax concessions on buying of aircraft, simulators, land, aviation turbine fuel etc. The Civil Aviation Requriements relating to infrastructure, procedures and manpower for grant of approval for training activities have to be relaxed..

•Reorganising Training- The primary need is to re-think pilot training and qualification to further improve safety and increase training capacity. The influx from the instituites have to be increased. The training is an expensive proposition. On the lines of other central universitites government should offer proper subsidies so as to attract the students and provide incentive to newer training institutes. The DGCA office regualtions for selection and training which are on lines of Sec 7 of the Civil Aviation Act, 1937 have to be eased. The examination procedure set is tough in comaprison to foreign universities. Examination intervals, number of examinations, high percentage have given rise to backlogs and hence the passing percentage is shockingly low. India lacks adequate number of training aircrafts owing to strict norms in the EXIM policy and high excise duties. Also, Flight Duty Time Limitations(FDTL) for trainee pilots needs to be increased from 6 to 8 hours. IATA proposition of providing a multi-crew pilot licensing (MPL) training which would reduce cost and aslo allow trainees to put in less hours of flying and more in a simulator can prove to be of great help

•Other Measures- The New FDTL Rules issued by DGCA, increasing the pilot rest period from eight to ten hours and other norms are worsening an already acute pilot shortage. The Government may consider the implementation of a transparent regulatory structure, which could reduce uncertainties, ensure a level playing field and improve the quality of services taking into account the interest of consumers. Instead of direct intervention, the Government should act as a facilitator, leaving it to the private sector to take operational and management decisions. This will enable the country to achieve the desired objectives of growth, capacity-enhancement and efficiency in both the public and private sectors. Also, facilitating an easier licensing process, hike in salaries and assuring job assurance would ensure inflow of newer ones and retaining the existing ones who have lucrative offers all over the world.

EMERGING REGULATORY ISSUES AND CHALLENGES

Air Transport is one of the world's most vital resources. Its development as an industry and its technical and service achievements rank air transports as one the greatest contributors to the advancement of modern society. Since the first jet airliner flew in 1949, use of commercial aviation has grown more than seventy-five fold. This is a rate of progress unmatched by any other major form of transport. Air Transport is essential to economic progress.[1] In an increasingly global community and marketplace, air transport makes possible the rapid movement of millions of people and billions of dollars worth of goods to markets around the world. With regarding to regulations, the International aviation was highly regulated till mid 1970s. However, late seventies and early eighties, global aviation is undergoing the most dramatic changes in its history.

Since the passing of the De Regulation Act of 1978 in the USA, the international air transport is undergoing the dramatic changes in its history. Globalization, deregulation, liberal bilateral air transport agreements, international alliances, privatization of airlines and airports, and economic constraints are some of the factors challenging established management and business practices[2]. In this process each region plays variations on a common theme. In North America, air travel is the normal way of moving people, mail and increasingly, freight. In the European Union, we have liberalization, consolidation, concentration and decentralization. Civil aviation in Eastern Europe and the Former Soviet Union is being restructured and needs strengthening –while adjusting to a free market economy. Impressive Aviation expansion is seen in India, China and ASEAN. Latin America shows promise. Everywhere, these regional trends co-exist with an intensification of global ties across the Atlantic, the Pacific and the Eurasian Continent.

The process of the Liberalization Privatization and Globalization (LPG) has become the buzzword in today's world, and aviation industry is no exception to this general norm. Deregulation, liberalization and privatization started for the last two and half decades. This process has led to the independent states increasingly becoming inter-dependent states and the roles of governments are changing form regulators to facilitator. The concept of sovereignty thus suffered a massive dilution; thereby the states have become law-takers rather than law-makers. It is also well-known that though multilateral treaties such as the Chicago Convention in many aspects governed the international air transport but the major part was dealt with by the bilateral treaties. WTO provides a classic example of this emerging trend in the arena of international trade. Since there was a pressure for movement for the present system to plurilate framework there is also growing recognition of the need to define the industry 'sub sector' for trade purposes; to keep the airline industry 'on-board' and to generate new thinking, inter-alia on whether the concept of 'conditional most-favored nation' (MFN) could be applied to air transport in the context of GATS. However the main reasons for limiting GATS coverage of air transports was that at an initial stage the Uruguay round negotiators recognized that the air transport was governed by a large number of bilateral agreements based on balanced and reciprocal exchange of rights between states coupled with fair and equal opportunity.

With this scenario privatization of airlines and airports, and liberal and open "open skies" bilateral agreements, are the some of the new trends emerging on the horizon. Deregulation and intensified global competition are forcing airlines to become responsive, competitive and efficient by focusing more closely on their customers and operations. The technological, infrastructural, institutional, economic and human challenges have prompted those in charge of airlines and aviation-related agencies to effect a shift in their polices and approaches pursued for years. In fact, civil aviation in the new millenium would be one of the biggest growth sectors.

The attitude of the government and industry towards the regulation of air transport has undergone a profound change over the past few years in almost all parts of the world. The worldwide impact of deregulation, privatization and globalization forced all parties to rethink the ground rules by which the airline industry had been regulated since the Chicago Convention 1944. Even many countries in Africa, Asia which once adopted a defensive position against liberalization, have recognized powerful pressures for changes in the regulatory system.

The global economic forces are compelling the governments and airlines everywhere to redefine their respective roles in air transport. the entire industry is undergoing a drastic transformation from regulation to deregulation, mergers, acquisitions, alliances, consolidations, and allied issues of privatization, liability, insurance and infrastructure, code-sharing arrangements, computer reservation systems and other inter-airline agreements are changing the structure of the airline industry. On the other hand, new concepts of ownership, financing, management and operation of airports are emerging. Traditional patterns of state involvement are increasingly being questioned. Many governments have begun to pursue competitive policies domestically - including the continuing movement to privatize many government-owned airports - and to expand foreign holdings in airport equity. As a result, there is a significant growth in the number of alliances over marketing, code sharing and computer reservation system.

The beginnings of reform process in civil aviation in India.

Regulatory frameworks have had significant impact on the evolution of the Indian aviation industry since its very beginning. The first generation of aviation regulations were created in the colonial era to ensure that growth of aviation did not pose a threat to the colonial government and served the strategic interests of the imperial government. In the post-independence era the aviation industry was nationalized and the second generation of aviation regulations were introduced to cater to this state monopoly.

The Narasimha Rao government faced with an impeding economic crisis in the early 1990’s changed course and an era of liberalization and deregulation was ushered in. The aviation sector, which had been struggling as state monopoly, has also been slowly deregulated and private players are making their presence felt in the industry. However experiences in the past fifteen years have shown that as the industry moves increasingly away from the stated-centric model of the nationalization era to a multi-player model with large scale participation from private players in the post-liberalization era, crucial issues relating to regulation of the rapidly evolving civil aviation industry need to be addressed, in a manner, that would ensure effective and sustainable growth of the industry

The reform process in civil aviation in India was in response to the global developments, particularly after Deregulation Act 1978 in USA which followed because of new global economic philosophy to promote privatization , liberalization, and globalization in economic relations. Civil aviation is an international commodity which provides means for international economic relations between states. The ICAO also held important conferences inviting states to discuss new measures to introduce privatization and liberalization in global air transport. The Planning Commission in India made a study of deregulation in international air transport and lessons for India. There was a national debate on this subject. There was no alternative but to go with the global developments. Some reforms were introduced in stages. The domestic and international airports were merged for administration. Private enterprise was introduced for airports developments .The national airlines Air India and Indian Airlines were made into holding companies and private airlines were permitted to fly for public transport purposes. Besides there was new look being given to aviation policy to promote national economy through civil airlines and airports. An open sky policy was adopted to promote greater entry for foreign airlines to India. There was a proposal to merge Indian airlines and Air India into one single national carrier for domestic and international services and to provide a better competition with foreign airlines. Some GATT principles were adopted to promote free trade through civil aviation. Air India joined a group of airlines for common pool for cargo services. Code- sharing was introduced to promote joint marketing by national carrier with foreign airlines. Some times unilateral permission was given to foreign airlines to operate to India. In a way therefore the Government and the regulatory authorities had responded creatively to the challenges to the global civil aviation and made use of reforms to promote national economy.

In the aviation sector, the liberalization /open skies policy started in India in the late 1980s. A strong consumer demand and constraints on the rapid expansion of national carriers and tourism potential have favoured this policy. India first introduced the open skies policy in cargo services and chartered flights for domestic and foreign carriers. The open skies policy in cargo has facilitated the emergence of all-cargo airlines in India. India's new economic policies in the early 1990s have triggered far-reaching fiscal, trade, industrial and economic reforms, aimed at accelerating growth, employment, productivity and technical innovations. In civil aviation sector, the government repealed the Air Corporations Act 1953 and passed the Air Corporations (Transfer of Undertakings and Repeal) Act in 1994. This Act ended 40 years of state monopoly and a large number of private domestic airlines are now operating in the Indian skies.

The new legal issues in the area of airlines & airports activities have been growing every single day. Though we have existing aviation laws in place, it is not adequate enough to address all of them satisfactorily. So we have emerging issues like the privatization/commercialization of airport activities, intellectual property rights, questions of liability, Airport privatization areas & concerns, Due diligence consultancy & other issues, growing importance & legal issues involved in air cargo, commercial issues in civil aviation, safety , security& environmental issues , emerging issues and issues arising from the lack of Aviation legislation in most countries, our very own country, India, for example. As lawyers, we have to handle them, and handle them well. It is with this hope and heartfelt desire that I have envisaged the proceedings for the day and I am sure at the end of all the interesting presentations and discussions, each one of us would go home, aware and enlightened of all the facets that constitute and contribute to space law.

M.K. Law National Committee Report on Civil Aviation March 2006.

The terms of reference of above mentioned committee were to examine functions of DGCA as envisaged by ICAO, authorize DGCA to carry out its functions , comparison of regulations in India with other countries, organization of DGCA and its manpower and training requirements, procedures adopted by DGCA for a) Licensing of airlines, b) licensing of personnel that is pilots ,engineers, flight dispatchers etc. c) examination system d) clearance of international scheduled and non-scheduled flights, administrative and financial autonomy of DGCA for its functions, to conduct audit as per ICAO Protocols for air safety etc. The above committee invited top level experts from aviation world during its deliberations to complete the terms of reference.

The Kaw Committee made the following recommendations which have been approved by the Government of India and are being implemented ever since they were made.

4.1 There is need for overall civil aviation policy and the civil aviation act.

4.2 There is need for flexible use of Indian air space by both military and civil air traffic.

4.3 The Government should establish a National Advisory Committee on Civil Aviation with Secretary civil aviation as chairman and DGCA as member- secretary.

4.4 DGCA to act as aviation safety and aviation economic regulator. However, the Ministry of civil aviation has opted for a separate economic regulatory body.

4.5 The DGCA to act as a facilitator for developmental activities in operational and manufacturing fields.

4.6 DGCA to be catalyst for aviation manufacturing and training activities.

4.7 Urgent need for National Training policy and National Aviation University.

4.8 Streamlining of DGCA procedures for grant of clearances of flight schedules, licensing of airlines and aviation personnel.

4.9 Review of examination systems of DGCA and its central examination organization

4.10 Setting up DGCA Governing Council and its empowered committee with Secretary Civil Aviation as chairman to exercise administrative and financial autonomy for DGCA.

4.11 DGCA as an empowered arm of the Government rather than a civil aviation authority.

4.12 Need for a comprehensive manpower policy for DGCA and introduction of new all India civil aviation service.

It may be said, that the civil aviation law and policy are a reflection of the national economic policy for development and growth. Aviation in the modern world is a means for economic development. In the report by ICAO made in 1996(ICAO Doc 9687 dated May 1996), the Asia and the Pacific Region has the highest growth rate during period 1996 -2010.This forecast has been proved right. In the Annual Report of the Council 2005 the ICAO informed its strategic objectives and business plan for period 2005 -2007. It made six following important strategic objectives:-Safety, security, environment protection, efficiency, continuity, and the rule of law.

The ICAO recommends for the business plan that it should be achieved by requirements-driven, results-oriented organization, and there is need to introduce new methods for optimal use of limited resources.

PROJECT FINANCE IN AVIATION

India is one of the fastest developing country with poor infrastructure. Infrastructure of a country is backbone of the country. Airport being a nuclei of economic activity assume a significant role in national economy. Now there is dire need to develop the infrastructure. Airports are the very important part of infrastructure. The finance of infrastructure development projects is generally sought to be done through an approach termed as 'Project Finance'.

Project Finance can be defined as the method of financing of the development or implementation of any project where lenders look at the project for recovery of amount due to them rather than at the borrower or assets of them. Project finance is not financing a project. Project finance is defined as raising funds to finance an economically separable capital investment project in which the providers of fund look primarily to the cash flow from the project as the source of funds to service their loans and provide a return on their equity invested.

Passengers carried by domestic airlines increased by 36.47 per cent (to 317.29 lac passengers) in the first three quarters of 2007, against 232.49 lac in the same period last year. Overall aircraft movements also increased by 27.2 per cent in April 2006 – August 2007, as compared to the same period in 2005-06. International movement was up by 12.9 per cent and the domestic, by 31 per cent. Simultaneously, overall passenger traffic increased by 28.5 per cent, while the freight traffic was up by 11.9 per cent.

The International Air Transport Association (IATA) in its latest estimates this year reckons India to be a driving force behind the world's civil aviation business that is globally expected to grow from US$ 5.1 billion to US$ 5.6 billion this year.

Air Traffic

India's air passenger travel is expanding at about 25 per cent a year, and. Growth in this sector will outpace the global average until 2025, according to government estimates.

Domestic air traffic is likely to more than double and touch 86.1 million passengers by 2010, up from 32.2 million passengers in 2007, states the market research firm PhoCus.

According to data compiled by the Airports Authority of India (AAI), 16.21 million people flew on international routes to and from India during April-October 2007-08. This was a growth of 17.1 per cent over the same period last fiscal.

So there is a need of more airport infrastructure but government have limitations to finance the new airport infrastructure and develop the existing airports up to international standards. So project finance by private players is the best way to develop airport infrastructure according to requirement.

Issues:

Negotiation considerations such as identification of the project, drafting of the Memorandum of Understanding with State and Central Government officials, location of feasibility study funding, determination of project feasibility, and interaction with Central Government officials to move projects through required official clearances. I will examine foreign investment considerations such as a review of the Indian political, legal and business systems; the identification of major investors into India; an analysis of equity, export performance, local content, currency conversion, technology licensing agreements, dividends repatriation, and direct taxation requirements; an overview of government concessions and incentives; the identification of specific indirect taxation through import duties; and review of contract requirements.

Legal Feasibility- Here the most important aspect is the security for the loan

1. Term loans are usually fully secured

2. The term lending institution will have to examine the loan proposal from the 3. 3. view point of the nature and the extent of security offered

4. Term loans are secured by creating a charge on the immovable and movable properties of the plant

Project Finance In Airlin

In the last few years major structural and organisational changes have been occurring within the air transport industry. Major airlines have been consolidating their services by forming international alliances whilst a new generation of low cost carriers have entered the market. At the same time, a growing number of airports have been privatised which has allowed airport groups, which control a number of airports in different countries, to develop. In the era of globalisation, the aviation industry is booming very much and low cost operating airlines are coming up and project financing or we can say that financing in the airlines or like mergers or take over of major carriers in aviation are taking place. If we take the example Kingfisher is a major airline and it took over the small and budget carrier Deccan airways, so many low cost airlines are coming up and investment in this field is very much as we have seen the changes in the recent decade that the purchasing power parity of a common man has increased many times folded, so for increasing demand in the aviation industry so many low cost airlines or we can say budget airlines came up and huge money is being invested in this field, if we look at the past few years only few airlines were there and they were even not permitted by the aviation ministry to fly internationally but now many private airlines are there which are flying internationally. Now financing of the airlines or venturing up the capital in starting the new airlines is booming up, every day we hear of some or the other airline coming up in the market, competition is so high that financing in the aviation sector or like in airlines is a new phenomenon which has been seen in the recent days. Project financing involves various aspects like, first of all the attention required as such the latest techniques in airport traffic forecasting, revenue and cost projection, airport charges regulation, project finance and risk assessment. Key market trends will be evaluated, including the growth in global airline alliances, low cost airlines and increasing concern over environmental issues, together with their potential implications for future airport growth. In the same decade airports have transformed from a public service to a value creator in a transport network. Deregulation of air transport markets has shown that the introduction of competition may have drastic impacts on network configurations of airlines, because of free route entry and exit; airlines will use their route networks to achieve traffic economies and maintain spatial monopolies in a competitive environment, so the major thing is that project finance in airlines is increasing day by day, economy is growing, as the number of growth of airports is also growing, so financing projects related to the aviation industry is seen as a profitable venture. Predatory Pricing is assumed, when an incumbent airline responds to market entry by greatly expanding capacity and low-fare seats. Summing up project finance in airlines is now a seen as a profitable venture as the market trends are changing in the developing country like India, so financing the airlines is also seen as a new phenomenon.

