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International Business Laws

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MBA - INTERNATIONAL BUSINESS

III Semester

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PAPER - XIII

International Business Laws

Objectives

- To expose the students to the legal and regulatory framework and their implications concerning global business operations, and
- To have a better understanding of the functioning and objectives of various world organizations

Unit - I

Legal Framework of International Business - Nature and complexities; Code and common laws and their implications to business; International business contract – legal provisions; Payments terms; International sales agreements; Rights and duties of agents and distributors.

Unit - II

Regulatory Framework of WTO - Basic principles and charter of GATT/WTO; GATT/WTO provisions relating to preferential treatment of developing countries; Regional groupings, subsidies, technical standards, antidumping duties and other non-tariff barriers, custom valuation and dispute settlement; Implications of WTO to important sectors – GATS, TRIPs and TRIMs.

Unit - III

Regulations and Treaties Relating to - Licensing; Franchising; Joint Ventures, Patents and trade marks; Technology transfer, Telecommunications. Framework relating to Electronic Commerce.

Unit - IV

Regulatory Framework and Taxation - Electronic Commerce
– Cross Border Transactions – On-line Financial Transfers – Legal
Safeguards – International Business Taxation – Tax Laws – Multilateral
and Bi-lateral treaties – Sharing of Tax revenues

Unit - V

Indian Laws and Regulations - Governing International
Transactions: FEMA; Taxation of foreign income; Foreign investments;
Setting up offices and branches abroad; Restrictions on trade in endangered
species and other commodities.

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UNIT – I

Legal Framework of International Business

Learning Objectives:

- To understand the scope of Legal Framework of International Business
- To understand the nature and complexities of Legal Framework of International Business
- To familiarize with the code and common laws and their implications to Business
- To Understand International Business Contract – Legal Provisions
- To get acquainted with the International Sales Agreements
- To understand Payments Terms
- To familiarize with the Rights and Duties of Agents and Distributors.
- To analyze the issues involved in International Business Law Transnational Sales

The purpose of introducing this subject is to give an overview about the legal environment and the intricacies involved in international trade. Law is defined as a set of rules established by a Government to regulate the conduct of individuals and groups in a society. These rules are legal rights granted to and obligations imposed on citizens and enforced by the Sovereign. It is the duty of citizens to obey these rules and those who violate them are liable for punitive action as provided for in the law.

Major reasons for the development of law are:

- i. To give basic rights to individuals, to society and organizations, and

- ii. To legally protect the enjoyment of these rights. Put in a general way law is for regulating relationships between individuals or between individuals and their society.
- iii. To provide a positive force to promote worthwhile individual, social and national goals.

Coming to Business Laws, it may be stated we are living in a world of business with roles as consumers and producers, employers and employees, principals and agents, and so on with rights, responsibilities and obligations placed on us. In fact, in our business-oriented society law touches every aspect of business life. Therefore, it is imperative to know what Business Law is. Business law is that part of the law which deals with mercantile transactions of people and institutions. One of the reasons for studying business law is to learn what the law provides as conditions for conduct of businesses both at the national and international level. Understanding business law will enhance the ability to take right decisions without violating rules framed by the Government. The following brief introduction helps the students to get acquaintance with Business Law.

International law: International law may be defined as a body of law formed as a result of international customs, treaties, and organizations that governs relations among or between nations. International Customs are customs evolved over the centuries. Treaties and International Agreements are agreements between or among nations. International Organizations and Conferences are composed mainly of nations and usually established by treaty — for example, the 1980 Convention on Contracts for the International Sale of Goods, or CISG.

Legal systems are generally divided into common law and civil law systems. Common law systems are based on case law. These systems exist in countries that were once a part of the British Empire (such as Australia, India, and the United States). Civil law systems are based on codified law (statutes). Courts interpret the code and apply the rules without developing their own laws. Civil law systems exist in most European nations, in Latin American, African, and Asian countries that were colonies of those nations; Japan; South Africa; and Middle-east countries.

Scope of Legal Framework of International Business

Business today is truly international. International trade has existed since times immemorial. There are findings to indicate that international trade existed as long back as 2000 B.C. With increasing complexities and volumes in international trade, an urgent need for a uniform code for regulating these transactions was keenly felt. The importance of international trade and a uniform code is more keenly felt in present day economy where domestic and foreign politics play their influencing role in conducting transnational business.

International Law for business aims at providing the regulations required for execution of international transactions involving more than one nation. Every country has its own set of laws for regulating business.

Therefore, it is apparent that every international business transaction has to comply with provisions of both domestic as well as international law. In order to ensure performance of the transaction(s), parties enter into treaties/agreement.

These treaties are framed according to general practice and customs. The most significant aspect of international law is jurisdiction. Though it is not important for students to go for a detailed study of business law in each country, understanding the structure of the legal system in various countries helps in making a good comparative study.

Laws Applicable to International Business

Domestic Laws

Foreign Laws of Host Country

International Law

Executive Agreements

Treaties

Customary International (Common) Law

“Private Law” law of the K (Contract)

One should keep in mind that the base for law is a dispute. The judgment of a decided case becomes a referral point - known as a

precedent. The reason behind this reference is to facilitate uniformity in deciding similar cases. It may be noted that precedents may be overruled if the judgment pronounced earlier is found to be erroneous.

Overview of Business Laws in Select Nations

To enable students to have a better view of the legal structure, a discussion on the legal system existing in five economically important countries like Canada, Germany, Saudi Arabia, Japan, China, European Community and the USA would be fruitful.

Canada, the second largest country in the world framed its own constitution in 1982 by the Act of the British Parliament. It has a bicameral Parliament - House of Commons and a Senate. Canada follows the principle of legislative supremacy, giving importance to precedents. Cases, statutes, customs and royal prerogative are the sources of Canadian law. The judges for federal and provincial courts are selected by Governor-General of Canada. The legal system of Canada is primarily based on the common law tradition. By and large, the regulatory framework is uniformly applicable throughout Canada with the exception of the province of Quebec. Quebec has been given special rights to preserve its culture, language and governing institutions.

Germany, the largest European country, follows the civil law tradition. Of all the civil codes, the German Civil Code has had the widest influence in the development of laws in other countries like China, Japan and many Eastern and Central European countries. With the unification of the erstwhile two German nations, the political authority is divided between the federal government and the states. Matters of utmost importance like defence, foreign affairs, currency, nationality and intellectual property are exclusively looked into by the federal government. The Chancellor, the most powerful political figure, makes public policy and appoints heads of state. There is marked difference in the manner cases are resolved and the judiciary system that exists in Germany as compared to other countries. Two important codes play a significant role. They are the German Civil Code and the German Commercial Code. The civil code has 2300 sections divided into five parts with the first two covering legal and contractual obligations. The commercial code sets rules for doing business in Germany.

Saudi Arabia, an Islamic country, has a legal system that follows the Sharia –commandments of Prophet Mohammad. Unlike other countries, Saudi Arabian government has only two wings - the executive and judicial, and the King is the supreme authority. The regulations approved by the King are published in the official gazette. There are agencies to assist in regulating the administration of the Kingdom. The most important among them are the Supreme Commission on Labor Disputes, the Commissioner for the Settlement of Commercial Disputes and Board of Grievances. A well regulated country, Saudi Arabia strongly abides by the Holy Quran. As such students will note that unlike common law systems, charging of interest is prohibited among many other things. Dispute resolution normally results in damages or recession. Despite the difference in the regulatory structure, the importance of Saudi Arabia in present day economy is continually growing.

Japan, is perhaps the only example of ‘real development’ in almost all areas. Japan which was battered and ravaged during the World War II is now among the most advanced countries of the world. A look at its legal system shows traces of the Tokugawa period influence of the German Civil Code and the American influence. Right from the early days, Japanese gave much importance to the Confucian system where the head of the family/ village was the deciding authority. His word was rarely contested. The process of industrialization in the nineteenth century saw Japan draw up a Civil Code based on the German Civil Code. This however, underwent a drastic change after the Second World War when the American influence separated the church and state and introduced a parliamentary system with a duly elected Prime Minister and a bicameral legislature. Despite, the American influence Japanese have a different outlook in matters of international trade. All contracts have the regular clauses. Yet, the Japanese treat an international transaction as an opportunity to develop personal ties and business relationships. They look for flexibility, amicable settlement of disputes and performance of contract in good faith.

China has for many hundreds of years been known for the superior quality of goods it produces and its ancient medical practice. Thus, international trade has been an integral part of Chinese economy. Very much like the Japanese Confucian attitude, the Chinese have deep faith in behaving in an honorable and ethical manner. Until recently, the attitude of Chinese towards practitioners of law has been discerning. Primarily be-

cause it has gone through a lawless period during the Cultural Revolution known as 'Dark Ages' in 1966 and the second revolution which started in 1976 with the death of Mao Zedong's. Today, China has a large, complex system of agencies, the most important among them being Ministry-of Foreign Economic Relations and Trade which renders guidance in matters related to foreign trade. The governing statute for foreign trade is Foreign Economic Contract Law (FECL). According to FECL all contracts should be in writing, must express the real intent of the parties who must have legal contractual capacity and the contract should not violate law or public policy. Before resorting to arbitration, Chinese prefer to settle disputes out of court through friendly consultations, which again reflects their reliance on traditional value of honorable and ethical behavior.

European Community - The aftermath of the Second World War set the world leaders to think of a united Europe to achieve economic alliance and compatible political and legal setup. Thus started the European Community. The first step towards this was, building a common market between France and Germany for coal and steel through the European Coal and Steel Community (ECSC). The success of this led to signing of a number of treaties like the EURATOM, European Economic Community (EEC) and the Maastricht Treaty, all directed towards political and economic unity. To simplify the administration of ECSC, EURATOM and EEC, a merger treaty was subsequently signed. The European community has a well organized administrative set-up comprising of council of ministers, parliament, courts of justice and auditors, and advisory committees. These community institutions have developed substantive laws- which prevail over individual country laws and create rights in individuals and businesses which are to be protected by national courts.

United States America- The United States America regulates its exports under the Export Administration Act (EAA) of 1979. The primary objective being to protect its economy in case of short supply, to protect national security and to further its foreign policy objectives. The US has a complex regulatory structure for both imports and exports which includes the anti-boycott regulations. The EAA provides the statutory authority for export controls on sensitive dual-use goods and technologies: items that have both civilian and military applications, including those items that can contribute to the proliferation of nuclear, biological, and chemical weaponry. The EAA, which originally expired in 1989, periodically has

been reauthorized for short periods of time, with the last incremental extension expiring in August 2001. At other times and currently, the export licensing system created under the authority of EAA has been continued by the invocation of the International Emergency Economic Powers Act (IEEPA).

Global Frame of Business Laws

Students interest in International Business and Trade Law need to learn the present legal structure and operation of the world trade system, which is primarily handled through multilateral and regional trade treaties and associated law and the regional systems that are in effect, including the European Union and the North American Free Trade Agreement. Students also need to master U.S. obligations under these international instruments to U.S. trade statutes, especially those relating to dumping, subsidies, and unfair trade practices. In addition, students need to understand the legal framework of private international business transactions, including: the international sale of goods; bills of lading; letters of credit; government regulation of imports and exports; technology transfer and intellectual property protection; and forms and regulation of foreign direct investment.

- i. **Taxation in Global Economy:** To explore current important issues related to taxation in a global economy, tax treaty, double taxation avoidance, General Anti Avoidance Rules, domestic and global tax laws, etc.
- ii. **International commercial arbitration:** International commercial arbitration is the single most important means to resolve cross-border commercial disputes in today's flat world economy. This fundamental legal and jurisdictional underpinnings of the international commercial arbitration system of dispute resolution, the procedural mechanisms for conducting international commercial arbitrations, the domestic judicial tools to compel parties to arbitrate commercial disputes rather than proceed in domestic courts, the comparative law aspects of international commercial arbitration both for the procedural and the substantive matters in dispute and the enforcement of international commercial arbitration awards in domestic courts are important aspects.

- iii. Public International Law:** Laws for fight against global terrorism, laws of war, war crimes and tribunals; the UN Charter; the concept of universal jurisdiction. the rules, procedures, institutions and actors that are involved in the development, enforcement and adjudication of public international law, the role and influence of states, non-governmental organizations and international organizations; the law of treaties; customary international law; jurisdiction and immunities; the interpretation of international law by national courts; the law governing the use of force; international dispute resolution; and the role of the United Nations and of international judicial bodies, human rights, law of the sea, international trade law, international criminal law and international environmental law -- with an emphasis on such current challenges as international terrorism, the global financial crisis and climate change.
- iv. Laws on International Business Transactions:** The legal framework of private international business transactions, including: the international sale of goods; bills of lading; letters of credit; government regulation of imports and exports; technology transfer and intellectual property protection; and forms and regulation of foreign direct investment.
- v. International Trade Law:** The legal structure and operation of the world trade system, multilateral and regional trade treaties and associated law focusing on the World Trade Organization, the General Agreement on Tariffs and Trade, and other agreements concluded in the Uruguay Round of trade negotiations. Since the world system is complemented--and subject to tensions-- by regional systems, study of schemes of regional integration, in particular the European Union, SAPTA and the North American Free Trade Agreement, etc is important. Special attention to comparing national obligations under these international instruments to domestic trade statutes, especially those relating to dumping, subsidies, and unfair trade practices is needed The new trade issues such as trade and the environment, trade and investment, and trade and competition policy are also relevant.
- vi. International Intellectual Property laws:** With a growing global market, the spread of the Internet, and continuing disparity

between developed and developing countries, intellectual property assumes a major role in cross-border litigation, licensing, and diplomatic activity pertaining to copyright, patents, or trademarks. Study of international IP issues that arise in domestic courts, including conflict of laws, jurisdiction, parallel imports, and enforcement of foreign judgments, principal multilateral IP treaties and international dispute settlement is important for global businesses.

- vii. **International financial Law and Environment:** The law and practice of international financial markets, international financial intermediaries and international financial instruments like GDRs, ADRs, FCCBs, ECB, FDI, FII, Prevention of Money Laundering, International Transfer Pricing, etc through which cross-border loan and securities transactions, etc. Attention to issues of sovereignty, efficiency and ethics raised at the intersection of global and emerging financial markets, structures and practices associated with financial melt-down, sovereign debt crisis, etc is also relevant for global businesses for investment and financing purposes within the laws of different nations. Also issues of multilateral investment guarantee, financing of heavily indebted countries, financing for UN's MDGs, etc are relevant. Global capital market laws, laws on financial scams, etc need attention.
- viii. **International and Legal Research:** Aspects of legal research methods, sources of international and foreign law, treaty research, United Nations documents and European Union documents, and methods for finding the law of foreign jurisdictions are to be known by international business institutions.
- ix. **International Environmental Law and Policy:** Examining how society manages or fails to manage the environmental issues that fall beyond the authority or capability of one national government, law and policy on specific international environmental issues like global climate change control, stratospheric ozone depletion control, control of long-range air pollution, protection of biological diversity, management of global fisheries, etc is the core area of knowledge needed. Conceptual knowledge of foundations of international politics and international law

on international environmental issues like interpretation and assessment of scientific knowledge, negotiation, establishment and management of international organizations, implementation of international commitments, and monitoring, reporting, and verification of compliance is relevant for global business either for compliance or mitigation or exploring business opportunities on this arena. Discussion of linkages of environment to other international issues like trade, economic policy, security, and development is additional input. Insights from research and scholarship to help advance practical understanding of what is happening, why, and how things might be done better are to be gathered.

- x. **International Mergers and Acquisitions:** Knowledge of principal legal, commercial and practical issues typically encountered in structuring and executing cross-border merger and acquisition transactions between domestic and non-domestic entities is the thrust. Today cross-border M&A is taking place on a vast scale. The cultural adjustment, the legality of partisan attitude of the government to foreign take-over-party, etc are important.
- xi. **GATT (1946 – 1994):** The General Agreement on Tariffs and Trade popularly known as **GATT** attempted to promote multilateral fair trade and reduce trade barriers. Members of GATT reduced trade barriers by granting ‘Most Favored Nation’ (MFN) status and charging the lowest applicable tariff rates for imports from MFN. GATT provided for promotion of fair trade by prohibiting ‘dumping’ and ‘unfair subsidies, bounties and grants’. Lack of adaptability of GATT, to regulate world trade resulted in nations entering into a direct trade relationship like the North American Free Trade Agreement for example. In other cases some developed nations came forward to help the less-developed countries by permitting duty free imports of certain items under the Generalized System of Preferences.
- xii. **WTO (Since 1.1.1995):** The World Trade Organization (WTO) is an organization that intends to supervise and liberalize international trade. WTO’s current (2013) Director-General Pascal Lamy leads a staff of over 600 people in Geneva, Switzerland. WTO officially commenced on January 1, 1995

under the Marrakech Agreement, replacing the GATT. Until that time international trade was governed by GATT. WTO deals with regulation of trade between participating countries; it provides a framework for negotiating and formalizing trade agreements, and a dispute resolution process aimed at enforcing participants' adherence to WTO agreements, which are signed by representatives of member governments and ratified by their legislative bodies. Most of the issues that the WTO focuses on derive from previous trade negotiations, especially from the Uruguay Round of the GATT, 1986–1994. The organization is attempting to complete negotiations on the Doha Development Round, which was launched in 2001 with an explicit focus on addressing the needs of developing countries. As of March 2013, the future of the Doha Round remains protracted as opinion on protectionism on farm produce and subsidies for farm sector remains polarized.

