

Green Newsletter

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This month India Juris is Green.

An initiative of India Juris to spread the message of making our planet green.

CDM Practice Team
India Juris

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CDM Projects

Important Issues in Emission Reduction Purchase Agreements "ERPA"

Emissions' Reduction Purchase Agreement "ERPA" is an essential legal document required in Clean Development Mechanism "CDM" transactions. ERPA is a document for a transaction that transfers carbon credits (Certified Emission Reductions "CER") between two parties under the Kyoto Protocol. The buyer pays to the seller an agreed amount in exchange for Carbon Credits. The Standards for this agreement are also outlined by the International Emissions Trading Association. It's a kind of a sale and purchase agreement between a seller (the project entity) and a buyer.

For a successful ERPA and transaction, parties must (a) allocate risks involved in CDM Projects in the most efficient and equitable way (b) maximize the value of the project's CER's (c) develop risk mitigating strategies, and (d) find the adequate measures and solutions for every risk.

While finalizing and entering into ERPA, one should consider following issues in great detail:

Risks involved in CDM Projects:

- CDM projects generally rely on a new and developing international legal framework, which may give rise to certain risks. For example Designated Operation Entity "DOE" fails to accurately verify the Green House Gas "GHG" emissions reductions, risk that the parties will not be able to establish legal title to CERs, risk that CDM project is rejected by CDM Executive Board "EB".
- Risks in developing countries due to political and regulatory uncertainties e.g. change in laws, imposition of tax on CERs, requirement of licenses because CERs

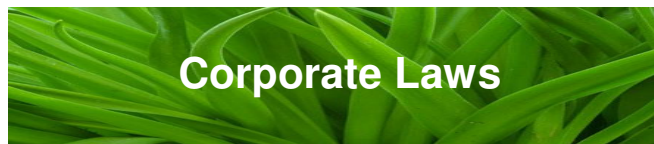
may be considered as derivatives and financial arrangements. Hence one need to secure support for the project through its Designated National Authority "DNA" in absence of efficient legal system for parties to enforce their rights.

- The price risks includes (a) traditional project risks such as, finance, approval, construction, cost overruns, project underperformance and delays (b) ERPAs include a fixed price or minimum of CERs at fixed and option at market or fixed price with adjustment, (c) Modalities of payment (full upfront), (d) Manage credit risk (penalties for late payment, increases in inflation), (e) Specify if price includes or excludes taxes on goods and services, (e) Specify who bears taxes, (f) CDM projects under Kyoto must reserve a share of proceeds to cover administrative and adaptation expenses, determine who will bear the share of proceeds, (g) Specify who will bear the risk of increased costs.
- Risk of failure to register project
- Verification and certification risks. Buyer could bear this risk by approving for payment and disbursing funds for ERs prior to certification by CDM EB. This will enhance value of ERPA. This risk is central to attractiveness of ERPA as collateral for financing.

Risk Mitigation Strategies

- **Risk allocation** - Allocate risks through the various project documents to contractors, financiers, suppliers of goods, off takers.
- **Risk Mitigation** - Mitigate risks through force majeure clauses. Parties should consider physical force majeure and political force majeure in great detail and properly take into account (a) adequate time to repair and replace (b) reasonable flexibility to re-establish operating performance (c) termination to be the last resort.

- **Transfer Risk** - Define clearly the number of Emission Reductions (ER's) and the years in which they are to be generated
- **Transfer of Title** - Specify at which point title to the ERs is transferred; e.g. signature of contract, payment, registration in a registry, time of delivery of CERs to buyer's account.
- **Uncertainty of Future Emission Reduction Achievement** - Define the two streams firstly Contract ERs and secondly Option ERs. Option ERs should be callable by the buyer with obligation to purchase otherwise value of ER stream diminishes for the lender. Lender is not a direct party to ERPA but lender is involved through the seller.
- **Shortfall or Failure to Deliver-** If CERs are not created / transferred, appropriate remedies and indemnities must be included in ERPA. Mechanisms should be included to manage shortfalls e.g. replacement of ERs from other projects, or future years, or repayment, negotiate amended delivery schedule, pay to the buyer the cost for him of purchasing replacement CERs or the market value of CERs, termination by buyer or penalty
- **Default, Termination and Indemnities** - Damages may arise from breach of obligations, events of default, negligent act or omission, false reports and warranties, gross negligence or willful misconduct. For remedies methods like early termination, withholding of payments and negotiation may be used.