SPECIAL ECONOMIC ZONES AND AIRPORTS

It could be another `chicken-and-egg' story, if we say infrastructure investment would follow investment by SEZ (Special Economic Zone) users, or can be said other way around. The rapidly growing number of SEZ across the country, after viewing the progression records of various other nations (like China, Philippines, UAE, Indonesia and Polland) fuelled by the establishment of SEZ, is evidencing the interest of Indian Government to make the units a successful and progressive step for the nation. These are export promoting zones identifying themselves as 'free' and 'special', distinguishing themselves from other regions by relaxed tariffs, taxation and administrative regimes.

To accomplish the success of the zones, a synergism on the part of government and developers can be seen. The SEZ providing an internationally competitive and hassle free environment for exports. Connectivity of each SEZ thus becomes a significant factor to be undertaken which make the project more efficient and cost effective. In order to create world class trade-related infrastructure facilitating import and export of goods aimed at making India a global trading hub, the multi-modal connectivity has already been a focus of the developers. The economic rationale behind the promotion of SEZ is to deal with infrastructural deficiencies, procedural complexities and attempts can be seen very well on part of developers providing high infrastructure. For instance- creation of logistic parks inside SEZ and enjoying world class logistic support, which is not only a part of infrastructure but indeed a grave requirement. For the time critical and time sensitive logistic platforms, the developers of SEZ/ Unit are confidently dependent on the airway. It has been noticed that an important factor which has been considered, while setting up SEZ, is the distance between SEZ unit and the airport, supplying a smooth access to airports.

The prevailing tendency of development of SEZ near airports is already being followed; further the priority of developing the airports near or inside SEZ can be seen in future being adopted as a frequent trend. Although in India in many of these units, the zone's private aerodrome with air strip of international class is fully functional which receives private/chartered flights. Establishment of international airports inside SEZ is a new source of energy, as the conception of establishment of SEZ unit inside an airport have already been adopted by the developers in many states. The idea is to provide the highest and fullest degree of infrastructural facilities in and around the SEZ. The easy and convenient air linkages to these units will result in maximum efficiency and will exhibit high ratio of output. Many Infrastructure development companies are also planning to set up an airport-based SEZ near the newly constructed International Airports, in which aircraft component manufacturing industries and high-end aircraft engineering support activities will be carried.

After the introduction of concept of privatisation of airports and commercialisation, new developers and private companies are investing in India's infrastructural development. Specially, in the field of airports, we can see many domestic and foreign companies interested in investing in Indian airports, which is a featured attraction for the confident and bold investments made by SEZ investors and developers. Without such facility of availing convenient air transport service, it would have been difficult for the SEZ developers to gain confidence on the heavy monetary investments made on the development of these export zones.

AIRCRAFT LEASING IN INDIA: AN OVERVIEW

The increasing popularity and possibility of leasing is dictated by the rapid growth of technical developments and the need for bigger and faster aircrafts. The airline companies had to face steeply rising costs and often could not afford to buy new aircrafts. At the same time these larger aircrafts contributed to temporary overcapacity, thereby reducing the profit of the airline companies. Thus one can say that privatization of aircrafts has led to the development of aircraft leasing and financing. An aircraft is an expensive commodity and aviation is a sector with great prospects so many private entities have started running airlines by acquiring aircrafts either through leasing or by getting it financed. As the aviation industry is growing by introduction of more and more airlines so is the business of leasing and financing of aircrafts. Therefore there arose an urgent need to regulate the aircraft leasing and financing industry. The article also briefly discusses the Cape town convention and the Protocol which can be called the mother convention of aircraft leasing and financing.

Owning the "Big Bird" is an expensive deal. Purchasing new aircrafts further makes it an attentive proposition in exchange of monetary. It is a common practice in the airline business to take aircrafts on lease. Leasing not only assists in increasing the paradigm of airline sector, and more importantly, reduces the instant cost of airline operators. Universally aircraft leasing is quite prevalent and practiced. In India, There is an entire gamut of legislations dealing this business, viz.

Directorate General of Civil Aviation ("DGCA"), the Reserve Bank of India ("RBI"), Taxation Department, which parties entering into aircraft leasing transaction have to consider.

Leasing of aircraft is a extensive portion of financing and accounting of airline operators in terms of both the magnitude of capital and the complexity of lease classification. Leasing is an important instrument used by Aviation companies dealing in capital management, especially when facing financial distress. Basically aircraft leasing provides two main purposes that is to have aircraft without the financial burden of buying them, and to provide temporary increase in capacity of business and services. In this regard lease classification and the related accounting treatments are critical and necessary to the airline industry.

Leasing has become a common and important technique to acquire an aircraft, which is governed by various law and regulations. One of its prime advantages of leasing is that it helps to manage the finance investment. Leasing of aircraft is most common in private as well as in public aviation sector. Both short and long term aircraft leasing options are available to aviation industry.

Aircraft leasing are classified into finance and operating lease. Finance lease is required to meet criteria like: a lease term greater than 75% of the aircraft's estimated life, option to purchase it at less than fair market value, or transfer of ownership to the lessee when lease expires. It also enhances tax benefits and is explicit on the balance sheet of the lessee. Generally, it's for a long term period. On the other hand, an operating lease is meant for a short term period. Presently, most of the aircraft leasing is on the basis of this type of lease. According to data, there are about12,500 commercial aircrafts over the world, among which about 2500 flying on operating lease. It's always a constructive and beneficial deal to relish aircraft leasing service from Commercial Aircraft Sales and Leasing, a collective term given to organizations involved in marketing airliners from manufacturers of like Boeing and Airbus. A innumerable number of other providers, such as commercial banks, financial institutions, and hedge funds, are also in the scenario to provide aircraft leasing services. Of which noticeable are GE Commercial Aviation Services (GECAS) and International Lease Finance Corporation (ILFC). Besides, some companies offer leasing as well as financing packages for commercial and corporate aircrafts. Customized aircraft leasing packages are also designed to meet the demands of the market.

Despite the high growth of the Indian aviation market, the legal, tax and regulatory environment continues to be a challenge for lessors and financiers of aircraft –both at domestic and international levels. A variety of issues comes to non-Indian lessor or financier of an aircraft to an Indian operator.

MEANING, DEFINITION AND CONCEPTS

Meaning of Aircraft Leasing: Aircraft leasing is a contract whereby the owner (lessor) of an asset agrees to another party (lessee) the exclusive rights to the use of asset (aircraft) for an agreed period of time, in return for of rent or premium which is to be paid periodically. In Indian context the word 'lease' is defined under section 107 of Transfer of Property Act, 1882 which deals with only immovable property only. Aircraft being the movable property so the appropriate word to be used is ‘Bailment’ of an Aircraft which is defined under section 148 of Indian Contract Act, 1872. In foreign context the word ‘lease’ could be used as the ICAO document (Manual of procedures for operations inspection, certificate and continued surveillance) and Regulation (EC) No. 1008/2008 (common Rule for the operation of Air service in community defines following :

Lease: a “...contractual agreement whereby a properly licensed air operator gains commercial control of an entire aircraft without transfer of ownership ”

Lessor: “…the party from which aircraft is leased ”

Lessee: “…the party to which aircraft is leased ”

Concepts of Aircraft Leasing: The nature of leasing is a contract between the lessor and lessee where lessor provides the right to use asset to lessee. The contract has its own specified time, referred to as the lease term for which the lessee is obliged to pay the installment as agreed between the lessor and lessee. Generally, a lease contract may not be cancelled by either party unless certain terms and conditions specified in the contract switch to its termination. A lease automatically terminated on the completion of the lease term unless renewed. At the expiry of the lease term, the lessee is usually required to return the asset (aircraft) to the lessor, unless the lessor provides an option to the lessee to purchase of the asset (aircraft). No separate act exit to do aircraft leasing. Neither the aircraft Act nor the Aircraft Rules contain any specific provision in this regard. As with leases in general, therefore, the provisions of the contract act will apply. In order for there to be a valid lease there must be an offer and acceptance together with consideration . The parties must be competent to contract .

Most airlines increasingly rely on aircraft leasing to large up front capital requirements and efficient way to purchase the aircraft. According to report , major airlines across the world had accumulated approximately 13,458 aircraft. The international Lease Finance Corporation (ILFC), estimates that one out of every three commercial aircraft is leased one. Thus the leasing is becoming more prevalent in the airline sector.

TYPES OF AIRCRAFT LEASING

Basically there are two types of Aircraft Leasing: Dry lease and Wet lease.

Dry Lease: A dry lease agreement is “… an agreement between undertakings pursuant to which the aircraft is operated under AOC of the lessee… ”In Dry lease, an aircraft is leased without insurance, crew, ground staff, supporting equipments, maintenance etc. Airlines enter into dry lease agreement which has its own flight and maintenance department and need aircraft only and no other services. Dry lease is used by the leasing companies and banks, requiring the lessee to put the aircraft on its own AOC and provide aircraft registration i.e. Aviation Regulation becomes the responsibility of the lessee. The tenure of the aircraft lease is more than two years and consist certain conditions regarding depreciation, maintenance, and insurance etc. and also depending upon the geographical and political circumstances etc.

Requirements of Dry lease in India

Registration of aircraft: - Operation of foreign aircrafts on dry lease requires registration of aircraft in India. The leased aircraft ought to have a valid Certificate of Registration (“CoR”) and must be entered in the operating permit of the operator. According to Civil Aviation Requirement (“CAR”) regulations , registration of aircrafts can be done either in Category A or B. For leased aircrafts, the registration falls under Category A. the registration of the aircraft is valid as long as the lease is in force and the aircraft is maintained in accordance with (i) the DGCA Regulations; (ii) the terms and conditions specified in the operator’s permit; and (iii) the operator’s maintenance control and operations manuals. The operator can apply to DGCA for extension of validity of the CoR. Airworthiness of the aircraft- once the aircraft is registered, the owner of his authorized representative has to apply to DGCA in a prescribed form together with the requisite fees prescribed in rule 62 of Aircraft Rules 1937 for obtaining CoA . An application for issue of Aircraft Noise Certificate is also to be made along with the CoA application. CoA is valid for a period of Twelve months. In case of imported aircraft, the validity begins from th date of issue of Export Certificate of Airworthiness and is restricted to the validity specified in the standard certificate of Airworthiness issued by the country of export.

Two types of Dry lease: There are two types of dry lease:

(a) An Operating lease; and (b) A finance lease.

An Operating lease: In case of an operating lease, the aircraft is leased for short period of time as compared to its total economic life. An operating lease is commonly used to acquire aircraft for a term of 2-8 Years. For instance, if the total economic life of aircraft is 20 years then under operating lease it may be leased upto 8 years, upon the end of the lease period, the lessee returns the leased aircraft to the lessor and there is no option of purchasing the aircraft. The lessee does not show aircraft into his balance sheet under operating lease.

Finance lease: The finance lease is also known as Capital Lease. Finance lease is long term lease and the lessee has the option to purchase the leased aircraft upon the expiration of leasing date and also includes:

- Lease payment more than 90% of the market value of the aircraft.
- The term of the lease is over 75% of the aircraft’s usage life.

Wet lease: “… an agreement between air carriers pursuant to which the aircraft is operated under the AOC of the lessor… ”.A Wet lease provides the aircrew, maintenance, aircraft logs and other support function with the leased aircraft to lessee. A wet lease is beneficial to a company that wants an aircraft at its disposal but does not want the burden of hiring a flight department to fly and maintain aircraft. Over the years the aircraft leasing terminology has gone through many changes which may not reflect the service provided; for instance, in U.K wet lease use to mean, quite logically, 'including fuel'.

Requirements of Wet Lease in India : Operation of foreign aircraft leased by Indian operators is normally permitted on dry lease basis. Import of aircraft for domestic air transport operations on wet lease basis is not permitted except in emergency situations and in the following circumstances such as the existing aircraft of an operator is grounded for maintenance/inspection checks or due to any other unforeseen reasons.(in such cases, wet leasing is permitted only for the duration of grounding of aircraft); or the existing aircraft is involved in some accident/ incident or due to expiry of existing lease and delay in finalization of new lease agreement, there is a reduction in capacity of the operator; or for revival of sick operators who should have an agreement with the lessor initially for wet lease for a period not exceeding six months and, thereafter, automatic conversion to dry lease for the remaining period of lease; or short term induction of capacity required to meet emergency situation such as natural calamity, industrial unrest or any other similar situation .

Other important provisions pertaining to operation of aircrafts on wet lease are discussed below:

- The state of registry has to confirm that their legislation enables them to divest themselves of the functions and duties which are the object of the transfer agreement, agree for surveillance of aircraft operations and maintenance by DGCA , and should furnish a letter from the concerned regulatory authority in this regard;

- There should be well stated agreement between the lessee and lessor stipulating that the Indian operator and DGCA will have the authority to exercise airworthiness and operational control on the wet lease aircraft operation:

- The lessee and the lessor must have a valid and effective operation permit or AOC for the type of operations.

Type of Wet Lease: Damp Lease: a "…wet leased aircraft that includes a cockpit crew but not cabin attendants" . Under Damp lease, the lessee will provide cabin crew. However, in order to give initial guidance to the crew of the lessee, sometimes, the lessor provides a trainer on board for a limited period of time to give SEP (Safety and Emergency Procedure) training to the cabin attendants.

General requirements applicable to both dry and wet leases: For leased aircraft operations in India, the aircraft should have been type-certificated by Federal Aviation Administration of USA or Joint Airworthiness Authority of Europe or Civil Aviation Authority of UK or any other authority acceptable to DGCAA. It is operator's responsibility to confirm that the lease agreement does not contain any provision which will be binding on the DGCA. The lessor, on his part, has to give an undertaking in the lease agreement that he would comply with all the application accordance to “CAR” rules.

Tests for lease classification In terms of criteria for lease classification, the following four tests are generally applied.

- Transfer of ownership test
- Bargain Purchase option test
- Economic life test: 75% rule.
- Rule of investment test: 90% rule.

ADVANTAGES AND STRUCTURE OF AIRCRAFT LEASING

Advantages: The advantages of aircraft leasing is as follows:

1. Full financing at fixed rates: The lessee is entitled to use an asset (aircraft) Without paying full cost-up-front which helps to conserve score cash.

2. Protection against Obsolescence: Leasing and asset reduces risk of obsolescence, and in many cases passes the risk in residual value to the lessor. If the asset value changes in a short period of time, lease is effective way to avoid such risk from lessee’s end.

3. Less costly financing: Tax benefits that accrue to the leasing company or financial institution may sometimes be transferred to ht e lessee in lower rent payment form.

4. Flexibility: The agreement of lease may less restrictive provision as compared to other debt agreements. For e.g., a lease payment schedule can be structured to meet financial condition of the lessee. If you own the aircraft, you may have virtually complete control over its use. Depending upon the resale market for the aircraft and how long you are willing to hold it, you may be building equity. However, there is less flexibility with ownership. The aircraft you purchase may become obsolete or the company's aircraft needs may change over time. A substantial down payment may be required to purchase an aircraft, depleting the company's working capital and adversely affecting your debt-equity ratio. In addition, payments towards purchase may be higher than available lease arrangements. Some companies may be subject to requirements prohibiting aircraft ownership due to shareholder or insurance liability concerns.

A lease arrangement may be more flexible than purchase of an aircraft. A lease can enable a company to get in and out of aircraft use more easily through shorter-term commitments and without the prepayment penalties that might be triggered upon sale of a leased aircraft and the risks and responsibilities of aircraft ownership.

5. Attractive minimum tax problems: As the ownership of equipment results in an increase in tax liability under alternative minimum tax rules, companies can avoid the onerous alternative tax provisions by way of leasing equipment.

6. Off Balance Sheet Financing: depending on the type of leases, the lessee can treat lease transactions as off-balance sheet. This is critical to those companies wishing to increase borrowing capacity. Companies can avoid increasing balance sheet liability by leasing equipment instead of purchasing. One reason to choose a lease over purchase is that it can minimize the cash flow required to provide what is, in effect, a service (transportation), rather than an asset, necessary to company operations. In most cases, the company has no inherent interest in owning aircraft, only in using aircraft. Even companies in business directly involving aircraft, such as the airline industry, often lease. Currently, about half of the commercial aircraft operating worldwide are leased.