- xiii. UN Conventions:** United Nations Organization, as an umbrella body of nations of the world, has made these nations to sign treaties and conventions that govern global business, economy, society, culture, human rights over war-time and peace-time etiquettes, etc. The listed conventions and treaties as agreed to by nations commit countries to collaborate and cooperate on relevant global issues dealt by respective agreements.

| | |
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| 1. Charter of the United Nations and Statute of the International Court of Justice | 2. Declaration of Death of Missing Persons |
| 3. Pacific Settlement of International Disputes | 4. Status of Women |
| 5. Privileges and Immunities, Diplomatic and Consular Relations, etc | 6. Freedom of Information |
| 7. Human Rights | 8. Penal Matters |
| 9. Refugees and Stateless Persons | 10. Commodities |
| 11. Narcotic Drugs and Psychotropic Substances | 12. Maintenance Obligations |
| 13. Traffic in Persons | 14. Law of the Sea |
| 15. Obscene Publications | 16. Health |

| | |
|---|------------------------|
| 17. Commercial Arbitration | 18. Law of Treaties |
| 19. International Trade and Development | 20. Outer Space |
| 21. Transport and Communications | 22. Telecommunications |
| 23. Navigation | 24. Disarmament |
| 25. Economic Statistics | 26. Environment |
| 27. Educational and Cultural Matters | 28. Fiscal Matters |

- xiv. Multilateral Institutions:** Multilateral Institutions like the International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD) now broadly called as World Bank (WB), International Financial Corporation (IFC), International Development Association (IDA) & Multilateral Investment guarantee Agency (MIGA) all impact global trade, investment, liquidity, capital market development, economy, industry, etc through their funding, policy and over-riding influence on shaping global business laws directly or indirectly.
- xv. UNCTAD:** The United Nations Conference on Trade and Development (UNCTAD) was established in 1964 as a permanent intergovernmental body. It is the principal organ of the UNO's General Assembly, dealing with trade, investment, and development issues.

The organization's goals are to "maximize the trade, investment and development opportunities of developing countries and assist them in their efforts to enter the world economy on an equitable basis." The creation of the conference was based on concerns of developing countries over the international market, multi-national corporations, and great disparity between developed nations and developing nations.

UNCTAD grew from the view that existing institutions like GATT, WTO, IMF and World Bank were not properly organized to handle the particular problems of developing countries.

The primary objective of the UNCTAD is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology. The Conference ordinarily meets once in four years. The Conference has its permanent secretariat in Geneva. One of the

principal achievements of UNCTAD has been to conceive and implement the Generalized System of Preference (GSP) which has great role global trade.. It was argued in UNCTAD, that in order to promote exports of manufactured goods from developing countries, it would be necessary to offer special tariff concessions to such exports. Accepting this argument, the developed countries formulated the GSP Scheme under which manufacturers' exports and some agricultural goods from the developing countries enter duty-free or at reduced rates in the developed countries. Since imports of such items from other developed countries are subject to the normal rates of duties, imports of the same items from developing countries would enjoy a competitive advantage.

Nature and Complexities of Legal Framework of International Business

Nature and complexities of Legal Framework of International Business are dealt here.

Principles of Law for Business across Borders: There are **three important legal principles** based largely on notions of courtesy and respect while doing business among nations, namely **Principle of Comity, Act of State Doctrine, and Doctrine of Sovereign Immunity.**

The Principle of Comity

One nation will defer and give effect to the laws and judicial decrees of another nation, as long as those laws and decrees are consistent with the law and public policy of the accommodating nation. For example, in an international contract, under the principle of comity, one nation defers and gives effect to the laws and judicial decrees of another country, as long as those laws and decrees are consistent with the law and public policy of the accommodating nation. The application of this principle is based primarily on courtesy and respect.

The Act of State Doctrine

The judicial branch of one country will not examine the validity of public acts committed by a recognized foreign government within its own territory. This doctrine avoids disturbing diplomatic relations.

The act of state doctrine and the doctrine of sovereign immunity tend to immunize foreign nations from the jurisdiction of domestic courts so that, in general, domestic firms or individuals who own property overseas have little domestic legal protection against government actions in the countries in which they operate. The act of state doctrine is a judicially created doctrine that provides the judicial branch of one country will not examine the validity of public acts committed by a recognized foreign government within its own territory. This doctrine is often employed in cases involving expropriation or confiscation.

The Doctrine of Sovereign Immunity

The Foreign Sovereign Immunities legislations of nations govern the circumstances in which an action may be brought in domestic land against a foreign nation, including attempts to attach a foreign nation's property. A foreign state is not immune from the jurisdiction of domestic courts if the state has waived its immunity; the action is based on a commercial activity carried on in domestic land by the foreign state. A "foreign state" includes a political subdivision and an instrumentality of the state. A "commercial activity" is a mercantile activity that has substantial contact with home.

The foreign state has committed a tort locally or violated certain international laws. Under the Foreign Sovereign Immunities legislation, a foreign state may be subject to the jurisdiction of domestic courts when the state has "waived its immunity either explicitly or by implication" or when the action is "based upon a commercial activity carried on in the domestic land by the foreign state."

Nature of Legal Framework of International Business

Legal Framework of International Business is all **pervasive, standardized, dynamic, governed by supra-national bodies and sustenance-oriented.**

- i. **All Pervasive:** International Business laws are all pervasive. These cover almost every aspect of business and also geographically all pervasive. The international legal environment pushes international laws into each state. In fact, laws developed by states concerning

business relations are often limited to operations connected to their borders. In this way, national legislation is often un-adaptable to international trade and presents the further difficulty of sometimes being incompatible with one another. From then on, states are accepting the loss of a part of their sovereignty more and more for the purpose of harmonization and to make the different legal systems compatible, but also to simplify rules governing international business operations. In this way, international commercial law has created a new legal framework, which it is advisable to refer to in certain economic situations such as, for example sales contracts or distribution agreements.

ii. Standardized: Multilateral agreements are leading towards unification and harmonization of international law, paving way for standardization. As a result many international treaties, agreements, institutionalized business-legal system and the like have evolved over the years. There are international treaties in certain areas such as transport or international sales. The International Organization for Standards, the International Chamber of Commerce and the International Bank for Settlement have given many standards to make global business follow standard practices. International law is a source of order and clarity. There are many conventions agreed upon by nations as well, like the listed ones below to make global business platform standardized.

- International Convention dealing with the international transport of goods by Road (CMR)
- International Convention dealing with the international transport of goods by Rail (CIR)
- Warsaw Convention on air transport of goods by Air
- The New York convention on (1958) on the recognition and carrying out of foreign arbitrary sentences
- Rome Convention on (1980) on laws applying to contractual obligations

iii. Dynamic: International business laws keep pace with newer developments in global business as well. The Money Laundering Control Acts are passed by nations making money laundering a crime prohibiting individuals from engaging in financial transactions with proceeds that were generated from certain specific crimes,

known as “specified unlawful activities”. International transfer pricing laws exist which bring related party transactions under scanner for possible tax avoidance. Business laws are dynamically adopted and new ones are passed to facilitate global trade.

- iv. **Governed By Supra-National Bodies:** World Trade Organization (WTO), International Court of Justice, International Chamber of Commerce, International Commercial Arbitration, United Nations Commission on International Trade Law, International Centre for Settlement of Investment Disputes, International Monetary Fund (IMF), World Bank and the United Nations, World Tourism Organization, Interpol, World Health Organization (WHO) and dozens of international agencies now work to regulate world trade, telecommunications, transportation, labor, business, health and the environment, among other issues. National laws are not to override respective international convention.
- v. **Sustenance-oriented:** International Business laws give importance for sustained business development across the globe. The Kyoto Protocol under the aegis of the UN Framework Convention on Climate Change (UNFCCC) is an international treaty that sets binding obligations on industrialized countries to reduce emissions of green-house gases. The Convention on Biological Diversity (CBD), known informally as the Biodiversity Convention, is an international legally binding treaty. The Convention has three main goals: conservation of biological diversity, sustainable use of its components; and fair and equitable sharing of benefits arising from genetic resources. In other words, its objective is to develop national strategies for the conservation and sustainable use of biological diversity. It is often seen as the key document regarding sustainable development. The Convention was opened for signature at the Earth Summit in *Rio De Janeiro*, past (until 1960) capital of *Brazil* on 5 June 1992 and entered into force on 29 December 1993.

Complexities of Legal Framework of International Business

Legal framework of international business is known for its complexities because of geographical, cultural, development, population, poverty-wealth, governmental, political, endowment, technological, societal, ecological and environmental diversities of nations.

- i. **Complexity due to Regional variations in operative aspects of multilateral laws:** Every international treaty/convention/law need to provide for regional variations for one or other reason. The good news is the internet is global, but the bad news is that copyright law is country by country. Copyright royalties eat up big chunk of revenue, and the difficulty that a publishing company has had in its attempts to strike deals in other countries, is enormous. International business law attorneys need to be engaged to tailor strategies that navigate the legal and regulatory complexities of global business.
- ii. **Complexity due to conflicting or unclear rules:** International law can actually exacerbate complexity with conflicting or unclear rules, uncertain enforcement, and overlapping and competing jurisdiction. International law must demonstrate the flexibility to embrace new issues, to look beyond the State, and to integrate new players (who may not follow its rules). Transparency, accountability, and participation must be guaranteed in new private regulatory regimes, shorn from State control. The instruments and processes of international law must provide means for scientific evidence to be sifted, understood, and translated into law. And yet, even as it adapts, international law must also remain a force for stability and predictability.
- iii. **Complexity due to Nationalism is not accepting Globalism:** Just from the titles of these treaties it is worth remarking that it is a long way before a general unification of law for international contracts. It is little by little, domain by domain, that states come to an agreement on uniform rules. It is also important to note that this unification of law in small measures is not truly efficient in a measure where treaties are ratified in a large number of states. But this ratification is often random as it creates new legal rules which states are not always ready to adhere to.
- iv. **Complexity due to Counterfeiters and Imitators:** Apart from protecting their intellectual property rights, business enterprises are faced with a more complex problem of dealing with piracy and counterfeit goods. Pirates and counterfeiters cause great harm as they deprive the owner of the protected work his share of royalty, the authorized dealer his profit and the buyer of quality product.

The US government through an amendment of the Trade Act of 1974, attempts to counteract such practices under Section 301 of the said Act.

Code and Common Laws and their Implications to Business

A **code** is a type of legislation that purports to exhaustively cover a complete system of laws or a particular area of law as it existed at the time the code was enacted, by a process of codification.

The legal code was a common feature of the legal systems of the ancient Middle East. In the Roman Empire, a number of codifications were developed, such as the Twelve Tables of Roman law (first compiled in 450 BC) and the *Corpus Juris Civilis* of Justinian, also known as the Justinian Code (429 - 534 AD). However, these codes did not exhaustively describe the Roman legal system.

In ancient China, the first comprehensive criminal code was the Tang Code, created in 624 AD. This, and subsequent imperial codes, formed the basis for the penal system of both China and other East Asian states under its cultural influence. The last and best preserved imperial code is the Great Qing Legal Code created in 1644 upon the founding of the Qing Dynasty. This code was the exclusive and exhaustive statement of Chinese law between 1644 and 1912. Though it was in form a criminal code, large parts of the code dealt with civil law matters and the settlement of civil disputes.

In Europe, Roman Law, especially the *Corpus Juris Civilis* became the basis of the legal systems of many countries. Roman law was either adopted by legislation or through processing by jurists. The accepted Roman law is usually then codified and forms part of the central Code.

Meanwhile, African civilizations developed their own legal traditions, sometimes codifying them through consistent oral tradition, enumerating regulations in both constitutional and civil matters, and transmitted to this day. The Continental civil law tradition spread around the world along with European cultural and military dominance in recent centuries.

Side by side, codifications also became more common in common law systems. For example, a criminal code is found in a number of common law jurisdictions in the USA, UK and Australia. In the Americas, the influence of Continental legal codes has manifested itself in two ways. In civil law jurisdictions, legal codes in the Continental tradition are common. In common law jurisdictions, however, there has been a strong trend towards codification. The result of such codification, however, is not always a legal code as found in civil law jurisdictions.

Criminal Procedure Code: Criminal procedure code refers to the adjudication process of the criminal law. While criminal procedure differs dramatically by jurisdiction, the process generally begins with a formal criminal charge, right to be heard for the accused and results in the conviction or acquittal, appeals and disposal. Currently, in many countries with a democratic system and the rule of law, criminal procedure puts the burden of proof on the prosecution – that is, it is up to the prosecution to prove that the defendant is guilty beyond any reasonable doubt, as opposed to having the defense prove that s/he is innocent, and any doubt is resolved in favor of the defendant. This provision is known as the presumption of innocence, until one is proved otherwise. However, in practice it operates somewhat differently in different countries. Similarly, all such jurisdictions allow the defendant the right to legal counsel and provide any defendant who cannot afford their own lawyer with a lawyer paid for at the public expense (which is in some countries called a “court-appointed lawyer”).

Civil Procedure Code: Civil procedure code is the body of law that sets out the rules and standards that courts follow when adjudicating civil suits. These rules govern how a lawsuit or case may be commenced, what kind of service of process (if any) is required, the types of pleadings or statements of case, motions or applications, and orders allowed in civil cases, the timing and manner of depositions and discovery or disclosure, the conduct of trials,, the process for judgment, various available remedies, and how the courts and clerks must function.

Difference between Criminal and civil procedure codes: Difference between Criminal and civil procedure does exist. Although some systems, including the English and French, allow private persons to bring a criminal prosecution against another person, prosecutions

are nearly always started by the State machinery, in order to punish the defendant. Civil actions, on the other hand, are started by private individuals, companies or organizations, for their own benefit. In addition, governments (or their subdivisions or agencies) may also be parties to civil actions. The cases are usually in different courts, and juries are not so often used in civil cases.

In jurisdictions based on English common-law systems, the party bringing a criminal charge (that is, in most cases, the state) is called the “prosecution”, but the party bringing most forms of civil action is the “plaintiff” or “claimant”. In both kinds of action the other party is known as the “defendant”. A criminal case against a person called Ms. Sanchez would be described as “The People v. (=”versus”, “against” or “and”) Sanchez,” “The State (or Commonwealth) v. Sanchez” or “[The name of the State] v. Sanchez” in the United States and “R. (Regina, that is, the Queen) v. Sanchez” in England and Wales. But a civil action between Ms. Sanchez and a Mr. Smith would be “Sanchez v. Smith” if it was started by Sanchez, and “Smith v. Sanchez” if it was started by Mr. Smith (though the order of parties’ names can change if the case is appealed). Most countries make a clear distinction between civil and criminal procedure.

For example, a criminal court may force a convicted defendant to pay a fine as punishment for his crime, and the legal costs of both the prosecution and defence. But the victim of the crime generally pursues his claim for compensation in a civil, not a criminal, action. In France and England, however, a victim of a crime may incidentally be awarded compensation by a criminal court judge.

Evidence from a criminal trial is generally admissible as evidence in a civil action about the same matter. For example, the victim of a road accident does not directly benefit if the driver who injured him is found guilty of the crime of careless driving. He still has to prove his case in a civil action, unless the doctrine of collateral estoppels applies, as it does in most American jurisdictions. In fact he may be able to prove his civil case even when the driver is found not guilty in the criminal trial, because the standard to determine guilt is higher than the standard to determine fault. However, if a driver is found by a civil jury not to have been negligent, a prosecutor may be estopped from charging him criminally.

If the plaintiff has shown that the defendant is liable, the main remedy in a civil court is the amount of money or “damages”, which the defendant should pay to the plaintiff. Alternative civil remedies include restitution or transfer of property, or an injunction to restrain or order certain actions.