Security for External Commercial Borrowings – Liberalization

Under the present External Commercial Borrowings "ECB" (foreign loan) guidelines, the choice of security to be provided to the overseas lender / supplier for securing ECB is left to the borrower.

However, creation of charge over immoveable assets and financial securities, such as shares, in favour of the overseas lender is subject to Regulation 8 of Notification No. FEMA 21/RB-2000 dated May 3, 2000 and Regulation 3 of Notification No. FEMA 20/RB-2000 dated May 3, 2000, respectively, as amended from time to time.

Accordingly, proposals for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees, on behalf of the borrower in favour of the overseas lender, to secure the ECB under automatic / approval route, are considered by the Reserve Bank.

As a measure of liberalization, Reserve Bank of India "RBI" has allowed banks to convey 'no objection' under the Foreign Exchange Management Act (FEMA), 1999 for creation of charge on immovable assets, financial securities and issue of corporate or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised by the borrower.

Before according 'no objection' under FEMA, 1999, banks may ensure and satisfy themselves that :-

- (i) the underlying ECB is strictly in compliance with the extant ECB guidelines,
- (ii) there exists a security clause in the Loan Agreement requiring the borrower to create charge on immovable assets / financial securities / furnish corporate or personal guarantee,
- (iii) the loan agreement has been signed by both the lender and the borrower,

and the borrower has obtained Loan Registration Number (LRN) from RBI.

On compliance of the above conditions, banks may convey their 'no objection', under FEMA, 1999 for creation of charge on immovable assets, financial securities and issue of personal or corporate guarantee, subject to the conditions indicated hereunder:

Creation of Charge on Immovable Assets

The 'no objection' for creation of charge on immovable assets may be conveyed under FEMA, 1999 either in favour of the lender or the security trustee, subject to the following conditions:

- (i) 'No objection' shall be granted only to a resident ECB borrower.
- (ii) The period of such charge on immovable assets has to be co-terminus with the maturity of the underlying ECB.
- (iii) Such 'no objection' should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender / security trustee.
- (iv) In the event of enforcement / invocation of the charge, the immovable asset (property) will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB.

Creation of Charge over Financial Securities

Banks may convey their 'no objection' under FEMA, 1999 to the resident ECB borrower for pledge of shares of the borrowing company held by promoters as well as in domestic associate companies of the borrower to secure the ECB subject to the following conditions :

- (i) The period of such pledge shall be co-terminus with the maturity of the underlying ECB.
- (ii) In case of invocation of pledge, transfer shall be in accordance with the extant FDI policy.
- (iii) A certificate from the Statutory Auditor of the company that the ECB proceeds have been / will be utilized for the permitted end-use/s.

Issue of Corporate or Personal Guarantee

The 'no objection' to the resident ECB borrower for issue of corporate or personal guarantee under FEMA, 1999 may be conveyed after obtaining -

- (i) Board Resolution for issue of corporate guarantee from the company issuing such guarantees, specifying names of the officials authorised to execute such guarantees on behalf of the company or in individual capacity.
- (ii) Specific requests from individuals to issue personal guarantee indicating details of the ECB.

Ensuring that the period of such corporate or personal guarantee is co-terminus with the maturity of the underlying ECB

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Private Equity & Venture Capital

Venture Capital Fund in defence sector gets FIPB permission to raise Rs 550 Cr

First of its kind, INDIA Rizing Fund, a mumbai-based venture fund for small and medium enterprises (SMEs) making defence equipments, has received the approval from FIPB and the government to raise Rs 550 crores with subscriptions from foreign investors.

The fund is expected to raise \$100 million initially and try to scale up investments by \$200 million. During a 10-year duration, it has an option to increase it by four more years. Its first closing is likely to be in October and the final closing by December this year.

India is one of the largest defence markets in the world. It has immense possibilities for foreign investors seeking a foothold in the industry. Now-a-days, multinationals are vying for multi-billion dollar defence deals from the Indian government including the mega orders for fighter aircraft.

India Rizing Fund is the first and the only SEBI-registered fund dedicated to investing in Indian Defence SMEs and R&D. As per defence scheme, 90% of the corpus is invested in SMEs and 10% of corpus is invested in R&D. More such funds are likely to be created in future to invest in Indian defence production sector.