7. Tax-Advantage: Ownership of an aircraft will generally give you the right to depreciate it for tax purposes. However, only interest, not principal, will be deductible. For some companies facing potential Alternative Minimum Tax issues, a lease with fully-deductible payments could present advantages. Or, if the company has insufficient tax liabilities to take advantage of depreciation deductions, leasing might provide a cheaper method of acquiring use of an aircraft. Also, a company with international operations may have options, in terms of structuring the acquisition of aircraft that make the option of leasing more desirable than purchase.

8. Since lessors assume a residual value to the aircraft being leased, they can typically offer a lower rental payment. However, to optimize the cash flow benefit, leases usually must be for a longer term. In addition to freeing up cash, leasing also may help keep your lines of credit open.

9. Leasing also can remove long-term debt from the balance sheet. Under many lease agreements, lease rental payments will qualify as an expense, not debt, under applicable accounting rules. Companies looking to clean-up their balance sheets may prefer leasing to purchase of aircraft. You may, however, have to reflect your lease obligations in the footnotes to your financial statements.

CHARGES AND TAXES UNDER AIRCRAFT LEASING

Fees and Charges: There are no fees or charges payable in respect of the creation of an aircraft lease. Registration of the lease (in case it gives rise to a charge) with the Registrar of Charges will entail a nominal fee. So too, will registration of the lease with the Sub-registrar of assurances.

Taxes: The usual taxes and duties on aircraft leases are described below:

VAT: This was introduced in April 2005 and has replaced Sales Taxes in all 29 States and six Union territories of India. However the following sales are exempt:

a)If made in the course of inter -state trade or commerce;

b)If made outside the state;

c)If made in the course of import of the goods into or export of the goods out of India.

Custom Duty: No customs duty is payable on import of aircraft by Scheduled/ Non- Scheduled Operators, Flying Clubs and Training Institutes into India.

Capital allowances: Capital allowances are in the nature of tax depreciation allowances arising on the purchase of certain plant and machinery, including aircraft. Capital allowances may be claimed in respect of aircraft by the owner.

Corporation tax: In the case of a non-resident assesses, engaged in the business of operation of aircraft, the income chargeable to tax in India under the head "Profits and gains of business or profession", is calculated at the rate of 5 per cent of the aggregate .

Stamp duty: Stamp Duty is levied in India on instruments in accordance with the Indian Stamp Act. If the instrument is executed overseas and relates to a property located overseas, there is no stamp duty.

DIRECTOR GENERAL OF CIVIL AVIATION'S (DGCA) REQUIREMENTS IN INDIA

DGCA Permission: For leasing an aircraft in India DGCA's permission is mandatory. A lessee can either take an aircraft on lease from a) foreign operator b) Indian operator.

Aircraft Lease from a Foreign Operator: Where the Indian operator intends to take a foreign registered aircraft on lease, charter or any similar arrangement for a person holding Air Operator Certificate (AOC) issued by another State, the following information has to be provided by the Indian Operator to the DGCA at least 45 days prior to the proposed date of operation with the eased aircraft. i.e. Name and Address of the Indian Operator and the lessor, aircraft details, AOC details along with operations specifications, if any, of the lessor, name and contact information of the State of Registry, a copy of the letter of intent, planned arrangements for operation and maintenance of aircraft during the lease period, proposed date of import into India.

Aircraft Lease from an Indian Operator: In the event an Indian Operator intends to borrow an aircraft on lease from an Indian Operator the following information has to be provided to the DGCA at least 45 days prior to the proposed date of operation with the leased aircraft, ie. The name and address of the operator from whom the aircraft is intended to be leased, AOC details along with operations specifications of the lessee and the lessor, aircraft type, registration number and its main base, maintenance agency with scope of approval, a copy of the draft lease agreement and maintenance agreement, any amendment proposed to be made in the Operations Manual or other relevant documents, a document giving details of the respective responsibilities of compliance with regulatory requirements such as arrangements for Flight Operations Quality Assurance, Flight dispatch and responsibilities of the lessor and the lessee with regard to operation, maintenance and quality system of the aircraft.

Upon receipt of the aforesaid information, the DGCA finalizes the modalities for operation of the leased aircraft at a meeting with the Indian Operator. Where the aircraft is taken on lease from a foreign operator, the representatives of the foreign operator and the regulatory authority are also allowed to participate in the meeting. The DGCA can conclude an agreement under Art. 83 with the State Registry and the State Operator for transfer of certain regulatory functions. It has also the discretion to impose conditions while granting permission to the Indian Operator for operations with the leased aircraft.

Lease agreement and stamp duty: Pursuant to the DGCA permission, the Indian operator can conclude a formal lease agreement with the lessor. The agreement should include the conditions decided by the State of Registry and the State of Operator and the ones imposed by the DGCA. A copy of the lease agreement has to be, thereafter, filed with the DGCA at New Delhi (the DGCA usually asks for a notarized copy from the airlines). The copy of the lease agreement does not attract stamp duty in the State of Delhi but it is necessary to stamp the lease agreement in the relevant state, (the state in which the airline is incorporated or has its operational base), prior to filing with the DGCA. Stamping is necessary to ensure that the lease agreement is enforceable in a court of law. In India, the stamp duty rates vary from state to state.

DRAFTING OF LEASE OF AIRCRAFT

While drafting a Lease Agreement of an Aircraft the following are considered at the time of execution of the deed between the parties. Information to be given regarding Aircraft which includes Aircraft Make and Model, Aircraft Manufacturer’s Serial Number, Aircraft Registration Mark, Made and Model of Engines, Serial Number of Engines etc., Summary of the Transaction, Place and Date of Delivery, Lease Term, Security Deposit, Transaction Fee, Rent, Reserves and other payments, Involvement with Aircraft Manufacturer, Pre-Delivery, Delivery and Post-Delivery Documentary and other requirements, Disclaimers, Manufacturers and Vendors’ Warranties, Operation of Aircraft, Subleases, Maintenance of Aircraft, Use of Reserves, Title and Registration, Identification Plates, Taxes, Indemnities, Insurance, Loss, Damage and Requisition, Representation, Warranties and Covenants of Lessee, Representations, Warranties and Covenants of Lessor, Financial and Related Information, Return of Aircraft, Assignment, Default of the Lessee, Notices, Governing Law and Jurisdiction and Miscellaneous.

OWNERSHIP INTEREST, LEASE INTEREST AND COMPETING INTEREST

OWNERSHIP INTEREST:

Ownership interest includes the following requirement:

1. Registration: It is likely record a lessor’s exclusive interest as the owner of an aircraft with the Indian Directorate General of Civil Aviation (DGCA) & this will be redirected on the aircraft’s certificate of registration.

2. Registration documents: The type of documents to be submitted to the DGCA in connection with any transfer of title and/or the issuance of the certificate of registration will be determined by the nature of the transaction: new delivery; sale and leaseback; or sale of aircraft subject to existing lease.
3. Registration fees: No registration fees are payable to the DGCA in connection with the recordation of an ownership interest, although a nominal fee of 1,000 Rupees is payable in relation to the issuance of a new certificate of registration upon change in aircraft ownership.
4. DGCA approvals: Depending on the nature of the transaction, a variety of DGCA approvals might be required
5. Effective title transfer: Indian law will generally recognize as effective an English law title transfer pursuant to an English law aircraft purchase agreement and an English law bill of sale.
6. Sales tax and VAT: Sales tax or VAT will apply if the aircraft is located in India at the time of title transfer.
7. Stamp Duty: As with a variety of other transaction documents, stamp duty might be payable in relation to a sale and purchase agreement and/or bill of sale as a condition to its enforceability in India.

LEASE INTEREST

It requires the following things:

1. Registration: It is possible to record the lease agreement with the DGCA.
2. Registration documents: A copy of the lease agreement must be filed with the DGCA in New Delhi.
3. Registration fees: No registration fees are payable to the DGCA in connection with the filing of the lease agreement, although a nominal fee of 1,000 Rupees is payable in relation to the issuance of a new certificate of registration upon change in aircraft ownership.
4. DGCA approvals: Depending on the nature of the transaction, certain DGCA approvals might be required. In the context of the sale of an aircraft subject to an existing lease, these are likely to include a formal approval in relation to the change of ownership and a formal approval for the continued leasing of the aircraft pending the issuance of a new certificate of registration.
5. Stamping requirement: Stamping is necessary so as to ensure that the lease agreement can be used in the relevant Indian courts in case of need.
6. Place of stamping: Careful consideration will invariably need to be given to the right State or States in which to stamp so as to balance the need to stamp against the cost of stamping.
7. Alternative to stamping: If the cost of stamping is prohibitive, a lessor or financier might decide to proceed without stamping on the basis that a judgment under an English law lease agreement would be obtained in the English courts and then enforced by the relevant Indian courts.

COMPETING INTERESTS

The supremacy of a lessor's interest can be threatened for a variety of familiar reasons. These will include:

- Detention rights in favour of the Airports Authority of India for unpaid landing, parking, navigation and x-ray charges.
- Arrest and sale rights in favour of the Customs Authority of India for unpaid import duties or for unpaid inland air travel tax.
- Governmental ability to detain and/or requisition aircraft under sections 6 and 8 of the Aircraft Act 1934 in certain circumstances (e.g. if it is in the interests of public safety to do so).
- Governmental ability to introduce legislation for the detention and/or requisition of aircraft under Article 352 of the Constitution in a state of emergency.

Needless to say, it will be important for a lessor and/or financier to be able to agree appropriate monitoring provisions with the lessee. This might include (a) a letter addressed by the airline to the Airports Authority authorising the release of payment/account information to the lessor and/or financier (although there is no guarantee of a response to any request made), (b) a similar letter addressed to the Customs Authority (although such a letter is only likely to be or real value if inland travel tax is reintroduced) and/or (c) a regular certificate from the airline's auditor confirming that all relevant amounts have been paid in full within the applicable time limits (a lessee will often baulk at such a request).

In terms of requisition risk, it will be advisable to assess whether or not state of registration risk is excluded from the insurance coverage. Local advice might also be sought as to the level of compensation payable by the government in the event of any state requisition.

Enforcement & Repossession

No self-help remedies: In the non-appearance of a consensual repossession of the aircraft succeeding any lease termination, an aircraft can only be repossessed via the courts - Indian law doesn't recognize self-help remedies.

Foreign judgments: A lessor / financier should if possible certify that the lease agreement is governed by a user friendly law & that a familiar court system has jurisdiction (English law & English jurisdiction being a mutual choice for leases to Indian airlines). Indian courts will usually uphold any choice of English law as the overriding law of the lease agreement (& any related submission to English jurisdiction), except the choice is not made in good faith or is opposing to Indian public policy. The Indian courts will normally recognise a judgment gotten against an Indian lessee in the English courts, subject to a number of familiar exceptions set out in Section 13 of the Civil Procedure Code 1908 (the "CPC"). A feasible mode of enforcement (particularly if the airline operates internationally) will thus be for the lessor or financier to obtain a ruling in the

English courts & have it enforced (without the requirement for a separate action) by the pertinent Indian courts.

Service of process: The lessor & financier will need to guarantee that any court proceedings can be authentically served on the lessee in the proper jurisdiction. This will, in the instance of English proceedings, involve the nomination of an agent to receive service of process on account of the lessee. Without a binding appointment, the English courts would have preference as to whether or not to consent jurisdiction. While all participants are acquainted with process agent appointment letters in cross-border transactions, some precaution needs to be taken when selecting or agreeing to the process agent.

Enforcement timeframe: It is hard to accurately forecast the likely timeframe for the contested retrieval of an aircraft run by an Indian airline. Observers propose that it could take between 10 - 15 years to exhaust all legal avenues, as well as any rights of appeal. However, the usual measure for the granting of an order for repossession is anything between 2 - 24 months.

Repossession: It is possible that the following consents or approvals will be required so as to permit the export of an aircraft from India after lease termination:

- an export permit from the DGCA
- an export certificate of airworthiness issued by the DGCA
- consent from the RBI
- consent from the Airports Authority of India
- consent from the Customs Authority of India

Even if the Indian courts would grant a court order for repossession / enforce the judgment of an English court, experience indicates that the relevant Indian authority may nevertheless refuse to issue the pertinent consent or approval. The DGCA, the Airports Authority & the Customs Authority would be uncooperative if there are unpaid charges, duties or taxes. Negations to consent are however open to face by the affected lessor / financier, & have been successfully confronted in the Indian courts.

Lease & Guarantee Payments

Withholding Tax Exemption: Indian lessees currently benefit (under section 10(15A) of the Income Tax Act 1961) from a rental withholding tax exemption dispensed by the Indian tax authorities, which would expire on 31 March 2006. Without the exemption, withholding tax at a rate equal to 40% would be in effect to lease rental payments to a non-Indian lessor (subject to the terms of any applicable double tax treaties).

So as to profit from the exemption, it is essential to file the signed lease agreement with the Indian Ministry of Finance, plus a letter requesting exemption under section 10(15A) of the Income Tax Act 1961. It is not at all times possible to predict with any precision how long it would take to obtain the exemption, although waiting periods of 2 to 3 months are not uncommon. Consequently, the parties would need to carefully plan the transaction agenda so as to accommodate this latent time lag (except if the lessee is willing to undergo the risk associated with an application for exemption following closing). Pending receipt of the exemption, the airline would have to deduct tax at the appropriate rate & pay it to the tax authorities (while this requirement may not always be constant with practice).

Exchange Control Approval: A lessor / financier will have to ensure that the lessee takes active responsibility for the exchange control approvals that are expected to be required from the Reserve Bank of India (RBI) in relation to the lease agreement & any payment guarantee that is given by an Indian entity in the framework of the transaction.

RBI exchange control approval is required for:

- any guarantee payments
- cash security deposits of more than US$1,000,000
- non-scheduled lease payments

RBI exchange control approval is not required for:

- rental & other scheduled lease payments
- cash security deposits of US$1,000,000 or less letters of credit in any amount

The applicable underlying legislation is the Foreign Exchange Management Act 1999 which controls the payment of foreign currency duties in India.

Lease rental payments & L/Cs: Subject to certain due assiduousness in relation to the pertinent transaction (like confirming that all required DGCA approvals have been acquired), an “authorized dealer” in foreign exchange (in most cases, the airline’s Indian banker) is legalized to allow a lessee to send lease rental payments (& other scheduled lease payments, like maintenance reserve payments) & open letters of credit regarding aircraft imported into India on an operating lease basis. There is no particular limit on the amount of lease rentals that could be paid or the amount in which a letter of credit could be issued without exchange control approval. It should be noted that approvals for finance leases should be sought on a case by case basis.

Cash security deposits :Authorized dealers may license airlines (other than certain public sector companies & governmental entities) to remit up to US$1,000,000 per aircraft as a security deposit (for the payment of lease rentals) to a non-Indian lessor in relation to the import of an aircraft or an aircraft engine on operating lease. If the cash security deposit exceeds US$1,000,000 per aircraft, then the lessor would have to arrange for the lessee with a standby letter of credit or a guarantee dispensed by either (a) a foreign international bank or (b) an authorised dealer in India backed by a counter-guarantee from a foreign international bank.

Other payments: Without the consent of a clarification from the RBI, an authorised dealer is not allowed to permit a lessee to remit any other monies to a lessor (payments which are not explicitly covered by the Circulars referred to above). This would include (without limitation) the following non-scheduled payments which are typically provided for in lease agreements: default interest, any amount owed pursuant to any gross-up provision & any insurance payments. RBI approval in relation to such payments can only be attained at the time the relevant payment becomes due (means there can be no pre-approval).

Guarantees: The sanction of the RBI is also mandatory for payments to be made under any guarantee. It should be noted that the guarantee can't be executed until RBI approval has been acquired. To the extent that the advantage of a guarantee executed in favour of the lessor is allocated by way of security to the financier, the RBI approval should also cover the security assignment to enable guarantee payments payable to the financier.

<u>Security Documents</u>

Indian Law Aircraft Mortgage: Indian statutory law doesn't make delivery for mortgages over moveable possessions (including aircraft). As such, it is not likely under statutory law to take an Indian law loan over an aircraft. Indian courts do however know mortgages over moveable property.