India’s Direct Tax Code: The Direct Tax Code proposed in the 2011 budget is a combination of major tax relief and removal of most tax-exempted benefits. It is expected to usher in a new tax regime of transparency and greater compliance. When archaic rules have to be replaced with new ones, the changes must be dramatic and path breaking. This was what then Union Finance Minister Hon’ble Pranab Mukherjee (now the Excellency, President of India) spelt when he introduced the draft Direct Tax Code (Tax Code). The Tax Code, now open to public debate, will be introduced as a Bill in Parliament’s winter session. If passed, it will become the new Income Tax Act, replacing the existing four decade old IT Act of 1961. The new IT Act will come into force from April 1, 2011. To eliminate distortions in the tax structure, introduce moderate levels of taxation, expand the tax base, improve tax compliance, simplify the language and lower tax litigations are the aims of the tax code. Initial analysis shows that most of these objectives are achievable by tweaking of some provisions. “The Code is a completely new law and not an amendment of the existing Income Tax Act. This is a commendable change as one has always experienced tinkering of existing laws. But use of the word, code is an exaggeration. Code is something great evolved over years. The DTC is generous in giving relief to tax payers. At the same time it also makes life miserable for those who evade tax through fraudulent means. As the Tax Code prescribes stiff penalties and prosecution for non-compliance with the tax laws, it proposes that every tax offense under the Code will be punishable by both imprisonment and fine. Apart from defaulters, the Tax Code proposes to punish tax consultants who help in tax evasion. It gives sweeping powers and blanket protection to Income Tax officials for initiating court proceedings on matters relating to tax offences.

Common Law: Common law, also known as case law or precedent, is law developed by judges through decisions of courts and similar tribunals, as opposed to statutes adopted through the legislative process or regulations issued by the executive branch.

A “common law system” is a legal system that gives great precedential weight to common law, on the principle that it is unfair to treat similar facts differently on different occasions. The body of precedent is called “common law” and it binds future decisions. In cases where the parties disagree on what the law is, a common law court looks to past precedential decisions of relevant courts.

If a similar dispute has been resolved in the past, the court is bound to follow the reasoning used in the prior decision (this principle is known as *stare decisis*). If, however, the court finds that the current dispute is fundamentally distinct from all previous cases (called a, ‘matter of first impression’), judges have the authority and duty to make law by creating precedent. Thereafter, the new decision becomes precedent, and will bind future courts.

In practice, common law systems are considerably more complicated than the simplified system described above. The decisions of a court are binding only in a particular jurisdiction, and even within a given jurisdiction, some courts have more power than others. For example, in most jurisdictions, decisions by appellate courts are binding on lower courts in the same jurisdiction and on future decisions of the same appellate court, but decisions of lower courts are only non-binding persuasive authority. Interactions between common law, constitutional law, statutory law and regulatory law also give rise to considerable complexity. However, *stare decisis*, the principle that similar cases should be decided according to consistent principled rules so that they will reach similar results, lies at the heart of all common law systems.

One third of the world’s population (approximately 2.3 billion people) lives in common law jurisdictions or in systems mixed with civil law. Particularly common law in UK where it originated is in the Middle Ages, and in countries that trace their legal heritage to England as former colonies of the British Empire, including India, USA and 30 other nations.

Impact of Code and common law on Business laws: The business laws are derived from Statutes, Customs and Practices, Common Law, Legal Codes and also new laws that emerge from time to time.

International Business Contracts: Legal Provisions

When parties from different countries enter into business deals, they are governed by international contract law unless they agree to abide by the laws of one of the countries. International contract law is frequently applied to international sales contracts. International contract law concerns the legal rules relating to cross-border agreements. This type of contract law is broadly based on the idea of good faith and fair dealing in contracts. These principles are the basis of contract law in most jurisdictions. Good faith includes fair negotiations, an obligation to cooperate and good faith when terminating a contract. It also ensures that unfair deals or contracts are not enforced. International sales contracts are governed by the UN Convention on Contracts for the International Sale of Goods from 1980. The convention was developed for promoting global trade and business by developing a global set of rules for contracts. The convention is a compromise between legal systems of common law, civil law and socialist law.

International Private Law and Public Law

One key element of international contract law includes the provision that the parties' nationality does not play any role when applying the law, thereby placing all parties on an equal playing field. Rules of the contracts are interpreted by what a reasonable person would consider fair and appropriate given the circumstances. International contract law is a branch of private international law, which relates to the cross-border dealings of individuals or companies. This differs from public international law, which concerns the interaction between governments and other state agencies.

After having discussed the general legal framework prevailing in the international business scenario, let us now discuss legal aspects of a contract. A contract is fundamental to any business. They are an integral part of business and assume significance in case of transactions for sale of goods between two or more countries. Different contract laws in each country necessitated formulation of a uniform international law - for contracts.

The essentials of a valid contract are that **there should be an offer and acceptance and consideration**. Utmost care is required to be taken while drafting the contract for incorporating the terms and conditions. This is important as a single contract can be incorporated in more than one way in case of any ambiguity.

Agreements and contracts are two different things. It is important to know first what constitutes a contract and what constitutes an agreement. Contract = Agreement + Legal Enforceability. So all contract are agreements, but not vice versa.

Essentials Elements of a Valid Contract:

- i. Proposal or Offer and acceptance
- ii. Consideration – lawful consideration with a lawful object
- iii. Capacity of parties to contract – competent parties
- iv. Free consent
- v. An agreement must not be expressly declared to be void.
- vi. Writing and Registration if so required by law
- vii. Legal relationship
- viii. Certainty
- ix. Possibility of performance
- x. Enforceable by law

i. Offer and Acceptance

The contract involves an offer (or more than one offer) to another party, who accepts the offer. For example, in a contract for the sale of a piano, the seller may offer the piano to the buyer for \$1,000.00. The buyer's acceptance of that offer is a necessary part of creating a binding contract for the sale of the piano. **Please note that a counter-offer is not an acceptance, and will typically be treated as a rejection of the offer.** For example, if the buyer counter-offers to purchase the piano for \$800.00, that typically counts as a rejection of the original offer for sale. If the seller accepts the counter-offer, a contract may be completed. However, if the seller rejects the counter-offer, the buyer will not ordinarily be entitled to enforce the prior \$1,000.00 price if the seller decides either to raise the price or to sell the piano to somebody else.

ii. Mutual Consideration (The mutual exchange of something of value)

In order to be valid, the parties to a contract must exchange something of value. In the case of the sale of a piano, the buyer receives something of value in the form of the piano, and the seller receives money. While the validity of consideration may be subject to attack on the basis that it is illusory (e.g., one party receives only what the other party was already obligated to provide), or that there is a failure of consideration (e.g., the consideration received by one party is essentially worthless), these defenses will not let a party to a contract escape the consequences of bad negotiation. For example, if a seller enters into a contract to sell a piano for \$100, and later gets an offer from somebody else for \$1,000, the seller can't revoke the contract on the basis that the piano was worth a lot more than he bargained to receive.

iii. Legal Capacity

Not all people are completely free to enter into a valid contract. The contracts of the groups of people listed below involve problematic consent and are dealt with separately, as follows: people who have a mental impairment; young people (minors); bankrupts; corporations (people acting on behalf of a company); and prisoners.

iv. Free Consent

Entering into a contract must involve the elements of free will and proper understanding of what each of the parties is doing. In other words, the consent of each of the parties to a contract must be genuine. Only where the essential element of proper consent has been given is there a contract which is binding upon the parties. The ultimate consequences of establishing that no proper consent was given to enter the contract are matters dealt with when considering remedies for breach of contract. Proper consent may be affected by any of the following matters: mistake; false statements; duress; and undue influence, un-conscionability.

v. An Agreement must not be Expressly Declared to be Void

The law will not enforce all contracts. There are some categories of contract to be wary of. Where a contract is illegal, this may affect

its enforceability. Contracts that are illegal by statute will be regulated as to enforceability by the statute; thus the statute will need to be read and interpreted. Contracts absolutely prohibited by statute will be void, whether the parties know of the illegality or not. However, where one party performs an otherwise legal contract in a manner that breaches legislation, the other party, if having no knowledge of the facts giving rise to the illegality, can still enforce the contract or recover damages for breach of it. They may also recover money or other property transferred under the contract.

Contracts made void by statute are treated differently; while they remain valid contracts, the courts will not enforce them. Again, the precise extent of the enforceability of, or the recovery of any money paid under, a void contract will depend on the particular statute. Certain types of contracts are illegal at common law, because they are contrary to the public good. These include contracts: to commit a crime, a tort or a fraud; which are sexually immoral; which prejudice public safety, including good relations with other states or countries; which prejudice the administration of justice; which tend to promote corruption in public life; and to defraud the revenue. Illegally formed contracts are generally void and unenforceable by either party at common law. Therefore, property or money transferred cannot be recovered.

vi. Writing and Registration if so Required by Law

Before entering into a contract, various statements will often be made by one party in order to encourage or induce the other party to enter into the contract. A dispute may later arise as to which of the statements made should be considered a part, or a term, of the contract, and which should be taken as merely pre-contract talk, and therefore not a part or term of the contract. Parties to a contract are bound only by its terms, not by any peripheral statements that may have been made. To avoid these problems it is better to put all these into writing.

The courts can look at evidence of intention by one or other of the parties that the statement should be part of the contract. For example, the longer the interval is between the making of the statement and the reaching of the final agreement and contract, the less likely it is that the statement will be considered to be a term of the contract. The fact that the

maker of the statement had a special knowledge or skill compared with the other party, will make the statement more likely to be a term. Where the agreement was subsequently reduced to writing and the statement was not included, it is less likely to be a term. If an agreement is eventually put into writing, then the statement is more likely to be a term of the contract. The general rule is that a party is bound by all the terms set out in a contractual document if they have signed it. This applies whether or not they have read the terms or understood them. The exceptions to the general rule are mistakes as to the nature of the document and false statements. When documents are registered rights and obligations of parties are further reinforced.

vii. Legal Relationship

Intention to create legal relations is one of the necessary elements of a contract. The courts must be satisfied that the parties had intended their agreement to have legal consequences.

viii. Certainty

Certainty in English contract law set out rules for how judges will interpret, sever or put contracts into effect. If the terms of the contract are uncertain or incomplete, the parties cannot have reached an agreement in the eyes of the law. An agreement to agree does not constitute a contract, and an inability to agree on key issues, which may include such things as price or safety, may cause the entire contract to fail. However, a court will attempt to give effect to commercial contracts where possible, by construing a reasonable construction of the contract.

Courts may also look to external standards, which are either mentioned explicitly in the contract or implied by common practice in a certain field. In addition, the court may also imply a term; if price is excluded, the court may imply a reasonable price, with the exception of land, and second-hand goods, which are unique.

ix. Possibility of Performance

Contracts based on impossibility of performance are not valid. The contracts must be capable of being performed.

x. Enforceable by Law

A contract in order to be valid must be enforceable by law which element distinguishes agreement and contract. It is enforceable by law if it is a contract otherwise it is an agreement. The aggrieved party should be able to obtain relief through law in the event of breach of contract. An agreement can also be inferred from correspondence exchanged between the parties.

International Contracts: Quotations and Pro Forma Invoices

Many export transactions, particularly initial export transactions, begin with the receipt of an inquiry from abroad that is followed by a request for a quotation. The preferred method for export is a pro forma invoice, which a quotation is prepared in invoice format.

Quotation: A quotation describes the product, states a price for it, sets the time of shipment, and specifies the terms of the sale and terms of the payment. Since the foreign buyer may not be familiar with the product, the description of it in an overseas quotation usually must be more detailed than in a domestic quotation. The description should include the following 15 points:

- i. Seller's and buyer's names and addresses.
- ii. Buyer's reference number and date of inquiry.
- iii. Listing of requested products and brief description.
- iv. Price of each item (it is advisable to indicate whether items are new or used and to quote in U.S. dollars to reduce foreign-exchange risk).
- v. Appropriate gross and net shipping weight (in metric units where appropriate).
- vi. Appropriate total cubic volume and dimensions packed for export (in metric units where appropriate).
- vii. Trade discount (if applicable).
- viii. Delivery point.
- ix. Terms of sale.
- x. Terms of payment.

- xi. Insurance and shipping costs.
- xii. Validity period for quotation.
- xiii. Total charges to be paid by customer.
- xiv. Estimated shipping date from U.S. port or airport.
- xv. Currency of sale.

Pro forma invoice: The pro forma invoice is generally submitted as a quotation in the early stages of import and export trade negotiations. The importing buyer submits a request for a pro forma invoice quotation. The document is used to negotiate with the exporting seller, apply for licensing to import the merchandise and arrange financing. The exporter prepares the quotation and clearly identifies it as a pro forma invoice. A finalized pro forma invoice may also be sent with the merchandise to facilitate the importation process.

Pro forma invoices are not used for payment purposes. In addition to the 15 items previously mentioned, a pro forma invoice should include two statements. One that certifies the pro forma invoice is true and correct and another that gives the country of origin of the goods. The invoice should also be clearly marked “pro forma invoice.” Pro forma invoices are models that the buyer uses when applying for an import license, opening a letter of credit or arranging for funds. In fact, it is a good practice to include a pro forma invoice with any international quotation, regardless of whether it has been requested or not. When final commercial invoices are being prepared prior to shipment, it is advisable to check with the U.S. Department of Commerce or another reliable source for any special invoicing requirements that may be required by the importing country. If a specific price is agreed upon or guaranteed by the exporter, the precise period during which the offer remains valid should be specified. Additionally, it is very important that price quotations state explicitly that they are subject to change without notice.

International Sales Agreements

Trading on a global rather than domestic basis means there are extra factors to consider when forming a sales agreement. Most importantly parties must be decisive as to which country’s law will apply in the international sales agreement. Even, if both countries are in the EU

it is essential that the relevant jurisdiction is agreed beforehand. Once jurisdiction and the specific clauses of a contract have been agreed the parties need to be aware of how these will be interpreted. In international sales the seller may want payment before the release of any goods and the buyer may want to delay payment until they are received. This needs to be reconciled for trade to flow. International sales contracts necessarily involve the transportation of goods from one country to another. The issues relating to transportation can be complicated as usually more than one type of transport is involved. With international contracts some general principles may apply automatically. The **United Nations Convention on Contracts for the International Sale of Goods (CISG; the Vienna Convention)** provides sound basis for all the above issues. Unless excluded by the express terms of a contract, the CISG is deemed to be incorporated into (and supplant) any otherwise applicable domestic law(s) with respect to a transaction in goods between parties from different Contracting States. Even under the U.S. Constitution, the CISG became “supreme law of the land” superseding any conflicting state law, including the Uniform Commercial Code.

United Nations Convention on Contracts for the International Sale of Goods (UNCISG; the Vienna Convention)

UNCISG is a treaty providing a uniform international sales law. The CISG was developed by the UN Commission on International Trade (UNCITRAL) and was signed in Vienna in 1980. The CISG is sometimes referred to as the **Vienna Convention** (but is not to be confused with other treaties signed in Vienna). It came into force as a multilateral treaty on 1 January 1988, after being ratified by 11 countries. In 1988, the United Nations Convention on Contracts for the International Sale of Goods (CISG) came into force with 10 nations endorsing it. As of 6th March 2013, it had been ratified by 79 countries (Brazil is the last) that account for a significant proportion of world trade, making it one of the most successful international uniform laws.

The CISG is organized in four parts.

- Part I (Articles I to 13) contains the Convention’s general provisions, including rules on the scope of its applications and rules of interpretation.

- Part II (Articles 14 to 24) governs the formation of contracts.
- Part III (Articles 25 to 88) governs the rights and obligations of buyers and sellers.
- Part IV (Articles 89 to 101) contains provisions for the ratification and the entry into force of convention.

To ensure uniformity in international contracts, certain common terms relating to price, delivery, title, insurance like FOB, CIF, C&F, FAS, etc., have come into use. These are known as **Incoterms**. These are used in contracts involving sale of goods. It is reiterated that the term 'contract' is not restricted only to sale of goods. There are contracts for setting up ventures, mergers and acquisitions and for transfer of intellectual property. In order to ensure performance of contracts and provide for remedy in case of dispute, CISG also provides a resolution mechanism. Generally, the choice of forum and enforcement clauses is included in a contract, so as to define the area of jurisdiction in case of a dispute.

Part I: Sphere of Application and General Provisions (Articles 1–13)

The CISG applies to contracts of the sale of goods between parties whose places of business are in different States, when the States are Contracting States (Article 1(1)(a)). Given the significant number of Contracting States, this is the usual path to the CISG's applicability.