The proposed scheme will offer two categories of units of par value of Rs 10 lakh each to investors and Rs 100 each for promoters and management of the company. Funds from the scheme will be invested in niche areas of defence production which include tanks, aircraft and war gaming simulators, as well as radars, military aircraft, missile launch systems and howitzer guns.

According to industry estimates, there are around 6,000 SMEs registered with a Defence Ministry. India is planning to acquire multi-role combat aircraft (MRCA) and the SMEs can get benefit

from such defence deals under which the selected aircraft manufacturer has to source 50% of the components from India. Government targets to source 70% of defence requirements from indigenous sources by 2010 and the Indian defence SMEs are expected to benefit from it.

Infrastructure Special Economic Zones

Tax bug may nibble at IT Special Economic Zones profits

Under the SEZ Act, profits earned by a unit are 100% tax-exempt for the first five years, and 50% tax-exempt for the next five years. The 50% tax exemption can be extended by five more years based on the amount re-invested in the SEZ unit.

However, according to the proposed tax exemption scheme for SEZs under Section 10AA(7) of the Income-Tax Act, only a percentage of the profits based on the proportion of export sales from the SEZ unit to the total turnover of the company will be eligible for exemption.

This significantly reduces the tax exemption a company can get on profits from SEZs at least in the initial years, when a greater percentage of exports come from outside of SEZ units.

By 2010, most leading software companies expect to get up to 50% of their export revenues from SEZs. Under Section 10AA(1), which defines the benefits under SEZs, 100% of export profits from the unit are tax exempt. But according to Section 10AA(7), which defines how these profits will be computed, profits from the SEZ unit have to be multiplied by the ratio of export sales from the unit to the total turnover of the assessee.

If Section 10AA(7) is not changed, there could be significant implications in terms of exemptions available.

Intellectual Property Laws

Cipla to oppose 60 drug patents of global companies.

Cipla, a renowned name in drug manufacturers, has once again filed pre-grant oppositions for over 50 drugs in various patent offices in India. If the oppositions are successful, it will help in introducing cheap drugs in the country.

The company plans to challenge over 60 drug patents of global majors in cardiology, oncology, anti-bacterial and psychiatric segment.

There are about 10,000 patent applications filed in India. Global companies such as Merck, Gilead, Novartis, Pfizer, Abbot and Amgem, among others have been filing applications in India since the time India became TRIPS compliant in 1995. In oncology alone, global companies have filed over 400 claims for patent protection.

Cipla is also fighting two cases against Roche anti-cancer drug Tarceva and Gilead's anti-HIV drug Viread.

Other Indian companies have also challenged patents of global MNCs. Torrent Pharmaceuticals is learnt to have filed about 45 oppositions. Besides Indian generic drug makers, a host of healthcare groups and NGOs are also aggressively challenging exclusivity attempts of discovery companies.

Mixed verdict for Ranbaxy in Lipitor case in Australia

In a mixed verdict for Ranbaxy in its ongoing battle to launch generic version of anti-cholesterol drug Lipitor, a Full Federal Court of Australia has

upheld an earlier decision which had gone in its favour. However, the court said that Ranbaxy's generic drug infringes upon another patent of Pfizer's patent for the same drug. This means that Ranbaxy can advance its generic version of drug in Australia by four months.

Impact of amended Patent Act, 2005 on pharma companies.

As per data received from the Controller General of Patents, only 449 patent applications were filed in 2007-08 as compared to 765 filed in 2006-07, it shows that Indian pharma firms have witnessed a sharp fall of 41% during Financial Year 2008.

This is seen as the first fall in number of patent applications by Indian companies in the past four years. It was on a steady rise since 2004.

From about 2002, many Indian pharma companies, big and small, have been filing several defensive patent applications on what might not be considered patentable invention under the amended Indian Patent Act, effecting from January 2005. Most of these applications did not translate into granted patents. The cost of prosecution is seen as major cause of concern.

According to Indian Drug Manufacturing Association (IDMA), one of the reasons why many companies not applying for patents in India but abroad, is the longer time frame required for the patent controller to approve patents as it requires clinical trials.

Post 2005, Indian pharma companies have been forced to spend more on R&D since India has amended its Patent Act to make it Trade-Related Aspects of Intellectual Property Rights (Trips) compliant. They now have to file product patents to protect their research instead of process patents.

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