The interest of a mortgagee cannot therefore be listed with the DGCA under the supplies of the Aircraft Act and/or the connected rules & regulations. Accordingly, no footnote of the interest of a mortgagee can be made on an aircraft's certificate of registration under constitutional law in India (subject to the comments made in the following sentence). The DGCA has however generally in certain instances marked the mortgagee's interest on an aircraft's certificate of registration.

English Law Aircraft Mortgage: The Indian courts will usually recognise the efficiency of an English law mortgage to create a security importance in an aircraft in agreement with its terms & will generally recognise a judgement got against an owner in the English courts, subject to Section 13 of the CPC.

As Indian constitutional law doesn't anticipate mortgages over aircraft, the mortgage need not satisfy any Indian (being the lex situs) legal necessities, except that the document might be liable to stamp duty if (a) executed in India or (b) if, while the aircraft is situated in India, executed outside India & then brought into India. If the aircraft were situated in an Indian State at the time of implementation of the aircraft mortgage, the rate of stamp duty would be the rate appropriate in that state. Stamp duty concerns connecting to the aircraft mortgage represent another aim for the parties to seek to ensure that the aircraft is positioned outside India at closing.

Lease Security Assignment: For a financed aircraft, the security suite will (assuming fundamental English law rights & obligations) usually include an English law security task in relation to, inter alia, the rights of the owner under the contract agreement & any related contract document (such as any guarantee).

As with an English law aircraft loan, the Indian courts will generally identify the effectiveness of an English law security task to create a security interest in relation to the contract agreement & any other related collateral in accordance with its terms & will identify a judgment gained against the owner in the English courts, subject to the exceptions set out in Section 13 of the CPC.

Insurance Security Assignment: For a financed aircraft, a standard security package would typically include an English law security assignment in relation to certain of the airline's rights in relation to the insurances and/or reinsurances. The lessor's & financier's aim will of course be to ensure, through appropriate registration against the relevant debtor, that the security is creditor & insolvency-proof if at all possible. An assignment of insurances is register against an Indian airline with the Registrar of Companies in the airline's state of registration. As a condition to registration, the assignment of insurances must however be stamped.

Deregistration Power of Attorney: The DGCA has in most instances refused to distinguish the exercise of powers under deregistration powers of advocate. The Civil Aviation Requirements also deliver that, in the case of a dispute, the DGCA will only deregister an aircraft pursuant to a court order.

It is however usual for the lessor/financier to necessitate that the airline execute a de-registration power of attorney in favour of the lessor & the sponsor as several attorneys. This (Indian law) article would have to be implemented under the airline's company seal, notarized & stamped (nominal stamp duty of 100 Rupees will apply). It is recommended that a replica of the de-registration power of attorney be filed with the DGCA. Once India has approved the Cape Town Convention (and opted in to the applicable deregistration provisions), deregistration powers of attorney that are "Cape-Town compliant" will of course enable a lessor or sponsor to deregister & export an aircraft without DGCA or other interference.

<u>PDP Financing</u>

RBI Exchange Control Approval: Although it is likely for a PDP financing to qualify for involuntary exchange control approval under the RBI's Guidelines on External Commercial Borrowings (the "ECB Guidelines"), it is unlikely since a PDP financing will usually not satisfy the following criteria for involuntary approval:

- the term of the mortgage must be more than 3 years (for mortgages of less than US$20m) & more than 5 years (for mortgages of more than US$20m)
- the "all-in-cost" (which includes interest, fees & expenditures) must not exceed 200bps (for mortgages of less than US$20m) & 350bps (for mortgages of more than US$20m), in each case above 6-month US$ LIBOR

Withholding Taxes: Withholding tax will usually apply in relation to interest expenditures made by an Indian airline to a non-Indian lender. PDP Security: A key element of any PDP security suite is likely to be the security assignment by the airline to the sponsor of its relevant rights under the manufacturer purchase contract.

AIRCRAFT LEASING BY AIR INDIA

Leasing aircraft on loss-making routes cost Air India Rs. 4,234 crore : An investigation by Air India's internal vigilance department found the airline lost a staggering Rs. 4,234.28 crore between 2005 and 2010 because it leased 16 aircraft to enhance capacity on routes that were already making losses, documents obtained by The Hindu show

The investigation, whose findings were submitted for review by Air India's Board on November 29, 2011, shows the leasing losses accounted for a third of the airline's total losses of Rs. 13,835 crore.

Earlier, a report by the Comptroller and Auditor-General said the airline had also lost Rs. 68,000 crore because it committed itself to purchasing aircraft far beyond the recommendations of its own feasibility studies.

Air India officials declined to comment on the report. However, in a leaked communication to the Cabinet Secretary that became public earlier this month, the former Air India chief, Sunil Arora, alleged that key decisions had been colored by "unprecedented" interference by the former Civil Aviation Minister, Praful Patel.

In his May 28, 2005 letter, Mr. Arora said Air India's Board had been steamrollered into purchasing more jets than required. In some cases, Mr. Arora alleged, even seat configuration requirements had been changed to suit particular manufacturers. Indian Airlines, similarly, had been pulled out of profitable routes to make way for private operators.

Air India's Board, a briefing note on the investigation prepared for it states, was told a variety of reasons were assigned for leasing aircraft despite the negative returns on the routes, such as protecting slots at airports and maintaining schedule integrity. However, "no viability study was carried out of these futuristic issues vis-a-vis the loss that was going to be caused, which would justify taking the aircraft on dry lease at an estimated loss."

"From the actual operating results, it is seen that revenue earned by operating leased aircraft was about 50 per cent lesser than the revenues estimated in the Economic Viability Report," the report states.

"In a particular case," the note states, "[an] aircraft was taken on fresh dry lease five months before the lease period of the then operating dry leased aircraft came to a close, and that too when this route was making loss. Subsequently, operations on the same route were terminated."

The note also records that key documents on the decision-making process are missing.

Criticism to Aviation management: The concept Aircraft leasing is very efficient and successful for the aviation industry, but inspite of having so good mechanism due to mismanagement and lack of forecasting the aviation industry in India bears losses. The aviation industry should study the concept and nature of market before investment because aircraft leasing sector is very flexible concept it can give you good fruits if managed well and on the contrary can take it in huge loss if mismanaged.

CONCLUSION

The aircraft leasing & financing industry essentials to develop to a complete new level in India. Considering the prompt growth of the aviation industry, it is forecast that aircraft flotilla would nearly twofold in the coming years as India holds the rank of having the ninth largest aviation market in the world, showing the capability of international aviation traffic to reach a breath-taking value of 50 million & the domestic traffic reaching to more than three folds of international traffic. This would require more fleet than ever needed in the past, which can very efficiently be conceived by proper leasing & financing. Proper leasing & financing definitely requires extremely non-complicated procedures & solutions. The role of the Cape Town Convention & the Aircraft Protocol ratified by India has been of immense significance in ensuring security for both lessor & the lessee.

One very prominent reason for the lack of involvement from foreign investors to India & vice versa is the complexity of laws & policies governing the aircraft leasing in the country. Preservation of the domestic as well as international interest of parties by International Registration System is possible via enactment of the Cape Town Convention. Basic priority rule, which protects the right of first lessor or lessee, is applied. A few issues have still been left to the Contracting Parties, i.e. Court's decision upon any default committed by any party. This, & many other issues discussed previously in the paper have to be addressed if India is to become a prominent leader in aviation sector by executing flawless leasing & financing processes to feed the surge in requirement of aircraft in the coming years.

LEASING AND FINANCING OF AIRCRAFT: A CRITICAL ANALYSIS

Given the staggering costs of large commercial airplanes, even made more critical in the wake of the recent US subprime crisis, airlines around the world have adopted new methods of financing their acquisitions of aircraft. In recent years, leasing - a legal concept developed in the United States - has become more and more important in financing expensive capital goods globally. Although leasing does not yet play a vital role in most aircraft financing comparable to its importance in the United States, the general opinion and trend is that it is having increasing significance on the market. This is especially so with the latest trend of low-cost carriers taking the airline industry by storm. Aircraft are already considered as "classical leasing objects".

It is in this light that this paper seeks to investigate the nature and role of different modern methods of aircraft financing. Particularly, this paper will focus on three forms of aircraft finance namely debt finance; cross border leasing and operating leasing. These have emerged on the face of redundancy of such traditional methods of aircraft finance such as secured lending and leasing with no cross border element. The value of these modern methods of aircraft finance as a financial tool will be explored with reference to their unique capabilities and pitfalls. The paper will describe the aforementioned methods of aircraft finance in a multi-jurisdictional perspective including their legal and tax aspects. The analysis will extend to international and regional conventions on aircraft finance. It will also include an examination of the future prospects, issues and impediments with respect to the use of these methods in the global arena as well as local markets.

Airlines wishing to expand their fleet may either go in for a lease or go in for an outright purchase of new aircraft if finance is available on attractive terms. A 'dry lease' includes only the aircraft whereas a 'wet lease' includes both aircraft and crew. The airlines are also charged for maintenance and insurance apart from the rentals.

A lease is beneficial for an airline as it can be treated as expenditure. On the other hand a plane is generally purchased on credit and therefore treated as debt. Thus a leased aircraft helps the airline raise debt for other expenditure. The popularity of lease over purchase has resulted in lease rentals jumping by over 20 per cent in the past one year.

Purchasing marks the progression from leasing to owning the aircraft. As most purchases are made on credit the airlines' ability to raise future capital is evaluated before closing the sale. For the airlines price is the most critical factor. Discounts are given based on order size, future prospects of the airline and the prospects for the aviation industry in the operating country. Next the airline needs to consider various options as far as raising of finance is concerned. Usually one per cent of the aircraft costs have to be paid upfront by the airline. Export credit agencies like EXIM Bank and European Credit Agencies (ECA) also provide credit guarantees for a maximum of 85 per cent of the purchase price. Commercial loans are also available but work out to be more expensive. The airline may also raise finance from Private Equity players to fund the purchase.

Two options are available to an airline wishing to purchase a plane. A 'hire-purchase' lease allows the aircraft to be owned through a special purpose vehicle. At the end of the term of the lease the airline owns the asset and the last payment is made in a lump sum.

Another option for purchasing is a sale-and-lease-back. The airline sells the aircraft to a leasing company, who then makes all the remaining payments. The leasing company leases the aircraft back to the airline and eventually becomes the owner of the aircraft.

The Cape Town Convention: A New Era For Aircraft Financing

On November 16, 2001, the Convention on International Interests in Mobile Equipment (Convention) and the Protocol thereto on Matters Specific to Aircraft Equipment (Protocol) were opened for signature following three weeks of intensive work at a diplomatic conference in Cape Town, South Africa. Twenty-two other countries signed the treaty and are in the ratification process. Much of the Cape Town Convention is still uncertain as to its application.

The Cape Town Convention was drafted under the auspices of the International Institute for the Unification of Private Law (Unidroit). It is primarily intended to extend the benefits of a consistent registration and lien recordation and enforcement system to jurisdictions other than the U.S. that have less clear legal systems for financing. It was strongly supported by the U.S. State Department and the Export-Import Bank which is giving favored rates for aircraft financings to jurisdictions that adopt the Cape Town Convention.

The purpose is to facilitate aircraft financings by bringing a consistent system of creditors' rights and remedies to ratifying nations that do not have legal systems as comprehensive as in the U.S. The Cape Town Convention itself deals only with financing terms, not purchase and sale terms. The Protocol applies the Cape Town Convention to aircraft purchases and sales as a necessary part of the International Registry system.

The Convention contains the basic aspects of a legal regime for secured financing of equipment and the Protocol, then, contains the specialized provisions necessary to adapt the Convention to the financing of aircraft and aircraft engines. The Convention is not intended to operate on a stand-alone basis; it can be effective only in conjunction with a protocol covering a specific type of equipment.

The Convention and Protocol establish an international legal system for security interests in aircraft equipment (called "international interests" in the Convention). The goal is to facilitate efficient secured financing. During the next several years, manufacturers of commercial aircraft equipment hope to sell-and airlines worldwide hope to buy-trillions of dollars' worth of products. Yet, the local legal regimes in many states are inadequate to support secured asset-based financing. In the absence of legal reform, fewer transactions will take place and those that are completed will feature higher costs of financing and in some cases will require the sovereign credit of states in which airlines are based. The researchers in this paper would like to highlight the issues pertaining various matters pertaining to the financing of an aircraft under the Convention and Protocol and provide the necessary reforms.

MODULE V

AVIATION START-UPS: PRACTICAL & LEGAL ISSUES

FOREIGN INVESTMENT

Ever since India embarked on the path of liberalization and economic reform a couple of decades ago, the GoT (see Glossary of Terms) has been keen to attract foreign capital and investment. To this end the GoT has put in place a policy framework on foreign investment, which is transparent, predictable and easily comprehensible.

Over the past several years, the policy and procedures regulating and governing the inflow of foreign investments into India have been progressively liberalized and simplified. The initiatives taken by the GoI in this regard have resulted in significant inflows of foreign investment in almost all areas of the economy, except a select few, that continue to remain reserved for strategic reasons.

A non-resident entity may invest or participate in India in the following ways:

- Foreign Direct Investment ("FDI")
- As a registered Foreign Institutional Investor ("FII") under the Portfolio Investment Scheme
- As a registered Foreign Venture Capital
- As a holder of American Global Depository Receipts ("ADR") and Global Depository Receipts ("GDR"s) under the ADR / GDR Scheme
- Technology and Trademark Licence Agreements

Entry Options for Foreign Investors

Foreign entities have the option to set-up their business operations in India either in the form of incorporated entities or unincorporated entities. A foreign company opting for the incorporation route for setting up its operations in India is required to incorporate a company in India through either a Joint Venture or a Wholly Owned Subsidiary.

Companies in India are regulated under the provisions of the Companies Act. A "Company" can be formed and registered under the Companies Act, in one of the following two ways:

- Private Company
- Public Company (listed or unlisted)

The Companies Act prescribes specific requirements for incorporation depending on the type of entity established. Once incorporated, a company set up by the foreign entity is required to carry on business in India in accordance with Indian law.

A foreign company not opting to be incorporated in India is permitted to conduct its business operations in India through any of the following offices:

- Liaison Office
- Branch Office
- Project Office

Such offices can only undertake activities permitted to them under the Regulations framed by FEMA for such offices. These offices are further required to be in compliance with provisions of the Companies Act as applicable to them. The approvals for these offices are accorded by the RBI on a case-to-case basis, except project offices for which the RBI has granted a general permission.

Liaison Office (or Representative Office):

A "Liaison Office" means a place of business to act as a channel of communication between the principal place of business or head office and entities in India but which does not undertake any commercial / trading / industrial activity, directly or indirectly. A liaison office is not permitted to undertake any business activity in India and cannot earn any income in India and therefore is required to maintain itself out of inward remittances received from the head office outside India.

The activities of the liaison office are typically restricted to the following:

- Representing the parent company or group companies in India;
- Promoting exports from and imports to India. Such provisions include requirements pertaining to delivering of certain documents to the relevant authorities and provisions relating to the disclosure of accounts.
- Promoting technical and financial collaborations between parent or group companies and companies in India; and
- Acting as a channel of communication between the parent company and Indian companies.

Foreign insurance companies can establish liaison offices in India, after obtaining approval from the Insurance Regulatory and Development Authority ("IRDA"). Foreign banks can establish liaison offices in India only after obtaining approval from the Department of Banking Operations and Development, RBI.

Permission to set up a liaison office is initially granted for a period of three years and can be extended subject to certain conditions.

Branch Office

Foreign entities engaged in manufacturing or trading activities outside India are allowed to set-up a "Branch Office" in India.

A branch office is permitted to carry on the following activities, which are wider in scope as compared to the activities permitted to a liaison office:

- Export and Import of goods;

- Rendering professional or consultancy services;2
- Carrying out research assignments, in areas in which the parent company is engaged;
- Promoting technical or financial collaborations between Indian companies and their parent or overseas group company;
- Representing the parent company in India and acting as buying / selling agent in India;
- Rendering services in Information Technology and development of software in India; or
- Rendering technical support to the products supplied by parent / group companies.

The profits of a branch office are permitted to be remitted outside India subject to the payment of applicable Indian taxes. A branch office is not permitted to engage in any manufacturing or processing activities in India directly or indirectly. Retail trading activities of any nature are also not allowed for a branch office in India.

Project Office

A "Project Office" means a place of business established to represent the interests of a foreign company executing a project in India. Such offices are prohibited from undertaking or carrying on any activity other than the activity relating and incidental to the execution of the project for which such office is established.