The CISG also applies if the parties are situated in different countries (which need not be Contracting States) and the conflict of law rules lead to the application of the law of a Contracting State. For example, a contract between a Japanese trader and an Indian trader (India is not a signatory to this treaty) may contain a clause that arbitration will be in Sydney under Australian law with the consequence that the CISG would apply. A number of States have declared they will not be bound by this condition.

The CISG is intended to apply to commercial goods and products only. With some limited exceptions, the CISG does not apply to domestic goods, nor does it apply to auctions, ships, aircraft, or intangibles and services. The position of computer software is 'controversial' and will depend upon various conditions and situations.

Importantly, parties to a contract may exclude or vary the application of the CISG. Interpretation of the CISG is to take account of the 'international character' of the Convention, the need for uniform application, and the need for good faith in international trade. Disputes over interpretation of the CISG are to be resolved by applying the 'general principles' of the CISG, or where there are no such principles but the matters are governed by the CISG by applying the rules of private international law. A key point of controversy was whether or not a contract requires a written memorial to be binding. The CISG allows for a sale to be oral or unsigned, but in some countries, contracts are not valid unless written. In many nations, however, oral contracts are accepted, and those States had no objection to signing, so States with a strict written requirement exercised their ability to exclude those articles relating to oral contracts, enabling them to sign as well.

Part II: Formation of the Contract (Articles 14–24)

An offer to contract must be addressed to a person, be sufficiently definite – that is, describe the goods, quantity, and price – and indicate an intention for the offeror to be bound on acceptance. The CISG does not appear to recognize common law but, subject to clear indication by the offeror, treats any proposal not addressed to a specific person as only an invitation to make an offer. Further, where there is no explicit price or procedure to implicitly determine price, then the parties are assumed to have agreed upon a price based upon that 'generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances'.

Generally, an offer may be revoked provided the withdrawal reaches the offeree before or at the same time as the offer, or before the offeree has sent an acceptance. Some offers may not be revoked; for example when the offeree reasonably relied upon the offer as being irrevocable. The CISG requires a positive act to indicate acceptance; silence or inactivity are not an acceptance.

The CISG attempts to resolve the common situation where an offeree's reply to an offer accepts the original offer, but attempts to change the conditions. The CISG says that any change to the original conditions is a rejection of the offer – it is a counter offer – unless the modified

terms do not materially alter the terms of the offer. Changes to price, payment, quality, quantity, delivery, liability of the parties, and arbitration conditions may all materially alter the terms of the offer.

Part III: Sale of Goods (Articles 25–88)

Articles 25–88; sale of goods, obligations of the seller, obligations of the buyer, passing of risk, obligations common to both buyer and seller.

Duty of The Seller: The CISG defines the duty of the seller, ‘stating the obvious’, as the seller must deliver the goods, hand over any documents relating to them, and transfer the property in the goods, as required by the contract. Similarly, the duty of the buyer is to take all steps ‘which could reasonably be expected’ to take delivery of the goods, and to pay for them.

Generally, the goods must be of the quality, quantity, and description required by the contract, be suitably packaged and fit for purpose. The seller is obliged to deliver goods that are not subject to claims from a third party for infringement of industrial or intellectual property rights in the State where the goods are to be sold. The buyer is obliged to promptly examine the goods and, subject to some qualifications, must advise the seller of any lack of conformity within ‘a reasonable time’ and no later than within two years of receipt. The CISG describes when the risk passes from the seller to the buyer but it has been observed that in practice most contracts define the ‘seller’s delivery obligations quite precisely by adopting an established shipment term, such as FOB and CIF.

Remedies of the buyer and seller: Remedies of the buyer and seller depend upon the character of a breach of the contract. If the breach is fundamental, then the other party is substantially deprived of what it expected to receive under the contract. Provided that an objective test shows that the breach could not have been foreseen, then the contract may be avoided and the aggrieved party may claim damages. Where part performance of a contract has occurred, then the performing party may recover any payment made or good supplied; this contrasts with the common law where there is generally no right to recover a good supplied unless title has been retained or damages are inadequate, only a right to claim the value of the good.

If the breach is not fundamental, then the contract is not avoided and remedies may be sought including claiming damages, specific performance, and adjustment of price. Damages that may be awarded conform to the common law. The CISG excuses a party from liability to a claim of damages where a failure to perform is attributable to an impediment beyond the party's, or a third party sub-contractor's, control that could not have been reasonably expected. Such an extraneous event might elsewhere be referred to as *force majeure* (that is superior force), and frustration of the contract. Where a seller has to refund the price paid, then the seller must also pay interest to the buyer from the date of payment. It has been said the interest rate is based on rates current in the seller's State 'since the obligation to pay interest partakes of the seller's obligation to make restitution and not of the buyer's right to claim damages', though this has been debated. In a mirror of the seller's obligations, where a buyer has to return goods the buyer is accountable for any benefits received.

Part IV: Final Provisions (Articles 89–101)

Articles 89–101 (final provisions) include how and when the Convention comes into force, permitted reservations and declarations, and the application of the Convention to international sales where both States concerned have the same or similar law on the subject.

The Part IV Articles, along with the Preamble, are sometime characterized as being addressed 'primarily to States', not to business people attempting to use the Convention for international trade. They may, however, have a significant impact upon the CISG's practical applicability, thus requiring careful scrutiny when determining each particular case.

Evaluation of CISG

CISG is "written in plain business language," which allows judges the opportunity to make the Convention workable in a range of sales situations. It has been said "the drafting style is lucid and the wording simple and uncluttered by complicated subordinating clauses", and the "general sense" can be grasped on the first reading without the need to be a sales expert. However, CISG has been described as "a variety of vague standards and compromises that appear inconsistent with commercial interests".

Uniform application of the CISG is problematic because of the reluctance of courts to use “solutions adopted on the same point by courts in other countries”, resulting in inconsistent decisions. For example, in a case involving the export to Germany by a Swiss company of New Zealand *mussels* with a level of *cadmium* in excess of German standards, the Supreme court of Germany held that it is *not* the duty of the seller to ensure that goods meet German public health regulations. This contrasted with a later decision in which an Italian cheese exporter failed to meet French packaging regulations, and the French court decided it was the duty of the seller to ensure compliance with French regulations.

These two cases were held by one commentator to be an example of contradictory jurisprudence. Another commentator, however, saw the cases as not contradictory, as the German case could be distinguished on a number of points. The French court chose not to consider the German court’s decision, in its published decision. Precedent, foreign or not, is not legally binding in Civil Law.

CISG advocates are also concerned that the natural inclination of judges is to interpret the CISG using the methods familiar to them from their own State rather than attempting to apply the general principles of the Convention or the rules of private international law. This is despite the comment from one highly respected academic that ‘it should be a rare, or non-existent, case where there are no relevant general principles to which a court might have recourse’ under the CISG. This concern was supported by research of the CISG Advisory Council which said, in the context of the interpretation of Articles 38 and 39, there is a tendency for courts to interpret the articles in the light of their own State’s law, and some States have ‘struggled to apply [the articles] appropriately’. In one of a number of criticisms of Canadian court decisions to use local legislation to interpret the CISG, one commentator said the CISG was designed to ‘replace existing domestic laws and case law,’ and attempts to resolve gaps should not be by ‘reference to relevant provisions of [local] sales law’.

Critics of the multiple language versions of the CISG assert it is inevitable the versions will not be totally consistent because of translation errors and the untranslatability of ‘subtle nuances’ of language. This argument, though with some validity, would not seem peculiar to the CISG but common to any and all treaties that exist in multiple languages.

Other criticisms of the Convention are that it is 'incomplete' and there is no mechanism for updating the provisions, and no international panel to resolve interpretation issues. For example, the CISG does not govern the validity of the contract, nor does it consider electronic contracts.

Future Directions for CISG

Greater acceptance of the CISG will come from three directions. Firstly, it is likely that within the global legal profession, as the numbers of new lawyers educated in the CISG increases, the existing Contracting States will embrace the CISG, appropriately interpret the articles, and demonstrate a greater willingness to accept precedents from other Contracting States.

Secondly, business people will increasingly pressure both lawyers and governments to make sales of goods disputes less expensive, and reduce the risk of being forced to use a legal system that may be completely alien to their own. Both of these objectives can be achieved through use of the CISG.

Finally, UNCITRAL will arguably need to develop a mechanism to further develop the Convention and to resolve conflicting interpretation issues. This will make it more attractive to both business people and potential Contracting States.

In the U.S., all 50 states have adopted common legislation referred to as the Uniform Commercial Code (UCC). The UCC is generally similar to the CISG. The UCC differs from the CISG in some respects, such as the following areas that tend to reflect more general aspects of the U.S. legal system:

Terms of Sale – International Commercial Terms (INCOTERMS)

In any sales agreement, it is important that there is a common understanding of the delivery terms since confusion over their meaning can result in a lost sale or a loss on a sale. The terms in international business transactions often sound similar to those used in domestic business, but they frequently have very different meanings. For this reason, the exporter must know the terms before preparing a quotation or

a pro forma invoice. The following are a few of the more frequently used **inco-terms** in international trade:

- **CIF (cost, insurance, freight)** to a named overseas port where the seller quotes a price for the goods (including insurance), all transportation, and miscellaneous charges to the point of debarkation from the vessel. (Used only for ocean shipments.)
- **CFR (cost and freight)** to a named overseas port where the seller quotes a price for the goods that includes the cost of transportation to the named point of debarkation. The buyer covers the cost of insurance. (Used only for ocean shipments.)
- **CPT (carriage paid to)** and **CIP (carriage and insurance paid to)** a named place of destination. These terms are used in place of CFR and CIF, respectively, for all modes of transportation, including intermodal.
- **EXW (ex works)** at a named point of origin (e.g., ex factory, ex mill, ex warehouse) where the price quoted applies only at the point of origin. The seller agrees to place the goods at the buyer's disposal at the specified place within the fixed time period. All other charges are put on the buyer's account.
- **FAS (free alongside ship)** at a named port of export where the seller quotes a price for the goods that includes the charge for delivery of the goods alongside a vessel at the port. The seller handles the cost of wharfage, while the buyer is accountable for the costs of loading, ocean transportation, and insurance.
- **FCA (free carrier)** at a named place. This term replaces the former "FOB named inland port" to designate the seller's responsibility for handing over the goods to a named carrier at the named shipping point. It may also be used for multimodal transport, container stations, or any mode of transport, including air.
- **FOB (free on board)** at a named port of export where the seller quotes the buyer a price that covers all costs up to and including the loading of goods aboard a vessel.
- **Charter Terms:**

- **Free In** is a pricing term that indicates that the charterer of a vessel is responsible for the cost of loading goods onto the vessel.
- **Free Out** is a pricing term that indicates that the quoted prices include the cost of unloading goods from the vessel.
- **Free In and Out** is a pricing term that indicates that the charterer of the vessel is responsible for the cost of loading and unloading goods from the vessel.

It is important to understand and use sales terms correctly. A simple misunderstanding may prevent exporters from meeting contractual obligations or make them responsible for shipping costs they sought to avoid. When quoting a price, the exporter should make it meaningful to the prospective buyer. For example, a price for industrial machinery quoted “EXW Saginaw, Michigan, not export packed” is meaningless to most prospective foreign buyers. These buyers would find it difficult to determine the total cost and might hesitate to place an order. The exporter should quote CIF or CIP whenever possible, as it shows the foreign buyer the cost of getting the product to or near the desired country. If assistance is needed in figuring CIF or CIP prices, an international freight forwarder can help. The exporter should furnish the freight forwarder with a description of the product to be exported and its weight and cubic measurement when packed. The freight forwarder can compute the CIF price usually at no charge. If at all possible, the exporter should quote the price in U.S. dollars. This will eliminate the risk of exchange rate fluctuations and problems with currency conversion.

Format of International Sales Agreement

Business Name _____

Contact Person _____

Address _____ City _____

State/Province _____ Country _____

Postal Code _____

Telephone Number _____

E-mail Address _____

Terms and Conditions

- i. The manufacturer warrants each product sold by the manufacturer to be free from defects in material and workmanship for a period of one year from the date of purchase, normal wear and tear excluded. No other warranty or guarantee is implied or expressed and manufacturer's liability is limited to replacement of defective products during the warranty period.
- ii. The buyer shall not sell or distribute or promote the sale or distribution of the products back into the United States.
- iii. Buyer is solely responsible, at his/her own expense, for securing all import and other necessary permits, licenses and registrations and complying with all regulatory requirements applicable to the sale or use of the products in buyer's state, province, and/or country.
- iv. The relationship contemplated by this agreement is one in which manufacturer is the vendor and the buyer is the vendee. The buyer is not an agent, employee, or legal representative of the manufacturer for any purpose whatsoever, and shall have no power or authority to incur or create any obligations or liability of any kind for or on behalf of the manufacturer. The buyer shall conduct its business as an independent contractor and all persons employed in such business shall be employees of the buyer.
- v. Buyer may not use the name The Story Teller, the motto "See, Touch, Listen and Learn," the little boy kneeling at the easel or the logo as their business name or any form thereof. The buyer recognizes the validity of the manufacturer's intellectual property rights and will take no steps to register them or otherwise interfere with the ownership rights of the manufacturer.
- vi. All orders must be prepaid in US dollars. Money orders, cashier's check, direct wire or credit cards (Visa, MasterCard, and Discover) are acceptable.
- vii. Prices for the products sold to the vendee shall be the manufacturer wholesale price in effect at the time of shipment. The manufacturer may change the wholesale prices in whole or part, with ninety-(90) days notice to the vendee.

- viii. Product is shipped within five days after payment is received. If a longer time is required, manufacturer will notify buyer.
- ix. The manufacturer shall not be liable to the buyer or any of the buyer's customers for any loss, damage, detention or delay resulting from fires, strikes, lockouts, insurrections or riots, civil or military authority, acts of God, lack of timely instructions from or information from the buyer, war, act of government, unusually severe weather, default of any other manufacturer or supplier or subcontractor, freight embargoes, quarantine, transportation contingencies, or any other cause beyond its reasonable control.
- x. Freight carrier handling charges, procurement of documents, duties, customs and taxes of every nature, air or ocean freight charges and insurance are paid by buyer. Shipments are sent freight prepaid unless arrangements are made otherwise.
- xi. Product returns are accepted within 30 days of shipment and are subject to a 10% restocking fee (based on retail dollars). The buyer will be responsible for all return freight handling charges, procurement of documents, duties, customs and taxes of every nature, air or ocean freight and insurance are paid by buyer.
- xii. Pre-authorization must be received before any return shipment.
- xiii. Pre-authorization can be received by, faxing (801) 423-2568, or e mailing (ryan@thestoryteller.com) list of items to be returned and reason for your request.
- xiv. This agreement shall be read and construed and have effect according to the laws of the State of Utah, US. Should any questions or disputes arise as to the true intent and meaning of, or the performance or breach of any provision under this agreement, every such dispute shall be, if not settled amicably by mutual consultation, forthwith settled by arbitration. This arbitration shall be in accordance with the UNICITRAL Rules of Arbitration as at present in force. In the event the parties cannot agree on a mutually acceptable arbitrator within thirty (30) days of the delivery of notice of arbitration as provided under said rules, then the International Chamber of Commerce, Paris, France, shall be the appointing authority only for the purposes of selecting the arbitrator. The number of arbitrators shall be one

(1) and the place of arbitration shall be Salt Lake City, Utah, UT. The language used in the arbitration shall be English. Judgment may be entered upon the award of the arbitrator and will be enforceable in accordance with applicable law against the liable party.

- xv. Any award by the arbitrator or judgment of any court, as the case may be, shall include payment and/or reimbursement of the prevailing party's costs and expenses incurred in connection with any dispute, controversy, claim or breach, including reasonable attorney's fee and costs of enforcing the award of the arbitrator.
- xvi. The authentic text of this agreement shall be English.

This agreement shall become valid and binding when signed and received by The Story Teller, PO Box 921, Salem, UT 84653

Authorized Buyer Signature

Manufacturer Authorized Signature

Date: xxxxxx.

Method of Payment: Naturally, a contract for sale of goods involves purchase of goods for consideration, which is often money, and the mode of payment is an important clause in a contract. With today's dynamic market transactions across countries, Letters of Credit" (LOC) is considered to be one of the safest modes of payment. (LOC is an instrument issued by a bank or other person at the request of an account party that obliges the issuer to pay to a beneficiary a sum of money within a certain period of time upon the beneficiary's presentation of documents specified by the account Payee)

There is another use for LOC in America and Japan. It is the "standby Letters of Credit". In these two countries, banks are not permitted to engage in insurance activities. Standby LOC are more like insurance policies, performance bonds or repayment guarantees. Despite the inbuilt safety-net, frauds do take place in the transactions because the LOC requires payment to be made against presentation of documents and since banks are under no obligation to scrutinize the underlying transaction, the buyer may be defrauded. Two cases - United Bank Ltd. vs. Cambridge Sporting Goods Corporation and Itek Corporation vs. First National Bank of Boston make an interesting reading.

Transport and Insurance: A contract is incomplete unless the parties have decided on the mode of transport to be utilized for transporting the goods and the extent of risk coverage. Sales contracts involving transportation customarily contain trade terms like FOB and CIF. Transportation may be either by air or ship. When shipped, the parties to a contract may adopt the provisions of the Carrier of Goods by Sea Act (COGSA) to adjust their liability. One of the important shipping documents is the 'Ocean Bill of Lading' which is a contract between the carrier and the shipper. It serves as a receipt for the goods and also as a negotiable document of title. Where goods are transported by air, the documentation is called an 'Air Waybill'. An air waybill performs the same functions as a bill of lading, except that it is generally non-negotiable. A bill of lading or an air waybill is among the many documents to be submitted to the banks for obtaining Payment under a LOC. Most contracts also have an insurance clause to minimize risk of loss or damage during transit.

Payment Terms

There are different methods of payment for international purchase. There are problems as well. Let us first deal with payment modes like letter of credits, cash, draft, sight/usance bills, open account, etc.

Instruments of Payment: A brief account of different terms of payment is presented below.

i. Letter of Credit

A document issued by a bank (issuing bank) stating its commitment to pay someone a stated amount of money on behalf of a buyer so long as the seller meets very specific terms and conditions. Letters of credit are more formally called documentary letters of credit.

Before payment, the bank responsible for making payment on behalf of the buyer verifies that all documents are exactly as required by the letter of credit. If a United States exporter is unfamiliar with the credit risk of the foreign bank, or if there is concern about the political or economic risk associated with the country in which the bank is located, it is advised that a letter of credit issued by a foreign bank be "confirmed" by a U.S. bank. This means that the U.S. bank adds its pledge to pay to that of the

foreign bank. Letters of credit that are not confirmed are called “advised” letters of credit. The local Department of Commerce district office or an international banker will help exporters determine whether a confirmed or advised letter of credit is appropriate for a particular transaction.

Types of Letter of Credit

There are several types of LCs serving different needs and conditions. These are briefed below.

Irrevocable (unconfirmed) - A letter of credit that cannot be amended or cancelled without prior mutual consent of all parties to the credit. Such a letter of credit guarantees payment by the bank to the seller/exporter so long as all the terms and conditions of the credit have been met. This is the most popular form of letter of credit.

Revocable (confirmed) - A letter of credit that can be cancelled or altered by the drawee (buyer) after it has been issued by the drawee’s bank. Revocable letter of credits are rarely used because of security concerns.

Transferable- A letter of credit that can be redirected at the sellers request. These are used when an export broker is involved. Once all conditions on the letter of credit are met, the broker’s bank receives the payment, takes out his commission, and completes the transaction as negotiated.

Sight - A letter of credit that requires payment to be made upon presentation of documents.

Time Draft- A letter of credit that states payment is due within a certain time (usually 30, 60, 90, or 180 days).

Changes made to a letter of credit are called amendments. The fees charged by the banks involved in amending the letter of credit may be paid either by the buyer or the seller, but the letter of credit should specify which party is responsible. Since changes are costly and time-consuming, every effort should be made to get the letter of credit right the first time.

An exporter is usually not paid until the advising or confirming bank receives the funds from the issuing bank. To expedite the receipt

of funds, wire transfers may be used. Bank practices vary, however, and the exporter may be able to receive funds by discounting the letter of credit at the bank, which involves paying a fee to the bank for this service. Exporters should consult with their international bankers about bank policy on these issues.

| Type of LC | Time of Payment | When Goods Available to Importer | Risk to Exporter | Risk to Importer |
|--------------------|---|----------------------------------|---|---|
| Irrevocable | At sight of presentation of documents to issuing bank; or specified number of days after acceptance by issuing bank | After Payment | Risk lies with United States confirming bank | None |
| Revocable | Same as Confirmed | After payment | Risk lies with foreign issuing bank and economic conditions of issuing bank | None |
| Sight | When shipment is made | After payment | Risk lies with local confirming bank | Assured shipment is made, but relies on exporter to ship goods described in documents |
| Time Draft | At maturity of draft, may or may not be discounted | Usually before payment | Risk lies with local confirming bank | |
| Red Clause | A percentage of total amount before shipment. Balance is same as type of L/C | After payment | See irrevocable and revocable | The % of payment in advance is at total risk. Balance same as type of L/C |

| | | | | |
|-----------------------------------|------------------------------|------------------------|--|------|
| Revolving Letter of Credit | Variable | Variable | See irrevocable and revocable | None |
| Standby Letter of Credit | At time shipment is received | Usually before payment | Delay in payment. Also see irrevocable | None |
| Back-to-back | Same as irrevocable | After payment | None | None |
| Transferable | Same as irrevocable | After payment | Same as irrevocable | None |
| Assignment of Proceeds | Same as irrevocable | After payment | Same as irrevocable | None |

Payment and Risks with Different Types Letter of Credits

ii) Cash in Advance (CIA)

Usually used only for small purchases and when the goods are built to order.

iii) Draft (or bill of exchange)

An unconditional order in writing from one person (the drawer) to another (the drawee), directing the drawee to pay a specified amount to a named drawer at a fixed or determinable future date. May be date, sight, or time draft.

iv) Credit cards

Used mainly in transactions where the dollar value of the items sold is low and shipment is to be made directly to the end user.

v) Open Account

The exporter bills the customer, who is expected to pay under agreed terms at a future date. Some of the largest firms abroad make purchases only on an open account, which is a convenient method of payment if the buyer is well established and has demonstrated a long and favorable payment record.

vi) Counter Trade/Barter

Sale of goods or services that are paid for in whole or in part by the transfer of goods or services from a foreign country.

vii) Consignment Sales

Exporter delivers goods to an agent under agreement that the agent sell the merchandise for the account of the exporter. The agent sells the goods for commission and remits the net proceeds to the exporter.

Payment Problems

The best solution to a payment problem is to negotiate directly with the customer. If negotiations fail and the sum involved is large enough to warrant the effort, obtain the assistance of your bank, legal counsel, and other qualified experts. If both parties can agree to take their dispute to an arbitration agency, this step is faster and less costly than legal action. The International Chamber of Commerce handles the majority of international arbitrations and is usually acceptable to foreign companies because it is not affiliated with any single country.

For more information on these issues, contact the U.S. Council for International Business, American National Committee of the ICC, 212-354-4480; American Arbitration Association, 212-484-4000; Trade Remedy Assistance Office International Trade Commission, 202-205-2200.

| Details | Letter of Credit | Cash on Documents | Open Account |
|--|-------------------------|--------------------------|---------------------|
| Customer Relationship | New | Established | Established |
| Type of Order | Custom | Production | Production |
| Political Situation | Unstable | Stable | Strong |
| Economic Situation | Unstable | Stable | Strong |
| Competition | No | Yes | Yes |
| Volatility of Price Changing Downwards for Buyer | Yes | No | No |
| Cash Flow Timing and Needs | Yes | Adjustable | Adjustable |

Risk Factors Influencing Payment Terms

Payment Terms

A list of things to consider when determining the best price for your product overseas follows now.

Terms of Sale

Terms in international business transactions often sound similar to those used in domestic business, but they frequently have very different meanings. For this reason, the exporter must know the terms before preparing a quotation or a pro forma invoice.

Preparing Quotes for International Buyers

While a sales contract that spells out the details of a transaction is warranted for larger, more complex deals, a quotation in the form of a Proforma Invoice may be sufficient for smaller transactions. Learn how to prepare Pro forma invoices and the information they should contain and more about how to prepare quotes.

Proper pricing, complete and accurate quotations, choosing the terms of the sale, and selecting the payment method are four critical elements in selling a product or service overseas. Of the four, pricing can be the most problematic, even for an experienced exporter.

Pricing Considerations

The price considerations listed below will help an exporter determine the best price for the product overseas.

- At what price should the firm sell its product in the foreign market?
- What type of market positioning (customer perception) does the company want to convey from its pricing structure?
- Does the export price reflect the product's quality?
- Is the price competitive?
- Should the firm pursue market penetration or market-skimming pricing objectives abroad?

- What type of discount (trade, cash, quantity) and allowances (advertising, trade-off) should the firm offer its foreign customers?
- Should prices differ by market segment?
- What should the firm do about product line pricing?
- What pricing options are available if the firm's costs increase or decrease? Is the demand in the foreign market elastic or inelastic?
- Are the prices going to be viewed by the foreign government as reasonable or exploitative?
- Do the foreign country's antidumping laws pose a problem?

As in the domestic market, the price at which a product or service is sold directly determines a firm's revenues. It is essential that a firm's market research include an evaluation of all of the variables that may affect the price range for the product or service. If a firm's price is too high, the product or service will not sell. If the price is too low, export activities may not be sufficiently profitable or may actually create a net loss.

The traditional components of determining proper pricing are costs, market demand, and competition. Each of these must be compared with the firm's objective in entering the foreign market. An analysis of each component from an export perspective may result in export prices that are different from domestic prices.

It is also very important that the exporter take into account additional costs that are typically borne by the importer. They include tariffs, customs fees, currency fluctuation transaction costs and value-added taxes (VATs). These additional costs can add substantially to the final price paid by the importer, sometimes resulting in a total of more than double the U.S. domestic price.

Foreign Market Objectives

An important aspect of a company's pricing analysis is determining market objectives. For example, is the company attempting to penetrate a new market, looking for long-term market growth, or looking for an outlet for surplus production or outmoded products? Many firms view the foreign market as a secondary market and consequently have lower

expectations regarding market share and sales volume. This naturally affects pricing decisions.

Marketing and pricing objectives may be general or tailored to particular foreign markets. For example, marketing objectives for sales to a developing nation where per capita income may be one tenth of that in the United States are necessarily different from the objectives for Europe or Japan.

Costs

The computation of the actual cost of producing a product and bringing it to market is the core element in determining if exporting is financially viable. Many new exporters calculate their export price by the cost-plus method. In the cost-plus method of calculation, the exporter starts with the domestic manufacturing cost and adds administration, research and development, overhead, freight forwarding, distributor margins, customs charges, and profit.

The effect of this pricing approach may be that the export price escalates into an uncompetitive range. It clearly shows that if an export product has the same ex-factory price as the domestic product; its final consumer price is considerably higher once exporting costs are included. Marginal cost pricing is a more competitive method of pricing a product for market entry. This method considers the direct, out-of-pocket expenses of producing and selling products for export as a floor beneath which prices cannot be set without incurring a loss. For example, additional costs may occur due to product modification for the export market that accommodates different sizes, electrical systems, or labels. On the other hand, costs may decrease if the export products are stripped-down versions or made without increasing the fixed costs of domestic production.

Other costs should be assessed for domestic and export products according to how much benefit each product receives from such expenditures. Additional costs often associated with export sales include:

- Market research and credit checks;
- Business travel;
- International postage, cable, and telephone rates;

- Translation costs;
- Commissions, training charges, and other costs involving foreign representatives;
- Consultants and freight forwarders; and
- Product modification and special packaging.

After the actual cost of the export product has been calculated, the exporter should formulate an approximate consumer price for the foreign market.

| Sample Cost-Plus Calculation of Product Cost | | |
|---|----------------------|--------------------|
| | Domestic Sale | Export Sale |
| Factory price | \$7.50 | \$7.50 |
| Domestic freight | .70 | .70 |
| Subtotal | 8.20 | 8.20 |
| Export documentation | | .50 |
| Subtotal | | 8.70 |
| Ocean freight and insurance | | 1.20 |
| Subtotal | | 9.90 |
| Import duty (12 percent of landed cost) | | 1.19 |
| Subtotal | | 11.09 |
| Wholesaler markup (15 percent) | 1.23 | |
| Subtotal | 9.43 | |
| Importer/distributor markup | | 2.44 |
| Subtotal | | 13.53 |
| Retail markup (50 percent) | 4.72 | 6.77 |
| Final consumer price | \$14.15 | \$20.30 |

Market Demand

For most consumer goods, per capita income is a good gauge of a market's ability to pay. Some products may create such a strong demand such as popular goods like Levis, that even low per capita income will not affect their selling price. Simplifying the product to reduce its selling price may be an answer for the exporter to most lower per capita income markets. The firm must also keep in mind that currency fluctuations may alter the

affordability of its goods. Thus, pricing should try to accommodate wild changes in the U.S. and/or foreign currency. The firm should anticipate the type of potential customers. If the firm's primary customers in a developing country are expatriates or belong to the upper class, a high price might be feasible even if average per capita income is low.

Competition

In the domestic market, few companies are free to set prices without carefully evaluating their competitors' pricing policies. This situation is true in exporting, and is further complicated by the need to evaluate the competition's prices in each potential export market.

If there are many competitors within the foreign market, the exporter may have little choice but to match the market price or even under price the product or service in order to establish a market share. On the other hand, if the product or service is new to a particular foreign market, it may actually be possible to set a higher price than in the domestic market.

Pricing Summary: In summary, here are the key points to remember when determining your product's price:

- Determine the objective in the foreign market.
- Compute the actual cost of the export product.
- Compute the final consumer price.
- Evaluate market demand and competition.
- Consider modifying the product to reduce the export price.
- Include "nonmarket" costs, such as tariffs and customs fees.
- Exclude cost elements that provide no benefit to the export function, such as domestic advertising.

Agent or Distributors

Agency and Distributor arrangements are both examples of different methods of overseas market entry. For both Agency and Distributor Agreements, the basic parties involved are usually:

Rights and Duties of Principals, Agents and Distributors

The Principal (is Exporter), the Overseas Intermediary (Agent or Distributor) **and** the Overseas Buyers/end-user **are involved together with their banks in most cases**. However, the relationships between these parties will differ depending on whether the Intermediary is an Agent or Distributor. The term 'Agent' is often used as a 'generic' term to describe either an agent or a distributor. The term 'agent' is often, confusingly used, to describe what a 'distributor' arrangement is in fact. However, the two arrangements are fundamentally different in their operation, both offering different advantages and disadvantages to the parties concerned.

What are the differences between an Agent and a Distributor?

An Agent is a person employed by a Principal to make contracts on the principal's behalf with Third Parties. The Agent puts the Principal into contractual relations with the overseas buyer(s). There is no contract of sale between the Agent and the Buyer. The agent does not take the commercial risk. It is the Principal who takes the commercial risk.

A Distributor buys goods for their own account to resell into their overseas market. The contract of sale is between the Principal and the Distributor. There is no contractual relationship between the Principal and the Distributor's customers.

Advantages and Disadvantages between an Agent and a Distributor

1. Contracts of Sale

AGENCY: In an Agency arrangement, the Principal will be dealing with '**multiple accounts**' and therefore must undertake separate '**operations**' for each contract of sale, for example:

For **each account** the Principal must:

Take the commercial risk (credit insurance)

Separate invoicing, accounting and administration

Separate distribution and shipping arrangements

Handling smaller order quantities

The **disadvantage** here is that all these operations will incur additional costs, (distribution, invoicing, accounting, administration, debt collection) resulting in increased prices or reduced profits).

Distributor: In a Distributor arrangement, the Principal only deals with **one account** i.e. that of the Distributor. The Distributor takes the commercial risk of multiple accounts. The **advantage** here compared to Agency, is that:

Commercial risk is only with one account
Larger order quantities and bulk distribution
(Reduced costs)

2. Market Penetration

AGENCY: Because the Principal is contracting directly with the customers in the market, the Principal has a presence and reputation in the market.

The **Advantage** of this is:

1. **Future product launches** into the market are easier if the 'company' is known.
2. **Market trends, customer knowledge and end-user requirements** can be monitored and responded to if there is a direct relationship.
3. **Distributor:** The Principal has no control over which customers the Distributor sells to.
4. The **company name** of the Principal may not be marketed and Promoted in the overseas market.
5. **Market trends** can not easily be directly monitored and reacted to by the Principal.

3. Terms and Conditions

Agents

Terms and Conditions of **Agency Agreements** are governed by EU law (Commercial Agents Regulations 1993. These Regulations

cover primarily the Rights and Duties of Principal and Agent and are automatically incorporated into any Agency contract.

Duties of Agent

To perform duties in person (and not delegate)

Carry out work with ordinary skill and diligence

Not accept a bribe or secret profits

Must be no conflict of interest between Agent and Principal

To obtain the **best price** from customers that is **reasonably obtainable**.