In order to set up a project office, a foreign company has to secure a contract to execute a project in India from an Indian company, and the fulfillment of one of the following conditions:

- Such project is funded directly by inward remittance from abroad; or
- Such project is funded by bilateral or multilateral international financing agency; or
- Such project has been cleared by an appropriate authority; or
- The company or entity in India awarding the contract has been granted a term loan by a public financial institution or a bank in India for the project.

If either of the above conditions is not met, the foreign entity has to approach the RBI for approval.

Foreign Direct Investment

Foreign Direct Investment ("FDI") and the mechanisms (both substantive and procedural) governing its inflow into India are regulated by the policies of the GoI and subjected to review on an ongoing basis.

The GoI decided that a consolidated circular would be issued every year to update the FDI policy. The latest FDI Policy (circular 1 of 2013), which is effective from April 5, 2013 ("Consolidated FDI Policy"), reflects the current policy framework on FDI.

Areas where FDI is prohibited:

Under the current Consolidated FDI Policy, FDI is prohibited in the following areas or activities:

- Gambling and Betting, including Casinos,
- Lottery Business including Government, private and online lotteries,
- Business of Chit Funds,
- Real Estate Business or construction of farm houses,
- Trading in Transferable Development Rights,
- manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes and certain agricultural and plantation
- activities and activities / sectors not opened to private sector including Atomic Energy and Railway Transport (other than Mass Rapid Transport System) and
- Nidhi company.

Areas where FDI is permitted:

Other than in the sectors mentioned above, FDI is allowed in all other sectors, subject to the prescribed limits. FDI can be made by non-residents by subscribing to equity shares and/or fully and compulsorily convertible debentures / preference shares of an Indian company, through the following two routes:

I. The Automatic Route:

The GoI has placed a significant majority of sectors under the automatic route for FDI investment. Under this route, Indian companies are authorized to accept FDI without obtaining any prior approvals (although subject to the compliance of certain conditions). For FDI under the automatic route, the RBI must be notified in Advance Reporting Form within 30 days from receipt of such investment by the Indian company. Further, the equity or equity linked instruments should be issued within 180 days from the date of receipt of the inward remittance. Thereafter the Indian company has to file the Form FC-GPR (including certain supporting documents) with the RBI not later than 30 days from the date the shares are issued to the concerned foreign investor.

For most sectors under the automatic route, the GoI has permitted up to 100% FDI by non-residents. In some sectors, such as financial services, minimum capitalization norms have been prescribed. Investment in power, construction development projects7 and non-banking finance companies (subject to certain conditions), manufacturing activities, venture capital funds are some of the sectors where the GoI has permitted FDI up to 100% or all of the capital required. For certain specified sectors under the automatic route, FDI is permitted up to the prescribed limits (popularly called sectoral caps). FDI in excess of the sectoral caps is either not permitted or requires the prior approval of the GoI. For instance, FDI in Airports (existing projects as opposed to greenfield projects) is permitted up to 74% of the capital requirements under the automatic route without prior GoI approval, however FDI in excess of the prescribed 74% would require prior approval from the GoI.

II. The Prior Approval Route:

FDI in areas or activities, sectors which do not fall within the automatic route or where the proposed FDI exceeds the specific sectoral caps requires prior approval of the GoI through the Foreign Investment Promotion Board ("FIPB"). Further, investment in certain specific sectors of strategic importance including broadcasting, aviation, publishing, defence production, telecom etc. is subject to guidelines issued by relevant ministerial departments and also requires the prior approval of the FIPB.

Approval route process:

When a proposal for FDI is accorded approval by the FIPB, permission is granted for such proposal in the form of an approval letter issued by the FIPB. The terms and conditions of the said approval letter are binding both, on the investing company as well as on the Indian subsidiary. Subject to any specific terms of the approval letter, upon securing the FIPB approval, the Indian company may then arrange to receive the investment and issue shares to the foreign investor without having to secure any further approvals from the RBI. Depending on the sector as discussed above, the Indian company is however required to undertake filings pertaining to the issuance of shares in Form FC-GPR with the concerned regional office of the RBI within 30 days from when the shares are issued to the foreign investor.

Procedural requirements

A company in India issuing equity shares or fully and compulsorily convertible debentures / preference shares to a person resident outside India is required to receive the amount of consideration for such shares by inward remittance through normal banking channels or in the case of Non-Resident Indian ("NRI") investor, by debiting the non-resident external / foreign currency non-resident account of the person concerned maintained with an authorized dealer / authorized bank.

Foreign investment can be made for consideration other than cash by way of swap of shares or for issuance of warrants or partly paid shares. Such investment requires prior approval of the FIPB.

Pricing Guidelines

All issuances and transfers of shares under the automatic route of the FDI policy have to comply with the prescribed "pricing norms" which require the calculation to be in accordance with the "discounted free cash flow" ("DCF") method in respect of unlisted companies and valuation in terms of the ICDR Regulations for listed companies.

In respect of compulsorily convertible instruments such as fully and compulsorily convertible debentures and fully and compulsorily convertible preference shares, the price / conversion formula should be determined upfront at the time of issue of such instruments. The price at the time of conversion should not in any case be lower than the fair market value worked out, at the time of issue of such instruments in accordance with the DCF method of valuation for unlisted companies and valuation in terms of the ICDR Regulations for listed companies.

Previous amendments

- Subject to prior FIPB approval, equity and preference shares may now also be issued in the following cases:
    - ❖ against import of capital goods / machinery / equipment (excluding second hand machinery);
    - ❖ against pre-operative / pre- incorporation expenses (including payment of rent etc.)
- FDI in limited liability partnerships is now permitted with prior FIPB approval and subject to fulfillment of certain prescribed conditions.
- FDI up to 100% is permitted in single brand product retailing with prior approval of the FIPB, subject to complying with certain conditions.
- Prior FIPB approval is required in case of investment in any industrial undertaking which is not a micro or small scale enterprise, where foreign investment is more than 24% in the equity capital and such undertaking manufactures items
- Banks and registered depository participants are now permitted to open and maintain in India, interest bearing escrow accounts in Indian Rupees towards purchase of share consideration and keeping of securities to facilitate FDI transactions.

<u>Recent developments</u>

- Multi brand retail: In September 2012, the Government announced the revised FDI policy in Multi-Brand Retail Trading which has now been incorporated into the Consolidated FDI Policy. With this announcement, FDI in Multi-Brand Retailing has been permitted up to 51% with prior approval of the Government and subject to certain conditions.

  In June 2013, the Government issued certain clarifications to the FDI policy in multi brand retail trading pertaining to sourcing from small & medium industries and investment in front and back end infrastructure.

  The following issues are however still under consideration:

    a. Sourcing restriction amongst ‘group companies’.
    b. Requirement of 50% investment in 'backend infrastructure' within three years of the first tranche of FDI.
    c. Requirement of 30% sourcing from ‘small industry’.
- Aviation sector: Foreign airlines can now participate and invest (FDI and FII) in the capital of Indian companies operating scheduled and non-scheduled air transport services, up to the limit of 49% of the paid up capital of the Indian company. This permission does not extend to investment in the national carrier ‘Air India’. Investment in the aviation business is subject to some further conditions such as the chairman and 2/3rd of directors of the Indian company

should be Indian citizens (ii) majority ownership and effective control should be with Indian nationals.

- Broadcasting sector: The FDI limits for the following sectors has been increased from 49% to 74% (with prior approval of the Government):
  a. Cable Networks;
  b. Direct to Home;
  c. Setting up of up-linking HUB / Teleports.

  Any investment up to 49% is under the automatic route. Above 49% and up to 74% investment would require prior approval of the Government.

<u>Portfolio Investment Scheme</u>

<u>Foreign Institutional Investment</u>

A non resident entity wishing to invest / trade as a foreign institutional investor ("FII") is required to register itself with SEBI and comply with the Securities and Exchange Board of India (Foreign Institutional Investors Regulations) 1993. Only SEBI registered FIIs may invest / trade through a registered broker in the capital of Indian companies on recognised Indian Stock Exchanges.

A FII may invest in the capital of an Indian company under the Portfolio Investment Scheme which limits the individual holding of an FII to 10% of the capital of the company and the aggregate limit for all FII investments to 24% of the capital of the company. This aggregate limit of 24% can be increased to the sectoral cap / statutory ceiling, as applicable, by the Indian company concerned through a resolution of its Board of Directors followed by a special resolution to that effect of its shareholders and subject to prior intimation to RBI. The aggregate FII investment taking into consideration all forms of FDI should be within the overall sectoral limits for the particular industry.

FIIs may also purchase dated securities / treasury bills, non-convertible debentures / bonds issued by Indian companies and units of domestic mutual funds either directly from the issuer of such securities or through a registered stock broker on a recognized stock exchange in India.

<u>Non Resident Investment</u>

A NRI may invest in the capital of an Indian company under the Portfolio Investment Scheme under both repatriation or non-repatriation basis which limits the individual holding of a NRI to 5% of the capital of the company and the aggregate limit for NRI investment to 10% of the capital of the company. This aggregate limit of 10% can be increased to 24% through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body and subject to prior intimation to RBI.

NRIs may also purchase without any limits, Government dated securities, Treasury bills, units of domestic mutual funds, units of money market mutual funds or National Plan / Savings certificates, bonds issued by public sector undertakings and shares in public sector enterprise being divested by the GOI.

Qualified Foreign Investors

Qualified Foreign Investors ("QFIs10") are permitted to invest through SEBI registered Depository Participants (DPs) only in equity shares of listed Indian companies through recognized brokers on recognized stock exchanges in India as well as in equity shares of Indian companies which are offered to public in India in terms of the relevant and applicable SEBI guidelines / regulations.

The individual and aggregate investment limits for a single QFls are 5% and 10% respectively of the paid up capital of an Indian company. These limits are over and above the FII and NRI investment ceilings prescribed under the Portfolio Investment Scheme for foreign investment in India. Further, wherever there are composite sectoral caps under the extant FDI policy, these limits for QFI investment in equity shares shall also be within such overall FDI sectoral caps.

Foreign Venture Capital Investment

A SEBI registered Foreign Venture Capital Investor ("FVCI") may contribute up to 100% of the capital of an Indian Venture Capital Undertaking ("IVCU") and may also set up a domestic asset management company to manage the fund. A SEBI registered FVCI may also invest in a domestic fund registered under the SEBI (Venture Capital Funds) Regulations 1996 or SEBI (Alternate Investment Funds) Regulations, 2012

10 QFI means a person who fulfils the following criteria:

(i) Resident in a country that is a member of Financial Action Task Force (FATF); or a member of a group which is a member of FATF; and
(ii) Resident in a country that is a signatory to IOSCO's MMOU (Appendix A Signatories) or a signatory of a bilateral MOU with SEBI:

Such investments would also be subject to the extant FEMA regulations and extant FDI policy including sectoral caps, etc. SEBI registered FVCIs are also allowed to invest under the FDI Scheme as non-resident entities subject to the FDI Policy and FEMA regulations

ADR, GDR and FCCBs

FDI is permitted through the issuance of Foreign Currency Convertible Bond(s) ("FCCB(s)") and through the issuance of Global Depository Receipt(s) ("GDR(s)") or American Depository Receipt(s) ("ADR(s)") in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India from time to time. The proceeds from inward remittances received by the Indian company vide issuance of ADR / GDR and FCCBs issuance are treated and counted towards FDI.

Foreign Technology and Trademark License Agreements

The FDI policy and FEMA allows foreign technology collaboration agreements for the acquisition of foreign technology and trademark license agreements for the use of trademarks and brand names without requiring financial contributions on the part of foreign companies.

In the context of technology collaborations, the foreign company can, in lieu of the transfer of technology, receive technical know-how fees, payments for design and drawing, payment for engineering service and royalty. The payment may be in the nature of lump sum payments and royalty. In the context of trademark licenses, the payment is normally in the form of royalty.

In 2010, the exchange control regulations pertaining to payment of royalties were liberalised and accordingly, all limits / caps imposed on payments for royalty, lump sum fee for transfer of technology and payments for use of trademark / brand name were done away with.

It may be noted that payments for hiring of foreign technicians, deputation of Indian technicians abroad, are governed by separate RBI procedures and rules and are not covered by the foreign technology collaboration approvals. Under the FEMA Regulations, the limit for remittance towards consultancy services procured from outside India is US$ 1 million per project (for consultancy services in respect of infrastructure projects the limit is US$ 10,000,000 / US$ 10 million per project).

Until recently, if a foreign investor had a joint venture or a technology transfer or trademark agreement which was in “existence” as on January 12, 2005, the proposal for fresh investment in a new joint venture / technology transfer / trademark agreement, in the ‘same field’ would require prior approval of the FIPB. As a welcome move, the Consolidated FDI policy has now abolished the erstwhile condition of obtaining prior FIPB approval in such cases.

BUSINESS REGULATIONS

The Companies Act

Companies incorporated in India and foreign corporations with a branch or liaison office in India are regulated by the provisions of the Companies Act. The Registrar of Companies (“RoC”) and the Company Law Board (“CLB”) are responsible to ensure compliance with the provisions of the Companies Act. Once the National Company Law Tribunal (“NCLT”) is set up it will take over the functions of the CLB.

As stated earlier in this Guide, companies in India may broadly be classified as public or private companies. A company can also be registered as a guarantee company where the profits are not distributed to its members but are retained to be used for the purposes of the company. Shares of companies are either equity shares (common stock) or preference shares (preferred stock). Capital issued by publicly listed companies need to comply with the ICDR and other regulations issued by SEBI.

The management of a company is entrusted to its Board of Directors ("Board") who, subject to the Articles of Association, have full powers to act on behalf of the Company within the provisions of the Companies Act. A company can appoint executive, non-executive and independent directors. An executive director can be a managing director or a whole time director. There is no restriction on appointing foreign nationals as directors. All directors regardless of nationality or residence must obtain a Directors Identification Number ("DIN"). All listed companies are required to appoint up to half or one third of the Board, as the case may be, as independent directors and every public company with a paid-up capital of ` 50 million is also required to have an audit committee. The

Companies Act requires companies to hold a minimum of four board meetings and at least one shareholders' meeting as an Annual General Meeting ("AGM") in a calendar year.

Competition Law

The main objectives of the Competition Act, 2002 ("Competition Act") are to promote and sustain competition in markets in India, to protect the interests of consumers and to ensure freedom of trade for market participants.

The Competition Act prohibits anti-competitive agreements and abuse of dominance; regulates acquisitions, mergers and amalgamations of a certain size; establishes Competition Commission of India ("CCI") and sets its functions and powers.

The substantive provisions of the Competition Act dealing with anti-competitive agreements and abuse of dominant market positions have been made effective since May 2009. The provisions of the Competition Act governing acquisitions, mergers and amalgamations have been made effective since June 1, 2011.

Anti-Competitive Agreements

In terms of the Competition Act, agreements with respect to production, supply, distribution, storage, acquisition or control of goods, or provision of services, which cause or are likely to cause an appreciable adverse effect on competition in a relevant market in India may be considered to be anti-competitive.

Horizontal agreements i.e. agreements entered by persons operating at the same level of the production chain (i.e. competitors) are presumed to be anti-competitive. This presumption is however rebuttable. Vertical agreements i.e. agreements entered by persons operating at the different stages of the production chain are subject to the Rule of Reason12.

Abuse of Dominant Position

The Competition Act proscribes enterprises from abusing their dominant positions. “Dominant Position” means the position of strength enjoyed by an enterprise in the relevant market in India, which enables it to operate independently of competitive forces prevailing in that relevant market, or affects its competitors or consumers or the relevant market in its favour. It is pertinent to note that the Competition Act does not prohibit an enterprise from acquiring a position of dominance as such; it prohibits the abuse of such dominance.

Combination

The merger control provisions of the Competition Act have introduced the concept of ‘Combination’. The provisions of the Competition Act prohibit any Combination, which causes, or is likely to cause, an appreciable adverse effect on competition within the relevant market in India. A ‘Combination’ includes an enterprise formed by an acquisition of control, shares, voting rights, or assets of an enterprise, a demerger of an undertaking or the merger or amalgamation of enterprises. To classify as a ‘Combination’ the transaction must exceed the prescribed thresholds of assets and turnover.

The Competition Act authorizes the CCI to investigate anti-competitive agreements, abuses of a dominant position by initiating *suo moto* inquiries; or upon receipt of a complaint from any person; or upon a reference made to it by the GoI or a State Government or a statutory authority. In cases of Combinations, parties are required to seek notify the CCI, seeking mandatory prior approval for the consummation of the Combination.

The Competition Act also empowers the CCI to scrutinize Combination within one year from the date the Combination has come into effect. The CCI would be empowered to launch an investigation on its own initiative or in response to information received from any person.