Duties of Principal

Payment of Commission

Indemnify the Agent for any expenses incurred.

Rights of Agent:

Termination: There are mandatory **Notice Periods**:

- 1 Month during 1st year
- 2 Months during 2nd year
- 3 Months during 3rd and subsequent years

Compensation: On termination the Principal must pay: Compensation (calculated on the loss suffered as a result of the loss of the Agency. Indemnity (capped at 1 year commission)

The terms and conditions of a **DISTRIBUTOR** Agreement are essentially Contractual. The terms and conditions of the Agreement are essentially based on the formal agreement between the Principal and Agent. However, there are restrictions imposed by both UK and EU law:

Price Fixing Agreements: Price fixing is almost always inexcusable. **Minimum selling prices** are regarded as '**price fixing**'. However, Maximum 'Recommended' Selling Prices are not in breach are not in breach of EU law but they are unenforceable because they do not affect competition.

Advantages: Agency – more price control (must obtain reasonable price) the distributor could kill the market by overpricing the product

Disadvantages: Agency – more regulations imposed: Commission payment termination

4. Order Quantities

Agency: The volume of orders which the agent obtains is dependent on his/her ability to sell to contacts in the market.

Distributor: The contract between the Principal and Distributor often stipulates a minimum order quantity which the Distributor must take within a specified time period. The Principal is guaranteed a volume of sales provided the Distributor complies with the contract but is otherwise in breach of contract and can be sued for damages.

Disadvantages to Both Agents and Distributors

- a) Both Agents and Distributors usually require some kind of **Exclusivity** before they commit to representing their Principal. This means that the Agent or Distributor is given exclusive rights over a particular territory for a particular product. The Principal agrees that no other Agent or Distributor will be appointed to sell those products in that territory.

The **Disadvantage** here is that the Principal is **limiting** his/her market entry potential. Penetration into the market is dependent upon the ability and the results of the Agent/Distributor. It could be that there are other opportunities in the market which the Agent /Distributor are not accessing.

- b) Competing Products

It is not unheard of for a Representative to request exclusivity with a view to keeping the Principal out of the market, because they are successfully selling competitors products.

Advantages to Both Agents and Distributors

- a) Both Agents and Distributors offer the Principal a **Presence** in the overseas market. This gives the advantage to the Principal of:

Local presence abroad Language and cultural knowledge
Quicker service delivery (trouble shooting and servicing)

- b) Complementary Products

Both Agents and Distributors often have more than one Principal. It is important for the Principal to know who else the Agents/Distributor is representing, particularly if exclusivity is granted. An Agent or Distributor who represents a few Principals, who offer complementary products, can offer:

A comprehensive product range which enables products to be sold on the back of others. The agent will have an established database of customers and contacts to whom the Principal's products can be sold.

Issues Involved in International Business Law as to Transnational Sales

Choice-of-Law

Problem exists as to jurisdiction of courts. But there are international treaties to sort out this issue. Yet, non-adherence to the same may cause temporary problem.

Regional courts sitting in diversity apply State/Regional rules.

Most courts enforce choice-of-law clause, unless it violates a significant public policy.

Transfer Pricing

Pricing practice which entities under common control, charge each other for goods and services is called as transfer pricing. This may be tuned to secure tax arbitrage to the disadvantage of tax realization by State authorities, but to the benefit of business-group. Now there are legal solutions to address the issue.

Tax Treaties

Increase coordination of tax authorities, fight tax evasion

Try to eliminate overlapping taxation (integrate systems)

One country may forgo taxing a type of income or transaction and allow the other country to tax it.

International Litigation

All international contracts should have Choice-of-forum clause and Choice-of-law clause.

Arbitration

An International contract should contain some of the following clauses:

Agreement to submit some or all questions to arbitration

Place of arbitration

Must be signatory state

Should have history of enforcing arbitration awards

Issues must be arbitral in the place

Method of appointing arbitrators

Language in which arbitration takes place

Choice of law

Public International Law

International Court of Justice applies

- International Conventions (treaties)
- International Custom (general practice accepted as law)
- General Principles of Law Civilized Nations Recognize
- Judicial Decisions/School Writing (precedent not binding)
- Customary International Law
- International Custom (2 elements):
- General Practice (material number of states)
- Acceptance as Law (bound to apply, not just preferred)

World Trade Organization (WTO)

Dispute Settlement Body (DSB): if conciliation and mediation fail, DSB may assemble panel to hear case

Decision stands unless WTO vetoes it within 60 days

Appellate Body: hears appeals of law/legal interpretation

Agreement on Trade-Related Investment Measures (TRIMS):

Forbids rules on investment in a country that:

Prevent the enterprise from importing goods

Require it to buy local goods

Require it to export a certain amount of goods

General Agreement on Trade in Services (GATS)

Agreement on Trade-Related Aspects of I.P. Rights (TRIPS)

International Monetary Fund (IMF)

Objectives

Facilitate foreign exchange among members (almost all U.N. members are IMF members)

Floating rate is used for exchange

Keep countries from de-valuing their currency to gain economic advantage (leads to race to the bottom)

Restrict national exchange controls

Exchange Controls: government restricts its citizens from exchanging its currency for foreign currency (central bank rations foreign currency)

Exception: country may maintain and adapt existing controls to remedy balance-of-payment problems

Special Drawing Rights (SDR): IMF members may draw currency from other members in order to temporarily equalize balance-of-payments

If member violates rules on exchange controls, its SDRs may be eliminated.

Agency & Distributorship Agreements

Agents

- More control exerted by manufacturer, especially on price
- Agent never takes title to goods
- Manufacturer retains risk of non-payment
- Agent makes \$ as commission on sales
- Agent often has authority to bind principal in K
- Fewer antitrust problems for exclusivity
- Many countries have protective legislation for agents
- May created a PE for tax purposes

Distributors

- Manufacturer has less control, especially on price
- Distributor takes title to the goods (and risk of loss)
- Distributor has risk of non-payment
- Distributor makes \$ on profit (upside + downside risk)
- Distributor may not bind the principal in contract
- Exclusivity may raise antitrust problems
- Usually no protective legislation for distributors
- Probably will not create a PE
- Issues in Agency/Distributor Agreements:
 - “Exclusive” (may manufacturer enter the market itself?)
 - Survival of Confidentiality/Non-Compete Clause
 - Termination of Agreement

U.S. Law: Generally does not protect agents/distributors.

- “Good Faith” may be required in terminating agreement.
- Notice of Termination (mandatory rule):
- Term contract converts to Indefinite Period contract if continued
- Indefinite Period contract (tacks prior term if continued):
- 1 month for 1st year

2 months if 2nd year commenced
3 months if 3rd or subsequent year commenced
May require 4months/4yr, 5months/5yr, 6months/6yr notice
Principal's notice period may not be less than agent's
Damages or Indemnity (mandatory rule):
Up to 1 year's (5-yr average) compensation

Exceptions

Agent terminates (unless due to illness, age, death)
Breach of K (agent does not meet sales quota)
Term expires (decision not to renew ≠ damages)
Non-Compete: limited to 2 years after termination.
Choice-of-Forum or Law: cannot avoid Directive *Ingmar* or
“mandatory terms” Rome Convention by choice-of-law or -forum
clause
Mandatory terms may be “non-arbitral” for NY Convention
3 Types of Restraints:
Territorial Exclusivity: exclusive right to sell in territory
Territorial Restrictions: may not sell outside territory
Non-Compete: may not sell competing goods

Self Assessment Questions

1. Explain the necessity of International Business law and trace its history.
2. Examine the nature and complexities of International Business law.
3. What are the sources of International Business law?
4. Examine the implications of Civil, Criminal and Tax Codes and common laws to global business laws.
5. What is the Letter of Credit? Explain and its different types.
6. What are the payment risks involved in international contracts? How are these protected against through L/Cs.?
7. What are payment terms? How do INCO terms help?

8. Explain the contents of an International Sales Agreement.
9. What are the rights and duties of agents and distributors under international business?
10. What is the difference between agents and distributors under IBL?
11. Write short notes on: GATT, ii. MNEs/MNCs and iii. Revocable LOC
12. What is the relevance of multilateral institutions including the UNO in International Business legal paradigm?
13. Describe business laws affecting global trade in different countries.
14. Examine the basic legal requirements of global commercial contracts.
15. What are international public and private laws?

CASE STUDY

In Mid-February 1994, the British Paper, the Sunday Times ran an article that alleged that a 1 billion sterling sale of defence equipment by British companies to Malaysia was secured only after bribes had been paid to Malaysian Government officials and after the British overseas development administration had agreed to approve a 234 million sterling grant to the Malaysian Government for a hydroelectric dam of dubious economic value.

What happened next took everyone by surprise. The Malaysian Government promptly announced a ban on the import of all British goods and services into Malaysia and demanded an apology from the British Government.

Officially the ban applied only to Government orders. The private sector was free to buy as it chose. However, British companies with experience in the region were nervous that the private sector would follow the Government's lead in shunning British products. At stake was as much as 4 billion sterling in British exports and construction activities in Malaysia and a presence in one of the world's fastest growing developing economies. In announcing the ban, Malaysian Prime Minister noted that the British Media Portrays Malaysians as corrupt because "they are not

British and not White”... and “we believe the foreign media must learn the fact that developing countries including a country led by a brown mortem, have the ability to manage their own affairs successfully”.

The British Government responded by stating, it could not tell the British press what and that not to publish. To which the Malaysian Prime Minister replied there would be “no contracts for British press freedom to lies”. At the sometime, the British Government came under attack from members of parliament in Britian, who suspected the Government acted unethically and approved the ODA hydroelectric grant to help British companies win orders in Malaysia.

- a) What does this case teach us about the relationship between politics and international trade?
- b) How do you think the British Government should respond to the Malaysian action?
- c) You are the CEO of a British Company that now faces the loss of a lucrative contact because of this dispute. What action should you take?

UNIT- II

GATT/WTO and Global Liberalization

Learning Objectives

- To Understand the Regulatory Framework of WTO
- To understand the basic principles and Charter of GATT/WTO;
- To get acquainted with GATT/WTO provisions on preferential treatment of developing countries
- To familiarize with the Regional groupings
- To understand antidumping duties and other non-tariff barriers
- To understand about the provisions of custom valuation
- To familiarize with dispute settlement
- To understand the implications of WTO to important sectors – GATS, TRIPs and TRIMs.

Introduction

There are many multilateral organizations in the forefront steering economic liberalization in almost all regions of the world. In this unit, the role of World Trade Organization (WTO) along with that of its predecessor namely, General Agreement on Tariffs and Trade (GATT) is explored in respect of international business legal paradigm.

Regulatory Framework of WTO

The regulatory framework of international business is by and large covered earlier by the GATT and since 1995 to this day by WTO. The developments are presented below.

i. General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT), the predecessor to WTO, was established in 1946 as results of the international desire to liberalize trade. The establishment of an International Trade Organization (ITO) had also been recommended by the Bretton Woods Conference of 1944 which had recommended the IMF and World Bank. Although the IMF and World Bank were established in 1946, because of objective that its enforcement provisions would interfere with the autonomy of domestic policy making, the ITO charter was never ratified. Instead the GATT, which had been drawn up only as an interim agreement to fill the gap until the ITO charter was ratified, became the framework for international trading system in 1946. The international trading system since 1946 was, at least in principle, guided by the rules and procedures agreed to by the signatories to the GATT which as an agreement signed by the contracting nations which were admitted on the basis of their willingness to accept the GATT disciplines.

Geneva Round - 1946: In the first Round of trade talks among the members of GATT, called **Geneva Round** held in 1946, 45000 tariff concessions were signed worth \$ 10 billion.

Annecy Round – 1949: The second round took place in 1949 in Annecy, France. 13 countries took part in the round. The main focus of the talks was more tariff reductions, around 5000 in total.

Torquay Round – 1951: The third round took place in Torquay, England in 1950. Thirty-eight countries took part in the round. 8,700 tariff concessions were made totaling the remaining amount of tariffs to $\frac{3}{4}$ of the tariffs which were in effect in 1948. The contemporaneous rejection by the U.S. of the Havana Charter signified the establishment of the GATT as a governing world body.

Geneva Round - 1955-56: The fourth round returned to Geneva in 1955 and lasted until May 1956. Twenty-six countries took part in the round. \$2.5 billion in tariffs were eliminated or reduced.

Dillon Round - 1960-1962: The fifth round occurred once more in Geneva and lasted from 1960-62. The talks were named after U.S. Treasury

Secretary and former Under Secretary of State, Douglas Dillon, who first proposed the talks. Twenty-six countries took part in the round. Along with reducing over \$4.9 billion in tariffs, it also yielded discussion relating to the creation of the European Economic Community (EEC).

Kennedy Round - 1962-1967: Kennedy Round took place from 1962-1967. \$40 billion in tariffs were eliminated or reduced.

Tokyo Round - 1973-1979: Reduced tariffs and established new regulations aimed at controlling the proliferation of non-tariff barriers and voluntary export restrictions. 102 countries took part in the round. Concessions were made on \$190 billion worth.

The Uruguay Round began in 1986: Uruguay Round was the most ambitious trade conference among nations to date, hoping to expand the competence of the GATT to important new areas such as services, capital, intellectual property, textiles, and agriculture. 123 countries took part in the round. The Uruguay Round was also the first set of multilateral trade negotiations in which developing countries had played an active role. Agriculture was essentially exempted from previous agreements as it was given special status in the areas of import quotas and export subsidies, with only mild caveats. However, by the time of the Uruguay round, many countries considered the exception of agriculture to be sufficiently glaring that they refused to sign a new deal without some movement on agricultural products. These countries came to be known as the “Cairns Group”, The Cairns Group is a unique coalition of 19 agricultural exporting countries with a commitment to reforming agricultural trade. A diverse coalition bringing together developed and developing countries from Latin America, Africa and the Asia-Pacific region, the Cairns Group has been an influential voice in the agricultural reform debate since its formation in 1986 and has continued to play a key role in pressing the WTO membership to meet in full the far-reaching mandate. The countries are: Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Pakistan, Paraguay, Peru, Philippines, South Africa, Thailand and Uruguay.

The **Agreement on Agriculture (AoA)** of the Uruguay Round continues to be the most substantial trade liberalization agreement in agricultural products in the history of trade negotiations. The goals of

the agreement were to improve market access for agricultural products, reduce domestic support of agriculture in the form of price-distorting subsidies and quotas, eliminate over time export subsidies on agricultural products and to harmonize to the extent possible sanitary and phytosanitary measures between member countries.

In 1993, the GATT was updated (*GATT 1994*) to include new obligations upon its signatories. One of the most significant changes was the creation of the WTO. The 75 existing GATT members and the European Community became the founding members of the WTO on 1 January 1995

ii. World Trade Organization (WTO)

The GATT was transformed into a World Trade Organization (WTO) with effect from 1st January, 1995. Thus after about five decades, the original proposal of an International Trade Organization took shape as the WTO. The WTO which is a more powerful body than the GATT has an enlarged role than the GATT. India is one of the founder members of the IMF, World Bank, GATT and the WTO. The World Trade Organization (WTO) the successor to the General Agreement on Tariffs and Trade GATT, coming into being on 1 January 1995, is the only international organization dealing with the rules of trade between nations. And its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their Parliaments/ Legislatures as well. The goal is to help producers of goods and services, exporters and importers conduct their business.

The global business environment is very significantly influenced by the WTO principles and agreements. They also affect the domestic environment. For example, India has had to substantially liberalize imports, including almost complete removal of quantitative imports restrictions. Liberalization of imports implies that domestic firms have to face an increasing competition from foreign goods. Liberalization of foreign investment can result in growing competition from MNCs reducing the operational space for domestic firms. These liberalizations on the other hand, also provide new opportunities for Indian firms as the foreign markets become more open for exports and investments. The liberalization also enables Indian firms to seek foreign equity participation

and foreign technology. This could help them to expand their business or improve competitiveness. Further, Liberalization facilitates global sourcing by Indian firms to improve their competitiveness. Also, Indian suppliers can benefit from global sourcing by foreign firms. Firms will have to be efficient and dynamic to survive the global competition. Inefficient firms may go out of business.

Basic Principles and Charter of GATT/WTO

The primary objective of GATT was to expand international trade by liberalizing trade so as to bring about all round economic prosperity. The Preamble to the GATT mentioned the following as its important objectives.

- Raising standard of living
- Ensuring full employment and a large and steadily growing volume of real income and effective demand.
- Developing full use of the resources of the world.
- Expand of production and international trade.

GATT embodied certain conventions and general principles governing international trade among countries that adhere to the agreement. The rules or conventions of GATT required that (i) Any proposed change in the tariff, or other type of commercial policy of a member country should not be undertaken without consultation of other parties to the agreement and (ii) The countries that adhere to GATT should work towards the reduction of tariffs and other barriers to international trade, which should be negotiated within the GATT framework.

Principles and Charter of GATT

For the realization of its objective, **GATT adopted the following principles:**

- i. **Non – discrimination:** The principle of non discrimination requires that no member country shall discriminate between the members of GATT in the conduct of international trade. To ensure non- discrimination the members of GATT agree to apply the principle of most favoured nation (MFN) to all import and export

duties. This means that “each nation shall be treated as the most favoured nation.” As far as quantitative restrictions are permitted, they too, are to be administered without favor. However, certain exceptions to this principle are allowed. For instance, GATT does not prohibit economic integration such as free trade areas or customs union, provided the purpose of such integration is “to facilitate trade between the constituent territories and not to raise barriers to the trade of other parties,” The GATT also permits the members to adopt measures to counter dumping and export subsidies. However the application of such measures shall be limited to the offending countries.

- ii. **Prohibition of quantitative restrictions.** GATT rules seek to prohibit quantitative restrictions as far as possible and limit restrictions on trade to the less rigid tariffs. However, certain exceptions to this prohibition are granted to countries confronted with balance of payments difficulties and to developing countries. Further, import restrictions were allowed to apply to agricultural and fishery products if domestic production of these articles was subject to equally restrictive production or marketing controls.
- iii. **Consultation.** By providing a forum for continuing consultation, it sought to resolve disagreements through consultation. So far eight Rounds took several years. The Uruguay round, the latest one, took more than seven years to conclude, as against the originally contemplated more than four years. This shows the complexity of the issues involved in the trade negotiations.

An Evaluation of GATT

The growing acceptance of GATT/WTO, despite their shortcomings, is evinced by the increase in the number of the signatories. When the GATT was signed in 1946, only 23 nations were party to it. It increased to 99 by the time of the Seventh Round and 117 countries participated in the next, i.e. the Uruguay Round.

Consultative Forum: One of the principal achievements of GATT was the establishment of a forum for continuing consultations. “Disputes that might otherwise have caused continuing hard feeling, reprisals, and even diplomatic rupture have been brought to the conference table and

compromised". GATT could achieve considerable trade liberalization. There were, of course several exceptions.

Protection for Agriculture: Agricultural trade was clearly an exception to the liberalization. Far from becoming freer, trade in agriculture became progressively more distorted by the support given to farmers (Which took the form of severe barriers to imports and subsidies to exports) in the industrial nations.

Exemption for Textiles: Similarly, another exception was textiles. Trade in textiles was restricted by the Multifibre Arrangement (MFA). Under the MFA imports of textile items to a number of developed countries were restricted by quotas.

Protective Trade Regime if BoP Problems existed: Besides agriculture and textiles, two exceptions to the general trend of trade liberalization have been trade of developing countries and economic integration. Developing countries with balance of payments problems have been generally exempted from the liberalization. Even the Uruguay Round has granted such exemptions to developing countries.

Commendable Trade Liberalization: Although the picture of trade liberalization has to be qualified with such exceptions, the GATT achieved very commendable trade liberalization. The average level of tariffs on manufactured products in industrial countries was brought down from about 40 percent in 1947 to nearly three per cent after the Uruguay Round. Indeed the period of 1950 – 1973 was conspicuous by the splendid results of progressive trade liberalization. In 275 years since 1720, this period witnessed the highest average annual growth rates in output and international trade. These rates were substantially higher than for any other period. Indeed, the 1950s and 1960s are described as the golden decades of capitalism. The output levels of companies' using newer and newer technologies in many cases were much larger than the domestic markets could absorb. Expansions of markets to other countries enable even companies in other industries to increase their output. There was also a surge in international investments.

Trade Setback since 1974: The progressive liberalization of trade, however, suffered a setback since 1974, although the elimination of Tariff

Barriers continued, even the developed countries have substantially increased Non Tariff Barriers since then. The collapse of the Bretton Woods systems in the early 1970s and the oil crisis made matters very difficult for many countries, both developing and developed, and as a result of these demands for protection increased dramatically. The exports of developing countries have been hit very hard by the NTBs, as pointed out earlier in this chapter.

Developing Countries Gained Significantly Less: Further, the exports of developing countries gained significantly less from the GATT Rounds than did exports of the industrial nations. The trade liberalization has been confined mostly to goods of interest to the developed liberalization, but also there was an increase in protection. Manufactured products of interest to developing countries like textiles and clothing, footwear etc. have been subject to increasing non tariff barriers. While the developed countries enjoy a more liberalized trading environment, the growing NTBs have been severely affecting the exports of developing countries. Ironically, the developed countries are increasing the protectionism when the developing countries are liberalising. This is indeed a sad commentary on the GATT and other multilateral organizations.

Long-winding Uruguay Round: Uruguay Round (UR) is the name by which the eighth and the latest Round of the multilateral trade negotiations (MTNs) held under the auspices of the GATT is popularly known because it was launched in Punta del Este in Uruguay, a developing country, in September 1986. Because of the complexities of the issues involved and the conflict of interests among the participating countries, the Uruguay Round could not be concluded in December 1990 as was originally scheduled. When the negotiations dragged on, Arthur Dunkel, the then Director General of GATT, presented a Draft Act embodying what he thought was the result of the Uruguay Round. This came to be popularly known as the Dunkel Draft.

This was replaced by an enlarged and modified final text which was approved by the delegations from the member countries of the GATT on 15th December 1993. This Final Act was signed by ministers of 125 governments on 15th April 1994. The results of the Uruguay Round are to be implemented within ten years since 1995. Different time periods are given for effecting the different agreements.

Serious Apprehensions of Developing Countries: The first six Rounds of MTNs concentrated almost exclusively on reducing tariffs; while the Seventh Round (Tokyo Round – 1973 – 1979) moved on to tackle non tariff barriers (NTBs). The UR sought to broaden the scope of MTNs far wider by including new areas such as:

- Trade in services
- Trade related aspects of intellectual property (TRIPs)
- Trade related investment measures (TRIMs)

Because of the inclusion of these new aspects in the GATT negotiations, the developing countries had serious apprehensions, about outcome of the Uruguay Round.

The Uruguay Round took up three basic subjects for discussion:

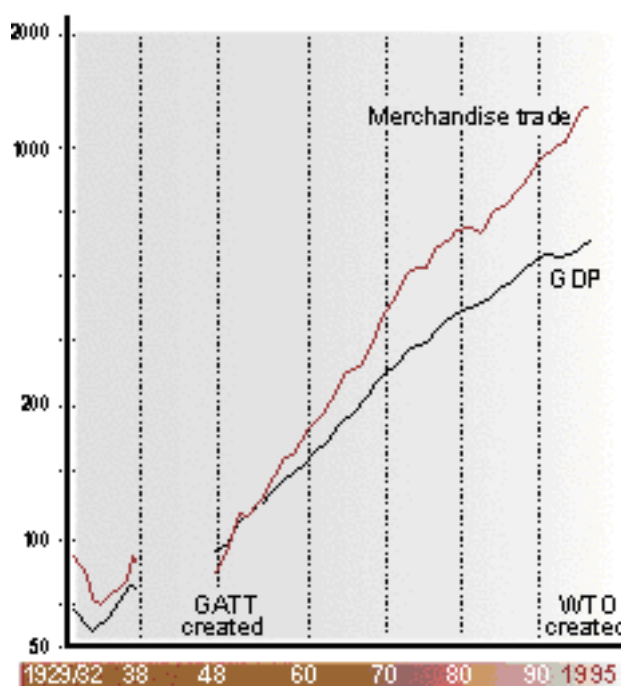
- i. Reducing specific trade barriers and improving market access.
- ii. Strengthening GATT disciplines.
- iii. Problems of liberalization of trade in services, trade related aspects of intellectual property rights (TRIPs) and trade related investment measures (TRIMs)

Elaborate Uruguay Round Bite More Than Chewable: The most outstanding feature of the UR was the inclusion of the subjects in the 3rd item referred to above in the MTNs of GATT. The traditional concerns of the GATT were limited to international trade in goods. The UR went much beyond goods to services, technology, investment and information.

GATT Trade Rounds

| Year | Place/name | Subjects covered | Nations |
|-----------|------------------------|------------------|---------|
| 1947 | Geneva | Tariffs | 23 |
| 1949 | Annecy | Tariffs | 13 |
| 1951 | Torquay | Tariffs | 38 |
| 1956 | Geneva | Tariffs | 26 |
| 1960-1961 | Geneva Dillon Round | Tariffs | 26 |

| | | | |
|-----------|----------------------|---|-----|
| 1964-1967 | Geneva Kennedy Round | Tariffs and anti-dumping measures | 62 |
| 1973-1979 | Geneva Tokyo Round | Tariffs, non-tariff measures, “framework” agreements | 102 |
| 1986-1994 | Geneva Uruguay Round | Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc | 123 |



Both Global GDP and Global trade grew well under the GATT regime, as depicted in the above graph.

Objectives, Functions, Structure, Basic Principles and Charter of WTO

Following the UR Agreement, GATT was converted from a provisional agreement into a formal international organization called World Trade Organization (WTO) with effect from 1 January, 1995. WTO now serves as a single institutional framework encompassing GATT and all the results of the Uruguay Round. It is directed by a Ministerial conference that will meet at least once every two years and its regular business is overseen by a General council. The WTO Secretariat is based in Geneva, Switzerland.

The membership of the WTO increased from 128 in July, 1995 to 144 countries as of 1st January, 2002 and about two dozen more nations were negotiating for the membership. Tajikistan is the newest full member, joining on 2 March 2013, taking the membership of WTO to 159. It is interesting to note that the People Republic of China, which was one of the original signatories of the GATT quit it in the late 1940s following the assumption of power by the communist party, but got admitted to the WTO, after a prolonged negotiations, with effect from 1 January, 2002. The WTO members now have the potential in bringing about an orderly development of the international trade.

WTO Objectives: The WTO has three main objectives:

- To help trade flow as freely as possible.
- To achieve further liberalization gradually through negotiation.
- To set up an impartial means of settling disputes.

A number of simple, fundamental principles run throughout all the WTO agreements. They are the foundation of the multilateral trading system.

WTO Functions: The WTO's overriding objective is to help trade flow smoothly, freely, fairly and predictably. It strives to achieve this through:

- i. Administering the WTO trade agreements
- ii. Providing the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreement.
- iii. Administering the mechanism for settling trade disputes between the member countries.
- iv. Monitoring national trade policies.
- v. Providing technical assistance and training for developing countries
- vi. Co operating with other international organizations like the IMF, IBRD and its affiliated agencies with a view to achieving greater coherence in global economic policy making.

WTO Organizational Structure: Decisions in the WTO are made by the entire membership-this is typically by consensus. A majority vote is also possible but it has never been used in the WTO, and was extremely rare under the WTO's predecessor, GATT. The WTO's agreements have been ratified in all members' parliaments. The WTO's top level decision making body is the Ministerial conference which meets at least once every two years. Below this is the General Council (normally ambassadors and heads of delegation in Geneva, but sometimes officials sent from members' capitals) which meets several times a year in the Geneva headquarters.

The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body. At the next level, the Goods Council, Services Council and Intellectual Property (TRIPS) Council report to the General Council. Numerous specialized committees, working groups and working parties deal with the individual agreements and other areas such as the environment, development, membership applications and regional trade agreements. All WTO members may participate in all councils, committees, etc., except Appellate Body, Dispute Settlement panels, Textiles Monitoring Body, and plurilateral committees.

Basic Principles of WTO

The WTO establishes a framework for trade policies; it does not define or specify outcomes. That is, it is concerned with setting the rules of the trade policy game, not with the results of the game. Five principles are of particular importance in understanding both the pre-1994 GATT and the WTO: **nondiscrimination, reciprocity, enforceable commitments, transparency, safety valves and encouragement to economic development.**

i. *Nondiscrimination to Promote Freer Trade Between Nation*

Nondiscrimination has two major components: the **most-favored-nation (MFN) rule**, and the **national treatment principle**. Both are embedded in the main WTO rules on goods, services, and intellectual property, but their precise scope and nature differ across these three areas. This is especially true of the national treatment principle, which is a specific, not a general commitment when it comes to services.

- a. **MFN rule** The **MFN rule** requires that a product made in one member country be treated no less favorably than a “like” (very similar) good that originates in any other country. Thus, if the best treatment granted a trading partner supplying a specific product is a 5 percent tariff, this rate must be applied immediately and unconditionally to imports of this good originating in all WTO members. In view of the small number of contracting parties to the GATT (only 23 countries), the benchmark for MFN is the best treatment offered to any country, including countries that are not members of the GATT.
- b. **National treatment** requires that foreign goods, once they have satisfied whatever border measures are applied, be treated no less favorably, in terms of internal (indirect) taxation than like or directly competitive domestically produced goods (Art. III, GATT). That is, goods of foreign origin circulating in the country must be subject to taxes, charges, and regulations that are “no less favorable” than those that apply to similar goods of domestic origin. The MFN rule applies unconditionally. Although exceptions are made for the formation of free trade areas or customs unions and for preferential treatment of developing countries, MFN is a basic pillar of the WTO. One reason for this is economic: if policy does not discriminate between foreign suppliers, importers and consumers will have an incentive to use the lowest-cost foreign supplier. MFN also provides smaller countries with a guarantee that larger countries will not exploit their market power by raising tariffs against them in periods when times are bad and domestic industries are clamoring for protection or, alternatively, give specific countries preferential treatment for foreign policy reasons. MFN helps enforce multilateral rules by raising the costs to a country of defecting from the trade regime to which it committed itself in an earlier multilateral trade negotiation.

If the country desires to raise trade barriers, it must apply the changed regime to all WTO members. This increases the political cost of backsliding on trade policy because importers will object. Finally, MFN reduces negotiating costs: once a negotiation has been concluded with a country, the results extend to all. Other countries do not need to negotiate to obtain similar treatment; instead, negotiations can be limited

to principal suppliers. National treatment ensures that liberalization commitments are not offset through the imposition of domestic taxes and similar measures. The requirement that foreign products be treated no less favorably than competing domestically produced products gives foreign suppliers greater certainty regarding the regulatory environment in which they must operate.

The national treatment principle has often been invoked in dispute settlement cases brought to the GATT. It is a very wide-ranging rule: the obligation applies whether or not a specific tariff commitment was made, and it covers taxes and other policies, which must be applied in a nondiscriminatory fashion to like domestic and foreign products. It is also irrelevant whether a policy hurts an exporter. What matters is the existence of discrimination, not its effects.

The rules on non-discrimination — MFN and national treatment — are designed to **secure fair conditions of trade**. So too are those on dumping (exporting at below cost to gain market share) and subsidies. The issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.

Many of the other WTO agreements aim to support fair competition: in agriculture, intellectual property, services, for example. The agreement on government procurement (a “plurilateral” agreement because it is signed by only a few WTO members) extends competition rules to purchases by thousands of government entities in many countries. And so on.

ii. *Reciprocity for Freer Trade Through Negotiation*

Lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively. From time to time other issues such as red tape and exchange rate policies have also been discussed.

Since GATT’s creation in 1947-48 there have been eight trade negotiations. A ninth round, under the Doha Development Agenda, is

now underway. At first these focused on lowering tariffs (customs duties) on imported goods. As a result of the negotiations, by the mid-1990s industrial countries' tariff rates on industrial goods had fallen steadily to less than 4%.

But by the 1980s, the negotiations had expanded to cover non-tariff barriers on goods, and to the new areas such as services and intellectual property. Opening markets can be beneficial, but it also requires adjustment. The WTO agreements allow countries to introduce changes gradually, through "progressive liberalization". Developing countries are usually given longer to fulfill their obligations.

Reciprocity is a fundamental element of the negotiating process. It reflects both a desire to limit the scope for free-riding that may arise because of the MFN rule and a desire to obtain "payment" for trade liberalization in the form of better access to foreign markets. The rationale for reciprocity is all there in political-economic literature.