The CCI has powers to pass, among others, all or any of the following orders in case of an adverse finding:

- Orders to cease and desist;
- Orders that impose very substantial penalties ;
- Orders directing the modification of agreements;
- Orders that an acquisition, acquiring of control and merger or amalgamation shall not be given effect to or should be modified;
- Orders directing the break-up of a dominant entity.

Appeals may be filed before the Competition Appellate Tribunal (“COMPAT”) and thereafter to the Supreme Court of India.

It may be pointed out that given the nascent stage of the competition regime jurisprudence under the Indian competition regime is yet to evolve and certain ambiguity about certain key aspects still exist.

Mergers and Acquisitions

Mergers and amalgamations are the subject matter of the Companies Act. The power to approve amalgamations, mergers and de-mergers rests with the High Courts of India of each state for both listed and unlisted companies. This power is proposed to be transferred pursuant to the Companies (Second Amendment) Act, 2002, to the National Company Law Tribunal (the "NCLT").

The GoI may order the amalgamation of two or more companies if it believes this to be in the public interest. The Board for Industrial and Financial Reconstruction ("BIFR") can issue orders under the Sick Industrial Companies (Special Provisions) Act, 1985 ("SICA"), for the amalgamation of a sick industrial company with another company.

SEBI regulates takeovers and substantial acquisitions of shares of a listed company vide the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("SEBI Takeover Regulations") as amended from time to time. The SEBI Takeover Regulations provide for acquirers to make disclosures of encumbrances and holding of shares and public announcements and launch open offers in cases of acquisition of shares or voting rights beyond a certain threshold percentage, consolidation of holdings and acquisition of control over a company. The SEBI Takeover Regulations also contain certain exemptions where an open offer need not be made. The regulations also provide for bail out takeovers i.e. the substantial acquisition of shares in a financially weak company in pursuance of an approved scheme of rehabilitation.

Foreign Exchange Laws

The Foreign Exchange Management Act, 1999 ("FEMA") consolidates the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of the foreign exchange market in India.

FEMA, along with the rules and regulations framed under it, governs foreign exchange transactions in and from India.

FEMA places all foreign exchange offences under the purview of civil law, thus subjecting them only to monetary penalties in contrast with their categorization as criminal offences under the previous regime.

TAX FRAMEWORK

Tax Structures and Incentives

India has a federal structure and a well-developed three-tier tax framework, comprising of taxes levied by the Central Government, the State Governments and the Local Authorities. Power to levy taxes and duties is distributed among the three tiers, in accordance with the provisions of the Constitution of India. Further fiscal revenue is shared between the Central Government and the State Governments.

The principle taxes and duties that the Central Government is empowered to levy are, Income Tax (which is a direct tax, levied on earning of income), Customs duty, Central Excise, Central Sales Tax (hereinafter "CST') and Service Tax (which are indirect taxes, levied on consumption of goods and services). The principal taxes levied by the State Governments are, Value Added Tax (hereinafter "VAT"), Stamp Duty, State Excise duty (levied on the manufacture of alcohol, alcoholic preparations, and narcotic substance), Land Revenue, Entertainment tax and Tax on professionals. The Local Authorities are empowered to levy tax on immovable properties, octroi, tax on markets and tax or user charges for utilities such as water supply and drainage.

In order to encourage savings, investments and to provide incentives for industrial growth and development, both Central and State Governments offer a number of concessions to an investor in India from time to time. India's main tax incentives are directed towards setting up new industries particularly in the infrastructure, mining and energy sectors.

Corporate Taxation

In case of resident companies, tax is levied on their gross global income less allowable deductions. These deductions include expenditures for materials, wages, salaries, bonuses, commissions, rent, repairs, insurance, royalty payments, interest, lease payments, depreciation, expenditures for scientific research and contributions to scientific research associations. A company is deemed to be a resident company if it is incorporated in India or control and management of its affairs is situated in India. A resident company is not only taxed at a lower rate but is also entitled to additional incentives and rebates. Corporate tax rate for a resident company is 30% (plus applicable surcharge and education cess).

A Foreign Company means a company which is not a domestic company (resident company). Foreign companies are subject to Indian income tax in respect of income derived from Indian sources or deemed to be so derived. Tate tax applicable to business income earned by a foreign company in India is 40% (plus applicable surcharge and education cess).

A branch of a foreign company is liable to corporate tax on the profits attributable to such branch at the rate applicable to a foreign company. Further the rules on deductibility of expenses remain the same as those for resident companies for computing taxable income.

The taxable income of companies is computed as profits or gains in business, capital gains and income from other sources. Corporate tax rates have decreased in recent years, in keeping with the

Central Government's aim to widen tax base and ensure greater compliance.

Capital Gains

Long-term capital gains (hereinafter "LTCG") on disposal of shares held in a company for more than one year and all other assets held for more than three years are computed by deducting cost, adjusted for cost inflation index in case of all assets, other than bonds or debentures, at the prescribed rates, from net sale proceeds.

LTCG arising from transfer of listed securities, on which Security Transaction Tax ("STT") is paid, are exempt from tax. LTCG from sale of a long-term capital asset are exempt from capital gains tax where amount of such capital gains is reinvested in certain specified financial products and assets within a specified period.

In case of non-residents, capital gain on transfer of shares or debentures of an Indian company is calculated by converting asset cost and transfer expenses into the foreign currency in which they were purchased and the computed capital gain is then converted back into `. The computation is carried out in the above manner in order to shield such transfers from exchange fluctuations. However, recently a tax rate of 10% (plus applicable surcharge and education cess) on long-term capital gains arising from sale of shares in an unlisted company by a non-resident without allowing any adjustment foreign exchange fluctuation and cost-inflation has been provided. Buy-back of shares by a company is subject to capital gains tax in the hands of the shareholder concerned. Short term capital gains ("STCG") i.e. gains arising from transfer of capital assets held for not more than three years or shares and other specified securities held for not more than one year are charged at normal rates applicable for personal or corporate taxation. India follows a progressive slab rate of tax on individual income. Peak rate of taxation applicable on income of an individual and corporate tax rate is 30% (plus applicable surcharge and education cess). However, STCG arising from transfer of listed securities are charged at a lower rate of 15% (plus applicable surcharge and education cess) subject to payment of STT. STCG on sale of listed shares sold by a non-resident otherwise than on stock exchange without payment of STT or on sale of shares of an unlisted company by a non-resident is subject to tax at 40% (plus applicable surcharge and education cess).

With respect to capital assets held as business assets any excess amount realized over the written down value of such a block of assets is treated as short term capital gains and is taxed at normal rates applicable to business profits.

Dividend Distribution Tax

A company is liable to pay Dividend Distribution Tax (hereinafter "DDT") on the amounts declared or distributed as dividend at the rate of 15% (plus applicable surcharge and education cess). Since DDT is paid by the company at the time of declaration or distribution of dividends, such dividends are not taxed in the hands of recipient (irrespective of the fact that whether dividends are paid to a resident or non-resident shareholder). As a result withholding tax is not payable on dividends distributed by an Indian company.

Withholding Tax

Indian tax law provides for deduction of tax at source on various types of income commonly known as "Withholding Tax". It may be noted that generally, all amounts payable to non-residents such as royalties, technical services fees and interest on loans are subject to withholding tax. Further the tax withheld is required to be deposited by person deducting such tax with the Central Government

Minimum Alternate Tax

In case tax liability of a company is less than 18.5% of its book profits, such book profits are deemed to be 'taxable income', and such company is liable to pay a Minimum Alternate Tax at 18.5% (plus applicable surcharge and education cess).

Loss relief

Losses arising from business operations in an assessment year may be carried forward and set off against future business profits over the next eight assessment years. However unabsorbed depreciation may be carried forward indefinitely. Business losses may be carried forward only where tax return is filed by the due date. In case of a closely held company such as a private limited company, carrying forward and setting off of losses will not be permitted unless shares of such company carrying not less than fifty-one per cent of the voting power were beneficially held by same persons both in the year in which losses were incurred and the year in which the losses are sought to be set-off.

Re-organizations

Indian Income-tax laws contain special provisions for facilitating amalgamations and mergers. It specifically exempts transfer of a capital asset in a scheme of amalgamation by the amalgamating company to the amalgamated company subject to certain conditions. In a cross border transaction when a foreign holding company transfers its shareholding in an Indian company to another foreign company as a result of a scheme of amalgamation, such transfer of capital asset, i.e. shares in the Indian company, is also exempt from capital gains tax in India, subject to certain conditions.

In case of a merger, relinquishment of shares of the amalgamating company held by shareholders is not regarded as a transfer of shares and is exempt from capital gains tax subject to certain prescribed conditions.

In the case of a de-merger transfer of assets by the de-merged company to the resulting (Indian) company is exempt from capital gains tax subject to the fulfillment of certain prescribed conditions.

Double Taxation Avoidance Agreements

India has comprehensive double-taxation avoidance agreements in force with several countries. Most of such agreements allow relief from double tax by the credit method or by a combination of the credit and exemption methods. Accordingly domestic companies are allowed credit against Indian income tax of the aggregate income tax paid overseas. Further credit is limited to lesser of actual tax paid on foreign income and Indian tax applicable to such income. Tax rates applicable on various transactions involving payment of royalties, fee for technical services, interest are also governed by such agreements.

Transfer Pricing

Income-tax laws provide for transfer pricing regulations ("TPR") which are applicable on 'international transactions' between 'associated enterprises'.

Recently, TPR have been applied to few specified transactions entered into between domestic parties as well. Indian tax authorities are empowered under the provisions of TPR to make adjustments to income generated from an international transaction if, among other things, in their opinion the price charged is not on arms length basis ("ALP") determined in accordance with the most appropriate method.

Appropriate documentation is required to be maintained to establish adequacy of ALP. Recently, a scheme in relation to unilateral, bilateral and multilateral advance pricing arrangements has been notified.

Indirect Taxes

Apart from the above mentioned taxes, companies in India are also subject to indirect taxes which are levied both by the Central Government, the State Government and the Local Authorities. In the past few years, indirect taxes have been steadily lowered and their structure and complexity has been rationalized.

Excise duty

Excise duty is levied by the Central Government on the manufacture of goods in India at the rates and on the basis of classification under the Central Excise Tariff Act, 1985 (the "Excise Tariff"), which is aligned with the harmonized system of nomenclature.

Further the Central Government provides for concessional rates or exemption from excise duty, by way issue of notifications which may be conditional or un-conditional.

Presently most goods are chargeable at a peak rate of excise duty of 12% ad valorem. The basis for determining the excise duty payable is the transaction value or Minimum Retail Price after allowing permissible deductions for each product liable to excise duty with reference to the MRP.

Certain goods are liable to specific rates of excise duty irrespective of sale price. Excise duty is payable by the manufacturer and is collected from the customer as a part of the sales consideration.

Customs Duty

The Central Government levies customs duty on import and export of goods at the rates and on the basis of classification under the Customs Tariff Act, 1975. A downward trend in customs duty rates has been seen over the past few years and presently most goods are liable to customs duty at the rate of 10% ad valorem. Customs duty on import comprises of the following:

♦ Basic Customs Duty ("BCD");

♦ An "Additional Customs Duty", also known as Countervailing Duty ("CVD") which is equivalent to Excise Duty leviable on like goods produced or manufactured in India, calculated either on the total of transaction value of the products plus BCD or on the basis of MRP.

♦ Additional duty of customs, also known as Special Additional Duty to counter-balance sales tax / VAT, local tax or other charges leviable on articles on its sale, purchase in India.

Service Tax

In 1994, the Central Government introduced the levy of a Service Tax on notified services in terms of Chapter V of the Finance Act. Generally, Service tax is payable at the rate of 12% plus eduction cess (effectively 12.36%) on the value of services by service provider and may be collected as part of consideration from the recipient of services.

However in case where the services are imported from outside India, the recipient of services is liable to pay service tax. Export of services is exempt from service tax in the hands of the service provider subject to meeting certain specified conditions.

A Negative List concept for taxation of services was also introduced. Services specified in the 'Negative List' will remain outside the tax net. All other services would thus be chargeable to service tax except those specifically exempted.

Cenvat Credit

To avoid the cascading effect of taxes, the Central Government has introduced a scheme allowing credit of excise duty, CVD and service tax to be paid on inputs, specified capital goods and input services used in or in relation to the manufacture of excisable goods or for providing taxable services to be set off against excise duty or service tax liability. The scheme of Cenvat credit is codified under the Cenvat Credit Rules, 2004.

VAT or CST

VAT is a state government levy and is collected under the authority of the respective states VAT Act. However, while CST is leviable under the Central Sales Tax Act, 1956, it is administered by

the State VAT authorities. VAT or CST is payable on a sale of goods transaction depending upon the nature of transaction. In case of intra-state sales transaction VAT is payable and in case of inter-state sales transaction, CST is payable.
Further, input credit of VAT paid on purchase of the goods is available to be set off against the VAT or CST liability of the dealer. However input credit is not allowed on CST paid on purchases.

Entry Tax
In addition to VAT, some states also levy entry tax on entry of goods in the State, which is allowed to be set off against VAT or CST liability of the dealer under specified conditions.

Tax Administration

Other Taxes

States in India levy moderate taxes on motor vehicles and freight traffic; municipalities charge taxes on services and levy professional fees. Financial instruments and transactions in India attract stamp duties that are levied at the federal and state levels.

All taxpayers, including foreign companies are required to follow a uniform financial year from April 1 to March 31 for the purposes of filing tax returns. The law requires that the taxpayer companies must file their prescribed periodical returns tax returns on or before a due date specified in the respective legislations.

If tax authorities can prove concealment of income or duty / tax evasion, penalties between 100 to 300 percent may be levied on the tax evaded. The Central Board of Direct Taxes and the Central Board of Excise and Customs in the Ministry of Finance of the Government of India are the nodal administrative bodies for administration of direct taxes and federal indirect taxes, respectively. VAT and CST are administered by the respective State's tax administration departments

Recent Developments

The GoI is proposing a complete revamp of the extant income tax laws provided by Income-tax Act 1961 by replacing it with Direct Tax Code ("DTC"). Presently, DTC Bill 2010 is under consideration at Indian Parliament and is expected to be passed in next few years.

The GoI is also looking at revamping indirect tax regime by introduction of Goods and Service Tax ("GST") at Centre and States level. GST will subsume many indirect taxes at Centre and State level. GST involves amendment of Indian Constitution for re-distributing powers of taxation among Centre and State Governments. GST will be introduced in next few years.

In an effort to curb tax avoidance and evasion, the Government has introduced general anti-avoidance rules ("GAAR") by inserting Chapter X-A in the Income-tax Act, 1961. As indicated in the Finance Bill, 2013 GAAR is due to come into effect on April 1, 2015.

Once GAAR comes into effect as proposed on April 1, 2015, GAAR will empower tax authorities to declare an arrangement as impermissible avoidance arrangement if it was entered into with the objective of obtaining a tax benefit. GAAR empowers the Indian tax authorities to examine commercial substance of an arrangement.

REAL ESTATE SECTOR

Legislative Framework

Laws governing the real estate sector in India are substantially codified. However, recently there have been talks of a real-estate regulator being introduced. Real estate laws are contained in different enactments pertaining to transfer of property rights, rent control and land ceiling among others. These enactments deal with areas such as:

- aspects related to real estate contracts;
- declaratory relief and injunctions in respect of property rights;
- transfer and conveyance of property in terms of sale, lease and mortgage;
- requisite covenants and terms and conditions to be incorporated in the documentation pertaining to such transfers and conveyance;
- testate and intestate succession;
- grant of letters of representation such as probate, letters of administration and succession certificates pertaining to property;
- total or partial partition of properties; stamp duties payable in respect of property transactions;
- modalities for computation and quantification of such duties;
- compulsory and optional registration of documents in respect of property transactions;
- consequences arising from non-registration of transactions with the registering authorities and procedural laws in respect of enforcement of legal rights pertaining to properties

The principal enactment in India pertaining to the sale of immovable property is the Transfer of Property Act, 1882 ("TPA"). Under the TPA "Sale" (with respect to immovable property), is a transfer of ownership, by one living person to another living person in exchange for price paid or promised or part paid or part promised. The TPA contains detailed provisions with respect to implied terms and conditions of such transfer by sale. Typically transactions of sale of immovable properties are spread out over a period of time commencing from the negotiations between the parties, perusal and scrutiny of the title deeds (for examination of title of the vendor), finalizing the terms and conditions of the prospective sale such as, quantum of price and the payment installments and completion of the transaction by the execution and registration of the formal deed or indenture of transfer. Importantly, under Indian law a contract of sale does not, of itself, create any interest or charge on the property as equitable estates are not accorded recognition under Indian law.

Growth and Development

Recent developments in the real estate sector in India have highlighted its tremendous potential and contributed to its phenomenal growth. This has caused the sector to appear on the agenda of all major international funds and developers. Today, the sector is witnessing a wide spectrum of advancements that are transforming India into a preferred and sought after destination for real estate activity.

Two major steps taken by the GoI have been the core catalysts in fuelling growth in the real estate sector in India:

1. *FDI in Real Estate in India*

   The first step comprises of the initiatives that have been taken to allow FDI in real estate in India in townships, housing, built-up infrastructure and construction development projects. Under these, the minimum area to be developed is (i) 10 hectares in case of development of service housing plots, (ii) a minimum built-up area of 50,000 sq. meters in case of construction-development projects and (iii) in case of a combination project, any one of the two conditions mentioned above. These projects are required to be designed keeping in consideration the local by laws and regulations. The minimum required capitalization amounts to US$ 10 million for a wholly owned subsidiary and US$ 5 million for a joint venture with an Indian partner[18].

   In terms of the Consolidated FDI Policy, the whole of the original investment cannot be repatriated before the end of a period of three years from the date of completion of minimum capitalization. The GoI has recently clarified that the original investment means the entire amount brought in as FDI. The lock-in period of three years will be applied from the date of receipt of each installment / tranche of FDI or from the date of completion of minimum capitalization, whichever is later. The investor may be permitted to exit earlier with prior approval of the Government through the FIPB.

2. *Introduction of Real Estate Mutual Funds*

   The second set of initiatives is the introduction of Real Estate Mutual Funds (“REMFs”) in India by way of amendments to the SEBI (Mutual Funds) Regulations, 1996 which permit mutual funds to launch REMFs. As per the amendment, REMFs are close-ended with units requiring compulsory listing on stock exchanges. REMFs are further required to file a declaration of net asset value requirements on a daily basis. As a part of the initiative SEBI has also approved guidelines for the REMFs (yet to come into force) relying on the recommendations of the committee on real estate investments scheme.

Real Estate Bill

In June 2013, the Union Cabinet approved the Real Estate (Regulation and Development) Bill, 2013. The Bill once enacted will provide for a uniform regulatory environment, to protect consumer interests, help speedy adjudication of disputes and ensure orderly growth of the real estate sector.

LAW GOVERNING START-UP COMPANIES BUSINESS OPERATIONS IN INDIA: AN GENERAL OVERVIEW

Prelude to Law & the New Economic Policy: The economic policy of the Government of India aims at promoting several new entrepreneurs to set up companies to facilitate investments in High Growth sectors such as software, electronics, service, engineering, infrastructure, pharmacy etc. Post 1990's witnessed a changed legal regime that facilitated trade and economic growth of India. Over last two decades, the legal regime was liberalised in a phased manner to facilitate trade domestically and internationally. The laws governing trade in India as it stands today have been designed to not only provide for a regulation of the business, but also provide for a rehabilitation and revival scheme for sinking companies which operated in adherence with law.

The legal framework regulating business in this country can be broadly discussed understood in 5 different aspects, namely;

- (i) Incorporation and establishment of Company.
- (ii) Labour Policy
- (iii) Free and Fair competition/ Protectionist regime
- (iv) Scheme of rehabilitation and Revival
- (v) Dispute Resolution

1 **Incorporation and establishment of Company:** Laws such as the Indian Companies Act, 2013 (read with relevant provisions of Indian Companies Act, 1956), Partnership Act, 1932 and the Limited Liability Partnership Act, 2008 provide a legal framework of commencing a business through various structures. Further the said laws also lay down the regulations and the rules that have to be adhered to by the incorporated entities to conduct their business. One of the key features to conduct business in accordance with law is to operate within the framework of regulations laid under aforesaid laws.

2 **Labour Policies:** A sound labor policy would facilitate removal of inequalities in profit sharing and wealth distribution. In furtherance of insuring a good labor police, laws such as the Factories Act 1948, the Industrial Disputes Act, 1947, the Minimum Wages Act, 1948, the Employees State Insurance Act, 1948 etc have been enacted to protect the interest of the labors.

3 **Free and Fair competition/ Protectionist regime:** Free and fair market can be established only by regulation of law and not otherwise. To uphold and implement this principal, laws such as the Competition Act, 2002, the laws protecting IPRs (Patents, Copyrights, Trade Mark), Consumer Protection Act, 1986, Real Estate (Regulation and Development) Act, 2016 etc have been enacted and put to force to curb unhealthy trade practices that would hamper free and fair trade.

4 **Revival:** Mere regulation of business would not suffice to foster the growth of trade, unless a scheme is provided to secure and revive a sinking company which strictly operates within the work of law. To further this need, organizations such as Board of Industrial and Financial Reconstruction and laws such as Micro, Small and Medium Establishments Act, 2006 and Sick Industrial Companies Act, 1985 have been enacted to give an opportunity to Companies alternative solutions to revive itself.

5 **Dispute Resolution:** To ensure efficient bargain there is a need for creating an effective dispute settlement mechanism to resolve all disputes arising between companies doing business in India. A sound judicial setup has been created in form of Courts (Judicial & Quasi Judicial) to resolve issues arising out of trade. Acts such as Arbitration and Conciliation Act, 1996 which was enacted during the liberalized phase of Indian economy, played an important role by providing expeditious alternate dispute resolution mechanism to resolve all trade disputes.

FINANCING MODELS FOR START-UPS IN INDIA

In the Indian context, the early stage financing of a start-up company happens in two ways, namely, equity financing and debt financing.

Equity Financing

Equity financing is regulated by the Securities and Exchange Board of India. The SEBI (Alternate Investment Funds) Regulations, 2012 describes the two primary forms of equity financing, viz. angel investors and/or venture capital/ private equity investors.

Venture Capitalist/Private Equity

As per the SEBI (Alternate Investment Funds) Regulations, 2012, a venture capital fund is a fund that primarily makes investments in unlisted securities of start-up companies or emerging venture capital undertakings. These undertakings are mainly involved in developing and manufacturing new goods and services, advancements in technology or intellectual property, novel business models, etc. A private equity firm is also a popular kind of venture capital fund which invests primarily in equity or equity linked instruments of new companies or dying companies.

As a pre-condition to investment, the investing firm and the start-up company must ideally perform a mutual analysis of the risks involved. If the investment seems prima facie feasible after a preliminary assessment, the investor and the start-up company will enter into a non-binding offer document. The next step is here the investor fund performs a thorough financial, legal and technical due diligence of the start-up company.[2] The criteria for deciding the profitability and risk of the investment for an investor fund are as follows- the growth potential is exponential, the attractiveness of the industry, the level of sustainable advantage in the platform, receptiveness of the owners to involvement of outsiders such as the investors, the profit sharing ratio between the investor and the owners and the availability of exit alternatives (4-7 years out). Once the due diligence report approves of the investment, the offer is finalized and the start-up must secure some form of written commitment from the venture capital fund. The venture capital fund will then release its fund into the company and help the company grow and become profitable and then sell its stake and exit the company.

Upon finalization of the investment, the following three transaction documents must be executed between the investors and start-ups: First, there must be a term sheet or commitment letter or memorandum of understanding that sets out the basic commercial understanding between the investor and investee.[3] It must also include all the legal terms and provisions for the subsequent final agreements to incorporate the results of the due diligence. Second, the parties must enter into a Share Subscription Agreement or a Debenture Subscription Agreement which details the issuance of shares in the share capital or debentures at subscription amount. This amount is calculated based on the valuation of the start-up as per the due diligence report; The agreement essentially lists the condition precedents to completion of transaction or conditions subsequent to be completed within the agreed time frame after the completion date. It also contains the representations and warranties and provisions on indemnification of losses resulting from due-diligence exercise or otherwise, etc.[4] Finally, the parties must sign a Shareholders' Agreement that provides for important rights and liabilities such as nomination/representation rights for the investor, reporting rights of the investors disclosure obligation of investee company, rights to redeem the investor's debentures or preference shares other right such as pre-emption, right of first refusal or right of first offer, lock-in-period for the investor or promoter's holding, put and call options, affirmative vote rights on certain reserved matters, anti-dilution provisions, etc. It also provides for the exit options available to the investor after the mandatory lock in period.

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[2] Nishith Desai Associates, START-UPS: WHAT YOU NEED TO KNOW, NDA (June, 2016) available at: http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Start_-_Ups_What_You_Need_To_Know.pdf (Last visited on 04.04.2018).

[3] Vinay Vaish, *Financing Options Available for Start-Ups in India*, MONDAQ (Jan 7, 2016) available at: http://www.mondaq.com/india/x/456326/Securities/Financing+Options+Available+For+Startup+Companies+In+India (Last visited on 04.04.2018).

[4] Vinay Vaish,

Angel Investors

Angel investors are usually individuals or a group of industry professionals who are willing to fund the start-up company at a very early stage in return for a stake in the equity shareholding of the company. Under the SEBI (Alternative Investment Funds) Regulations, 2012 which was subsequently amended in 2016, SEBI has made certain restrictions applicable to angel funds investing in an Indian company.[5]

As per the original form of the Regulations, angel funds can only invest in a company which is within 3 years of its incorporation. However, the SEBI (AIF) Amendment Act, 2016 has expanded this to allow investment into companies within 5 years of their incorporation. Second, the company should not be listed on the floor of a stock exchange. It must also have a turnover of less than INR 250 million and not be promoted by or related to an industrial group (having a total group turnover of over INR 3 billion). The original regulations stated that the size of the investment by the angel fund was required to be less than 50 lakhs and not more than 5 crores. However, the minimum investment has been relaxed from 50 lakhs to 25 lakhs by the 2016 Amendment. It was earlier required that an angel fund investment shall be locked-in for a period of at least 3 years, however, the 2016 amendment has reduced this period to 1 year.

Furthermore, certain documents such as the information memorandum or business plan, draft term sheet and a copy of charter documents must be executed and shared with both parties involved to finalize the investment.

Debt Financing

Loan from Banks & NBFCs

Loans from banks and NBFCs help finance the purchase of inventory and equipment, besides securing operating capital and funds for expansion. More importantly, unlike a VC or angels, which have an equity stake, banks do not seek ownership in your venture. However, there are several drawbacks of such funding option. Not only do you pay interest on loan but it also has to be done on time irrespective of how your business is faring. They require substantial collateral and a good track record, besides the fulfilment of other terms and conditions and a lot of documentation as follows:

a. Application for loan sanction by borrowers;
b. Issue of sanction letter by the Bank;
c. Agreement of Loan;

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[5] Anon, "*SEBI relaxes rules for angel funds to boost start-up funding*", LIVEMINT (Jan 5, 2017), available at: https://www.livemint.com/Companies/19CkJYgiOzpdNXvjJlslcK/Sebi-relaxes-rules-for-angel-funds-to-boost-startup-funding.html (Last visited on 04.04.2018).

d. Security/collateral documentation, such as (i) Deed of Mortgage; (ii) Deed of Hypothecation; (iii) Deed of guarantee; (iv) Share pledge agreement; (v) Memorandum of Entry; etc.

External Commercial Borrowings

External Commercial Borrowings (ECB) in form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. non-convertible, optionally convertible or partially convertible preference shares, floating rate notes and fixed rate bonds) can also be availed from non-resident lenders to fund the business requirement of a company. ECB can be accessed under two routes, viz., (i) Automatic Route; and (ii) Approval Route depending upon the category of eligible borrower and recognized lender, amount of ECB availed, average maturity period and other applicable factor.

ECB raised has also certain end use restrictions such as that it cannot be used for (a) on lending or investment in capital market; (b) acquiring a company in India; (c) real estate sector etc. Under ECB also the borrower needs to create certain charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees in favour of overseas lender / security trustee, to secure the ECB raised by the borrower, subject to compliance of certain conditions as prescribed under ECB guidelines framed by Reserve Bank of India. The documentation on similar lines as mentioned under bank loan section above will need to be executed.

CGTMSE Loans

Under the Credit Guarantee Trust for Micro and Small Enterprises scheme launched by Ministry of Micro, Small & Medium Enterprises (MSME), Government of India to encourage entrepreneurs, one can get loans of up to 1 crore without collateral or surety. Any new and existing micro and small enterprise can take the loan under the scheme from all scheduled commercial banks and specified Regional Rural Banks, NSIC, NEDFi, and SIDBI, which have signed an agreement with the Credit Guarantee Trust.

Initial Public Offer (IPO)

One of the most common modes of exit options for private equity firms and venture capital funds is an offer for sale or Initial Public Offer of the company’s equity. Most Start-ups in India are private limited companies. To be eligible for an IPO, the start-up company is required to be restructured into a Public Company, i.e., it must be authorised by its constitutional documents to have more than fifty shareholders and have no restrictions on the transferability of its shares.

The two main laws governing the process of an IPO are the Companies Act, 2013 and the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations). The main pre-conditions that the company has to satisfy at the time of filing offer document for public issue are listed in Chapters II and III of the ICDR Regulations.[6]

Importantly, before an IPO, the start-up company must meet all the eligibility criteria listed in five sub-regulations to Regulation 26 which are as follows:

- It must have net tangible assets of at least INR 3 crore for three full years.
- It must have reported distributable profits in at least three years.
- It must have had a net worth of at least INR 1 crore in the last three years.
- The issue size must not exceed five times the pre-issue net worth.
- If there has been a change in the company's name, at least 50 per cent of the revenue for preceding one year should be from the new activity denoted by the new name.

In case the company is a new start-up that has not been in existence for three years or does not meet certain financial strength tests, it must allot at least 50% of the shares forming part of the IPO to retail and institutional investors.[7]

It must also meet certain other conditions[8] such as-

- As per Regulations 2 and 4 of the ICDR Regulations, neither the company nor its affiliates must be barred from accessing the capital market by SEBI or any other authorities; It must also ensure that none of the promoters, directors or persons in control of the company are acting in such capacity for any other company which is barred from accessing the capital market, under any order or directions made by SEBI.
- The promoters must submit an application for listing of the specified securities in at least one recognised stock exchange having nationwide trading terminals.
- As per Regulation 5, the company must also ensure to appoint one or more merchant bankers, at least one of whom shall be a lead merchant banker and shall also appoint other intermediaries such as depositories, in consultation with the lead merchant banker, to carry out the obligations relating to the issue.
- The company must ensure that it does not go ahead with an IPO if the number of prospective allotees is less than 1000.
- As per Regulation 4, it must mandatorily pay up or forfeit all existing partly paid-up equity shares of the company.
- As per Regulation 26(6), the company must also ensure that the equity shares offered for sale to public have been held by the sellers for a period of at least one year prior to the filing of draft offer document with the Board subject to the statutory exemptions.

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[6] Rebecca Furtado, *Pre-conditions for doing an IPO in India*, iPleaders, (Aug 17, 2016) available at: https://blog.ipleaders.in/pre-conditions-ipo-india-start/ (Last visited on 4.4.2018).
[7] Ibid.
[8] KPMG, *IPO SEBI and ICDR Listing Obligations Checklist*, KPMG Online, (Feb 16, 2018) available at: https://home.kpmg.com/in/en/home/insights/2017/03/sebi-icdr-and-listing-regulations.html (Last visited on 4.4.2018)

- As per Regulation 36, the promoters of the company must mandatorily contribute 20 percent of the total capital being offered. This is known as 'minimum promoter's contribution' and is locked-in for three years since the issue. The provision also requires that the contribution of non-promoter entities, e.g. investors, is locked-in for a period of 1 year. However, venture capital funds that are registered with SEBI are exempted from the lock-in period requirement.
- The company is also required to obtain a credit grading for the IPO from one or more credit rating agencies registered with SEBI.
- Lastly, the company must ensure that the corporate governance compliances are met as required by the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Once the above compliance requirements are met, the Start-up must conduct an alteration of its memorandum and articles of association of the company as per Sections 13 and 14 of the Companies Act, 2013 and the Companies (Incorporation) Rules, 2014. Next, the SEBI will scrutinize these documents and conduct its investigation / background checks and call for further documentation as required. Upon completion of formalities, the Registrar shall consider the application for change in class of company, close the existing registration and issue a fresh certificate of incorporation as per Section 18 of the Companies Act, 2013 and the IPO process can be implemented.

Unconventional Modes of Financing Options Which are Popular In India

<u>Crowd Funding</u>

This is recent phenomena being practiced for getting seed funding through small amounts collected from a large number of people (crowd), usually through the Internet. Now we have companies existing in India which are specializing in "Crowd Funding". The entrepreneur can get money for his venture by showcasing his idea before a large group of people and trying to convince people of its utility and success.

Wishberry and Catapult are a few among many such forums operating / present in India. The entrepreneur needs to put up on a portal his profile and presentation, which should include the business idea, its impact, and the rewards and returns for investors. It should be supported by suitable images and videos of the project. SEBI in 2014, even rolled out a 'Consultation Paper on Crowdfunding in India' proposing a framework in the form of Crowdfunding to allow startups and SMEs to raise early stage capital in relatively small sums from a broad investor base. The Consultation Paper defined Crowdfunding as *solicitation of funds (small amount) from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause*. However SEBI till now has not issued any further regulations in this regard.

<u>Incubators</u>

These set-ups precede the seed funding stage and help the entrepreneur develop a business idea or make a prototype by providing resources and services in exchange for an equity stake ranging from

2-10%. Incubators offer office space, administrative support, legal compliances, management training, mentoring and access to industry experts as well as to funding through angel investors or VCs. These are usually government-supported institutes like the IIMs or IITs, technical institutes or private business incubators run by industry veterans or companies. The incubation period can be 2-3 years and admission is rigorous. Some of the top options in India include IIM-Bangalore NSRCEL, Microsoft Accelerator and IIT-Kanpur SIIC and the famous Sriram College of Commerce (SRCC).

T-HUB

To set up a co-working space, an incubator, which will ensure innovation, was vision and funded by the state government of Telangana. What started off as a project to support innovation has now, two years later, become India's largest start up incubator. T-Hub was launched in November 2015 with the idea of helping technology-related start-ups by giving them a working space and access to mentorship, networking opportunities, and workshops for a nominal fee. A start up in itself, T-Hub has grown leaps and bounds from being a co-working space for start-ups to creating an ecosystem involving start-ups, corporates, investors and academia not just from Hyderabad, but from across the globe. The extension of that is the growth stage when more people pay for it and there is organic growth coming in terms of traction and revenue. T-Hub now focuses on helping these start-ups scale and take their product or solution to the next level.

PROTECTION OF INTELLECTUAL PROPERTY IN STARTUPS

Intellectual Property Rights (IP Rights) are like any other property rights which are intangible in nature. The IP Rights usually give the creator an exclusive right over the use of his/her creation for a certain period of time. With the rapid increase in the globalization and opening up of the new vistas in India, the "Intellectual Capital" has become one of the key wealth drivers in the present era. There are different country specific legislations, as well international laws and treaties that govern IP rights.

Every startup has IP Rights, which it needs to understand and protect for excelling in its business. Every startup uses trade name, brand, logo, advertisements, inventions, designs, products, or a website, in which it possesses valuable IP Rights. While starting any venture, the startup also needs to confirm that it is not in violation of the IP Rights of any other person to save itself from unwarranted litigation or legal action which can thwart its business activities. Further, startup ventures should be proactive in developing and protecting their intellectual property for many reasons like improving the valuation of its business, to generate better goodwill, to protect its competitive advantage, to use intellectual property as a marketing edge and to use the IP Rights as a potential revenue stream through licensing.

IP Rights protect several aspects of a business and each type of IP Right carries its own advantages. The scope of IP Rights is very wide, but the prime areas of intellectual property which are of utmost importance for any startup venture are as follows:

- Trademarks
- Patents
- Copyrights and Related Rights
- Industrial Designs
- Trade Secrets

INDUSTRIAL DESIGNS

As per the definition given under Section 2(d) of the Designs Act, 2000, "design" means only the features of shape configuration patterns or ornament applied to any article by any industrial process or means whether manual mechanical or chemical separate or combined which in the finished article appeal to and are judged solely by the eye. However, "design" does not include any mode or principle of construction or anything which is in substance a mere mechanical device and does not include any trademark as defined under the TM Act or any artistic work as defined under the Copyright Act, 1957. The total period of validity of registration of an Industrial Design under the (Indian) Designs Act, 2000 is 15 years.

Features of shape, configuration, pattern, ornament or composition of lines or colours applied to any article, whether in two dimensional or three dimensional or in both forms, can be registered under the *(Indian) Designs Act, 2000*. However, functionality aspects of a design are not protected under the (Indian) Designs Act, 2000, as the same are subject matter of patents.

Design of an article is not registrable in India, if it:

- is not new or original;
- has been disclosed to the public anywhere in *India or in any other country* by publication in tangible form or by use in any other way prior to the filing date or priority date of the application;
- is not significantly distinguishable from known designs or combination of known designs; or
- comprises or contains scandalous or obscene matter.

Enforcement of Design Rights in India

The (Indian) Designs Act, 2000, only provides for civil remedies. Besides injunction, monetary compensation is recoverable by the proprietor of the design either as contract debt or damages. An action for infringement of design can only be initiated after the registration of the design, however, an action for passing-off is maintainable in case of unregistered design.

TRADE SECRETS

Trade secrets include any confidential business information which provides an enterprise a competitive edge over others. Trade secrets encompass manufacturing or industrial secrets and commercial secrets, formula, practice, process, design, instrument, pattern, commercial method, or compilation of information which is not generally known or reasonably ascertainable by other.

The unauthorized use of such information by persons other than the holder is regarded as an unfair practice and a violation of the trade secret. There are no specific statutes under the Indian law for the protection of trade secrets and the same are protectable under the common law rights.

STRATEGIES FOR PROTECTION AND EXPLOITATION OF IPR FOR STARTUPS

1. **Make Intellectual Property protection a priority:** Start-ups cannot afford the complete protection available under the intellectual property regime. The first step for any startup is to evaluate and prioritize the IP Rights involved in its business. Depending upon the type of industry involved, IP Rights play an important role. Failure to identify or prioritize IP Rights, is likely to create problems for startup's business, especially during negotiations with future investors or exiting its business. Sometimes IP Rights are the only asset available with a startup.
2. **Register Intellectual Property Rights:** It is important to note that certain IP Rights like patents and designs are required to be registered before claiming any protection under the respective statutes. On the other hand, certain IP Rights like trademark and copyright need not be mandatorily registered for protection under. Nevertheless, a registered IP Right carries a greater value and acts as evidence of use of the IP Rights before courts as well as enforcement agencies;
3. **Due Diligence of IP Rights:** For any startup, it is indispensable that it does not violate IP Rights of any other person. This will ensure safety from unwarranted litigation or legal action which can thwart its business activities. This makes it even more important for startups to make careful IP decisions in the initial phase and conduct proper due diligence of IP Rights, which it is using or intends to use.
4. **Implement clear and effective policies and strategies for protection of IP Rights:** It is in the long term interest of startups to have an Intellectual Property Policy for management of various IP rights which may be presently owned, created or acquired in future by startups. The aim of such a policy is to ensure that there are no inter-se dispute between the promoters of the startups, which remains till date to be one of the main concerns for failure of startups.

5. **Agreements related to Intellectual Property:** It is pertinent to note that having proper documentation in the form of agreements like non-disclosure agreements, agreements with employees or independent contractors, can make all the difference between the success and failure of startups. Usually, intellectual property is created either by the founders or some key employee or a third party. The intellectual property so created, must be protected through a proper agreement between the founder or key employee or a third party, as the case may be and the startup. If the agreement, with founders or employees or a third party, , under which a novel idea was/is created, is overlooked, it could create bottlenecks later after such idea becomes successful. Accordingly, the startups need to ensure that anything created on behalf of the startup, belongs to the startup and not the Employee or a third party. Further, it is advisable to enter into elaborate assignments, licensing or user agreements, and care should be taken to make provisions for all post termination IP Right issues.

START-UPS AND LABOUR LEGISLATIONS

Genesis of application of Labor Laws to Start-ups

Over the past decade, India has seen a rapid growth of vibrant new start-ups in different sectors, where young entrepreneurs are dominating the start-up scene with their new age and innovative businesses. Though these ideas as well as the promoters are of new age, all the business enterprises in India have to comply with a wide variety of laws and statutes, especially labour laws, that specifically deal with the employer-employee relationship, compensations, working conditions, medical benefits, discrimination and retirement benefits. One of the many challenges faced by any entrepreneur or organization is the prevalence of year old laws governing labour employment such as benefits and terminations, even though the working culture and economy has progressed with time. While most of the legislations have undergone amendments as per to suit the convenience of present day businesses, for example Companies Act 2013, there still exists a need for a labour law framework which shall be suitable for present day start-ups and MSMEs.

Due to decentralization of power in India, there are various Central and State level labour and employment legislations which govern the conditions of employment, social security, health, safety, welfare, wages, trade unions and industrial disputes, etc. Many of these statutes become applicable only upon fulfilment of prescribed thresholds, such as number of employees in the organisation, wages of an employee(s), etc, while other legislations may be applicable only to specific/specified industries or to certain types of employees. This implies that a start-up needs to be on a constant vigil regarding the compliance with the central and the state legislations, including the stage at which any one or more statutes may become applicable. Some non-compliances may pose a limited financial risk as well as loss of goodwill and may become a source of continuous inconvenience due to inspections by the concerned authorities and actions as a result thereof.

Another important problem that poses inconvenience to start-ups is the lack of uniformity in some of the common terms used across different labour and employment legislations applicable to an organisation. For example, a large number of labour legislations have different applicability criteria, definition of ‘employee’, definition of ‘wages’ and also what is included and excluded from the wages and manner of calculation of wages. Further, some of the basic aspects, such as the components that need to be taken into consideration while computing wages for the purposes of identifying provident fund contributions, could be different from components taken into account while accounting bonus entitlement of an employee, etc.

Another issue that arises is with respect to the relationship matters of an enterprise. Currently, most of the start-ups not only hire employees on their payrolls, but until they are certain of their growth and business needs, also use independent consultants, direct or indirect contract employees and various other vendors, etc., to meet with their manpower needs. In absence of labour laws governing and addressing each manpower arrangement, enterprises will depend upon professional guidance to ensure that any such arrangement does not expose it to the risk of claims or demands of compensation or/and permanent employment. Thus, there is an urgent need for laws that allow start-ups to agree short or long-term arrangements or engagements with individuals, without being worried about the possibility of such individuals making burdensome demands.

Recent Developments in the compliance framework for the Start-ups

<u>Recommendations for relaxation of compliance requirements</u>
In 2016, the Ministry of Labour and Employment issued an advisory to all states, union territories and the central labour authorities recommending that there could be implemented a compliance regime for start-ups based on self-certification under different labour legislations.[9] Further, there would also be restrictions imposed on inspections that could happen under such labour laws. This initiative of the Government has been aimed at promoting the development of start-up companies in India and incentivizing entrepreneurship.

<u>Laws applicable to a start-up</u>

Statute	Scope & Application
Factories Act, 1948	Factories Act embodies the law relating to regulation of labour in factories. It prescribes the terms of health, safety, working hours, benefits, overtime ad leave. This Act has been enforced by state governments in accordance with the state specific rules as framed under the Factories Act.
Shops and Commercial	These are state specific statutes, regulating the conditions of work and employment in shops, commercial establishments, residential hotels,

[9] PRESS INFORMATION BUREAU, GOVERNMENT OF INDIA, Notification dated 25 April 2016, Available at – *<u>https://www.pib.nic.in/newsite/PrintRelease.aspx?relid=14119</u>*.

Establishments Acts	restaurants, eating houses, theatres, places of public amusement/ entertainment and other establishments located within the state. These statutes prescribe the minimum condition of services and benefits for employees, including working hours, rest intervals, holidays, overtime, holidays, leave, termination of service, rights and obligations of an employer and employees, etc.
Payment of Wages Act, 1936	The Act regulates the conditions of payments of wages and is applicable to factories, railways, tramways, motor transport services, docks, wharves, jetty, inland vessels, mines, quarries and oil fields, workshops, establishments involved in construction work and other establishments as notified by the appropriate state governments.
Maternity Benefit Act, 1961	The Act prescribes conditions of employment for women employees, before and after childbirth and also provides for maternity benefits along with other benefits. The Act is applicable to all shops and establishments in which 10 or more persons are employed; and factories, mines, plantations and circus.
Sexual Harassment of Women at Work-place (Prevention, Prohibition and Redressal) Act, 2013	This Act aims to provide protection to women against sexual harassment at the workplace and prescribes guidelines to be adhered by the employers and employees for the prevention and redressal of complaints of sexual harassment. The Act applies to both organized and unorganized sector, including government bodies, public and private sector organizations, non-governmental organizations and organizations carrying on commercial, vocational, educational, etc. activities. It also applies to all the places visited by the employee during the course of employment or for reason arising out of employment.
Minimum Wages Act, 1948	The Act provides for fixing and revision of minimum wage rates by the respective state governments periodically for both organized and unorganized sectors.
Payment of Bonus Act, 1965	Thee Act provides for payment of bonuses under certain defined circumstance, thereby enabling the employees to share the profits earned by the establishment. The Act applies to every factory and establishment in which 20 or more persons are employed on any day during an accounting year.

<u>Labour Laws exempting Start-ups</u>

Since the labour and environment law compliances are time consuming and cumbersome in nature and that the start-ups are often caught unaware as to the issues pertaining to such laws, the Government has proposed a self-certification mechanism for certain compliances as mentioned before. Under this initiative the Government has set up a mobile application as well as a dedicated web portal where start- ups can complete this self-certification process. After the self-certification process, it is proposed that there will be no inspection for a period of 3 years, unless instances of specific violations are reported. Even in such a case, prior approval from a senior officer would be required for any inspection.

Following are the labour laws legislations from which the start-ups are exempted from-

Statute	Scope and Application
Industrial Employment (Standing Orders) Act, 1946	The Act is applicable to factories, railways, mines, quarries and oil fields, tramway or motor, omnibus services, docks, wharves and jetties, inland steam vessels, plantations and workshops, where 100 or more persons are employed. It mandates every employer to lay down clear terms and conditions of service which is to be certified by the concerned labour department and thereafter enacted.
Trade Unions Act, 1926	Trade Unions Act provides for the registration of trade unions and lays down the law relating to registered trade unions.
Industrial Disputes Act, 1947	The Industrial Disputes Act prescribes and governs the mechanism of collective bargaining and dispute resolution between employer and employees. The Act contains provisions related to unfair labour practices, strikes, lock-outs, lay-offs, retrenchment, transfer of undertakings and closure of business.
Employees' State Insurance Act, 1948	The Act applies to all factories, industrial and commercial establishments, hotels, restaurants, cinemas and shops. Employees drawing wages below Rs. 15,000 per month are eligible for benefits under the Act. The Act provides for benefits in cases of sickness, maternity and employment injury and certain other related matters.
Employees' Provident Funds and Miscella-neous Provisions Act, 1952	It is an important social security legislation, providing for an institution of provident funds, pension fund and deposit-linked insurance fund for employees in factories and other prescribed establishments. The Act applies to establishments having at least 20 employees, the basic salary of the employee should be less than Rs. 15,000 per month or who has an existing provident fund membership based on previous employment arrangement.
The Payment of Gratuity Act, 1972	The Act is applicable to every factory, mine, oil field, plantation, port, railway company, shop and commercial establishment where 10 or more persons are employed or were employed on any day of the preceding 12 months. Employees are entitled to receive gratuity upon cessation of employment, irrespective of the mode of cessation. The eligible employee should have completed a 'continuous service' of at least 5 years (interpreted to mean 4 years and 240 days) at the time of employment cessation.
Building and Other Construction	The Act applies to establishments employing 10 or more building workers in any building/ construction work and regulates the conditions of employment and service of the workers and imposes obligations on the

Workers (Regulation of Employment and Conditions of Service) Act, 1996	employer, with respect to health, safety and welfare of the construction workers.
Contract Labour (Regulation and Abolition) Act, 1970	The Act applies to all establishments employing 20 or more persons (or that have employed 20 or more persons) on any day of the preceding 12 months and contractors employing (or have employed) 20 or more workmen on any day of the preceding 12 months. The Act regulates the conditions of employment of contract labour, the duties of a contractor and principal employer and provides for abolition of contract labour in certain circumstances. It does not govern establishments where work of a casual or intermittent nature is carried out.
Inter-State Migrant Workmen (Regulation of Employment & Conditions of Service) Act 1996	The Act applies to all "establishments" that have been defined under section 2(1)(d) of the Act. It prohibits the employment of inter-state migrant workers in the establishment without having registered the establishment and prescribes protection to level the playing field between local workers and migrant workers.