The costs of liberalization generally are concentrated in specific industries, which often will be well organized and opposed to reductions in protection. Benefits, although in the aggregate usually greater than costs, accrue to a much larger set of agents, who thus do not have a great individual incentive to organize themselves politically. In such a setting, being able to point to reciprocal, sector-specific export gains may help to sell the liberalization politically. Obtaining a reduction in foreign import barriers as a *quid pro quo* for a reduction in domestic trade restrictions gives specific export-oriented domestic interests that will gain from liberalization an incentive to support it in domestic political markets. A related point is that for a nation to negotiate, it is necessary that the gain from doing so be greater than the gain available from unilateral liberalization. Reciprocal concessions ensure that such gains will materialize.

iii. *Predictability through Binding and Enforceable Commitments*

Liberalization commitments and agreements to abide by certain rules of the game have little value if they cannot be enforced. The nondiscrimination principle, embodied in Articles I (on MFN) and III (on national treatment) of the GATT, is important in ensuring that market access commitments are implemented and maintained. Other

GATT articles play a supporting role, including Article II (on schedules of concessions). The tariff commitments made by WTO members in a multilateral trade negotiation and on accession are enumerated in schedules (lists) of concessions. These schedules establish “ceiling bindings”: the member concerned cannot raise tariffs above bound levels without negotiating compensation with the principal suppliers of the products concerned. The MFN rule then ensures that such compensation—usually, reductions in other tariffs—extends to all WTO members, raising the cost of going back on or not keeping up one’s earlier commitment.

Once tariff commitments are bound, it is important that there be no resort to other, nontariff, measures that have the effect of nullifying or impairing the value of the tariff concession. A number of GATT articles attempt to ensure that this does not occur. They include Article VII (customs valuation), Article XI, which prohibits quantitative restrictions on imports and exports, and the Agreement on Subsidies and Countervailing Measures, which outlaws export subsidies for manufactures and allows for the countervailing of production subsidies on imports that materially injure domestic competitors.

If a country perceives that actions taken by another government have the effect of nullifying or impairing negotiated market access commitments or the disciplines of the WTO, it may bring this situation to the attention of the government involved and ask that the policy be changed. If satisfaction is not obtained, the complaining country may invoke WTO dispute settlement procedures, which involve the establishment of panels of impartial experts charged with determining whether a contested measure violates the WTO.

Because the WTO is an intergovernmental agreement, private parties do not have legal standing before the WTO’s dispute settlement body; only governments have the right to bring cases. The existence of dispute settlement procedures precludes the use of unilateral retaliation. For small countries, in particular, recourse to a multilateral body is vital, as unilateral actions would be ineffective and thus would not be credible. More generally, small countries have a great stake in a rule-based international system, which reduces the likelihood of being confronted with bilateral pressure from large trading powers to change policies that are not to their liking.

iv. *Transparency*

Enforcement of commitments requires access to information on the trade regimes that are maintained by members. The agreements administered by the WTO therefore incorporate mechanisms designed to facilitate communication between WTO members on issues. Numerous specialized committees, working parties, working groups, and councils meet regularly in Geneva. These interactions allow for the exchange of information and views and permit potential conflicts to be defused efficiently. Transparency is a basic pillar of the WTO, and it is a legal obligation, embedded in Article X of the GATT and Article III of the GATS.

WTO members are required to publish their trade regulations, to establish and maintain institutions allowing for the review of administrative decisions affecting trade, to respond to requests for information by other members, and to notify changes in trade policies to the WTO. These internal transparency requirements are supplemented by multilateral surveillance of trade policies by WTO members, facilitated by periodic country-specific reports (trade policy reviews) that are prepared by the secretariat and discussed by the WTO General Council.

The **external surveillance** also fosters transparency, both for citizens of the countries concerned and for trading partners. It reduces the scope for countries to circumvent their obligations, thereby reducing uncertainty regarding the prevailing policy stance. Transparency has a number of important benefits. It reduces the pressure on the dispute settlement system, as measures can be discussed in the appropriate WTO body. Frequently, such discussions can address perceptions by a member that a specific policy violates the WTO; many potential disputes are defused in informal meetings in Geneva. Transparency is also vital for ensuring “ownership” of the WTO as an institution—if citizens do not know what the organization does, its legitimacy will be eroded. The trade policy reviews are a unique source of information that can be used by civil society to assess the implications of the overall trade policies that are pursued by their governments. From an economic perspective, transparency can also help reduce uncertainty related to trade policy. Such uncertainty is associated with lower investment and growth rates and with a shift in resources toward non-tradables. Mechanisms to

improve transparency can help lower perceptions of risk by reducing uncertainty. WTO membership itself, with the associated commitments on trade policies that are subject to binding dispute settlement, can also have this effect.

Transparency at both the multilateral (WTO) level and the national level is essential to ensure ownership of commitments, reduce uncertainty, and enforce agreements. Efforts to increase the transparency of members' trade policies take up a good portion of WTO resources. The WTO requires that all trade laws and regulations be published. Article X of the GATT, Article III of the GATS, and Article 63 of the TRIPS agreement all require that relevant laws, regulations, judicial decisions, and administrative rulings be made public. More than 200 notification requirements are embodied in the various WTO agreements and mandated by ministerial and council decisions.

The WTO also has important surveillance activities, since it has a mandate to periodically review the trade policy and foreign trade regimes of members. The WTO's Trade Policy Review Mechanism (TPRM), established during the Uruguay Round, builds on a 1979 Understanding on Notification, Consultation, Dispute Settlement, and Surveillance under which contracting parties agreed to conduct a regular and systematic review of developments in the trading system. The objective of the TPRM is to examine the impact of members' trade policies and practices on the trading system and to contribute to improved adherence to WTO rules through greater transparency. The legal compatibility of any particular measure with WTO disciplines is not examined, this being left for members to ascertain.

The TPRM is an important element of the WTO because it fosters transparency and enhances communication, thereby strengthening the multilateral trading system. Country-specific reviews are conducted on a rotational basis, and the frequency of review is a function of a member's share in world trade. The four largest players—the European Union, the United States, Japan, and Canada—are subject to review by the WTO General Council every two years. In principle, the next 16 largest traders are subject to reviews every four years, and the remaining members are reviewed every six years. A longer periodicity may be established for least-developed countries.

The trade policy review (TPR) for a country is based on a report prepared by the government concerned and on a report by the WTO Trade Policies Review Division. TPRs are supplemented by an annual report by the Director-General of the WTO that provides an overview of developments in the international trading environment. By subjecting the trade policies of the largest industrial country markets to regular public peer review, the TPRM shifts the balance of power in the WTO ever so slightly in favor of the developing countries. Equally important, the TPRM provides domestic interest groups with the information necessary to determine the costs and benefits of national trade policies. The reports are not analytical in the sense of determining the economic effects of various national policies—the size of the implied transfers and the beneficiaries and losers under the prevailing policies. This task is left to national stakeholders, namely the think tanks and policy institutes.

v. *Safety Valves*

A final principle embodied in the WTO is that, in specific circumstances, governments should be able to restrict trade. There are three types of provisions in this connection: (a) articles allowing for the use of trade measures to attain noneconomic objectives; (b) articles aimed at ensuring “fair competition”; and (c) provisions permitting intervention in trade for economic reasons. Category (a) includes provisions allowing for policies to protect public health or national security and to protect industries that are seriously injured by competition from imports. The underlying idea in the latter case is that governments should have the right to step in when competition becomes so vigorous as to injure domestic competitors.

Although it is not explicitly mentioned in the relevant WTO agreement, the underlying rationale for intervention is that such competition causes political and social problems associated with the need for the industry to adjust to changed circumstances. Measures in category (b) include the right to impose countervailing duties on imports that have been subsidized and antidumping duties on imports that have been dumped (sold at a price below that charged in the home market). Finally, under category (c) there are provisions allowing actions to be taken in case of serious balance of payments difficulties or if a government desires to support an infant industry.

vi. *Encouraging Development and Economic Reform*

The WTO's prime goal is to contribute to global and equitable economic development. Developing countries need flexibility in the time they take to implement the system's agreements and developed countries need to keep their pace of development without any slackening. Over three quarters of WTO members are developing countries and countries in transition to market economies. During the seven and a half years of the Uruguay Round, over 60 of these countries implemented trade liberalization programs autonomously. At the same time, developing countries and transition economies were much more active and influential in the Uruguay Round negotiations than in any previous round, and they are even more so in the current Doha Development Agenda.

At the end of the Uruguay Round, developing countries were prepared to take on most of the obligations that are required of developed countries. But, the agreements did give them transition periods to adjust to the more unfamiliar and, perhaps, difficult WTO provisions — particularly so for the poorest, “least-developed” countries. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them.

More recently, developed countries have started to allow duty-free and quota-free imports for almost all products from least-developed countries. On all of this, the WTO and its members are still going through a learning process. The current Doha Development Agenda includes developing countries' concerns about the difficulties they face in implementing the Uruguay Round agreements.

GATT and WTO – Comparison and Contrast

The old GATT system allowed, under what was known as the ‘grandfather clause’, existing domestic legislation to continue even if it violated a GATT agreement that a member country had accepted by being a signatory to GATT. The WTO, specially rules this out. This situation, after the coming into effect of WTO, may be described as the GATT is dead, long live the GATT.

Under the old system, there were two GATTs:

- **GATT the Agreement** – i.e., the agreement between contracting parties (governments) setting out the rules for conducting international trade
- **GATT the Organization** – an international organization created to facilitate discussions and administration related to the Agreement (ad-hoc, through, continued to exist until the establishment of the WTO).

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| GATT was Adhoc and provisional | WTO and its agreement are permanent |
| GATT had contracting parties | WTO has members |
| GATT system allowed existing domestic Legislation to continue even if it violated a GATT agreement | WTO does not permit this |
| GATT was less powerful, slow and less efficient than WTO. | WTO is more powerful, its dispute settlement mechanism is faster and more efficient than that of the GATT. |
| GATT ruling could be easily blocked | It is very difficult to block the rulings of WTO |

Comparison and Contrast between GATT and WTO

GATT the Organization ceased to exist with the establishment of WTO, but GATT- the Agreement, which always dealt with (and still does) trade in goods, continues to exist, in amended form, as part of the WTO alongside two new agreement, viz., General Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) and Trade Related Investment Measures (TRIMs). The old text is now called “GATT 1947” and the updated version is called ‘GATT 1994’.

In Short, the WTO is GATT plus a lot more. GATT (the institution) was small and provisional, and not even recognized in law as international Organization. GATT (the agreement) has been amended and incorporated into the new WTO Agreement. GATT deals only with trade in goods. The WTO Agreements now cover services and intellectual property as

well. The WTO is a more powerful body with enlarged functions than the GATT and is envisaged to play a major role in the world economic affairs. To become a member of the WTO, a country must completely accept the results of the Uruguay Round.

WTO Agreements – A Bird’s Eye View

The WTO endeavors to ensure that trade is as fair as possible and as free as practicable by negotiating rules and abiding by them. The WTO’s rules – the agreements are the result of negotiations between the members. The current sets were the outcome of the 1986 -1994 Uruguay Round negotiations which included a major revision of the original General Agreement on Tariffs and Trade (GATT).

GATT is now the WTO’s principle rule-book for trade in goods. The Uruguay Rounds also created new rules for dealing with trade in services, relevant aspect of intellectual property, dispute settlement and trade policy reviews. The complete set runs to some 30,000 pages consisting of about 30 agreements and separate commitments (called schedules) made by individual members in specific areas such as lower customs duty rates and services market opening.

Through these agreements, WTO members operate a non-discriminatory trading system that spells to their rights and their obligations. Each country receives guarantees that its exports will be treated fairly and consistently in markets of other countries. Each promises to do the same for imports into its own market. The System also gives developing countries some flexibility in implementing their commitments.

Goods: Trade in goods was the concentration of GATT until the Uruguay Round negotiations. From 1947 to 1994, GATT was the forum for negotiating lower customs duty rates and other trade barriers; the text of the General Agreement spelt out important rules, particularly non discrimination.

Since 1995, the updated GATT has become the WTO’s umbrella agreement for trade in goods. It has annexes dealing with specific sectors such as agriculture and textiles and with specific issues such as state trading, product standards, subsidies and actions taken against dumping.

Services: Banks, insurance firms, telecommunications companies, tour operations, hotel chains and transport companies looking to do business abroad can now enjoy the same principles of freer and fairer trade that originally only applied to trade in goods. These principles appear in the new General Agreement on Trade in Services (GATS). WTO members have also made individual commitments under GATS stating which of their services sectors they are willing to open to foreign competition, and how open these markets are.

Intellectual property: The WTO's intellectual property agreement amounts to rules for trade and investment in ideas and creativity. The rules state how copyrights, patents, trade markers, geographical names used to identify products, industrial designs, integrated circuit layout designs and undisclosed information such as trade secrets – “intellectual property” – should be protected when trade is involved.

Dispute settlement: The WTO's procedure for resolving trade quarrels under the Dispute Settlement Understanding is vital for enforcing the rules and therefore for ensuring that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under the agreements are being infringed. Judgments by specially appointed independent experts are based on interpretations of the agreements and individual countries' commitments.

The System encourages countries to settle their differences through consultation. Failing that, they can follow a carefully mapped out, stage by stage procedure that includes the possibility of a ruling by a panel of experts, and the chance to appeal the ruling on legal grounds. Confidence in the system is borne out by the number of cases brought to the WTO – almost 250 cases in seven years compared to some 300 disputes dealt with during the entire life of GATT (1947 – 1994).

Policy review: The trade Policy Review Mechanism's purpose is to improve transparency, to create a greater understanding of the policies that countries are adopting, and to assess their impact. Many members also see the reviews as constructive feedback on their policies. All WTO members must undergo periodic scrutiny, each review containing reports by the country concerned and the WTO Secretariat.

Development and Trade: Over three quarters of WTO members are developing or least developed countries. All WTO agreements contain special provision for them, including longer time periods to implement agreements and commitments, measures to increase their trading opportunities and support to help them build the infrastructure for WTO work, handle disputes, and implement technical standards.

The 2001 Ministerial conference in Doha set out tasks, including negotiations, for a wide range of issues concerning developing countries. Some people call the new negotiations the Doha Development Round. Before that, in 1997, a high level meeting on trade initiatives and technical assistance for least developed countries resulted in an “integrated framework” involving six intergovernmental agencies, to help least developed countries increase their ability to trade, and some additional preferential market access agreements.

A WTO committee on trade and development, assisted by a sub committee on least developed countries, looks at the special needs of the developing countries. Its responsibility includes implementation of the agreements, technical cooperation, and the increased participation of developing countries in the global trading system.

Technical Assistance and Training: The WTO organizes around 100 technical cooperation missions to developing countries annually. It holds on average three trade policy courses each year in Geneva for government officials. Regional seminars are held regularly in all regions of the world with a special emphasis on African countries. Training courses are also organized in Geneva for officials from countries in transition from central planning to market economies.

The WTO set up reference centers in over 100 trade ministries and regional organizations in capitals of developing and least developed countries, providing computers and internet access to enable ministry officials to keep abreast of events in the WTO in Geneva through online access to the WTO’s immense database of official documents and other materials. Efforts are also being made to help countries that do not have permanent representatives in Geneva.

UR Liberalization of Trade in Manufactures

Liberalization of trade in manufactures is sought to be achieved mostly by reduction of tariffs and phasing out of non-tariff barriers.

Tariff Barriers

The major Liberalization in respect of trade in manufactured goods, regarding tariffs are: (i) Expansion of tariff bindings (ii) Reduction in the tariff rates and (iii) Expansion of duty free access

The UR agreement envisaged substantial tariff reductions in both industrial and developing countries. The main liberalization by industrial countries include the expansions of tariff bindings (i.e., commitment not to exceed a particular level of tariff) to cover 99 per cent of imports, the expansion of duty free access from 20 to 43 per cent of imports, and the reduction of trade weighted average tariff by 40 per cent, from 6.2 to 3.7 per cent.

However, the gain to developing countries from the tariff cuts by industrial countries is less impressive. The reduction in the average tariffs on their exports to industrial markets is 30 per cent and the labour intensive manufactures (textiles, clothing, leather goods) and certain processed primary products (fish products) which are regarded as sensitive have been below average tariff cuts.

In industrial countries, tariffs will be eliminated in several sectors like steel, pharmaceuticals and wood and wood products.

Developing countries agreed to bind their tariffs on 61 percent of their imports of industrial products, compared with 13 per cent before the UR Round. They also offered to reduce their trade weighted average bound tariff on imports from industrial countries by 28 percent, from 15 to 11 per cent. The offers of tariff reduction on manufactures by developing countries are estimated to amount to over a third of the work total. The expansion of tariff binding by the developing countries, which rules out future increases in tariffs, is regarded as a significant achievement.

India had bound tariffs at 40 per cent (where they were above 40 per cent in 1993 – 1994) on industrial raw materials, components and capital goods and at 25 per cent in other cases. After the UR Agreement came into

force, about 68 per cent of India's tariff lines are bound (Compared to five per cent earlier). In comparison, many developing countries in Asia and Latin America have bound between 90 and 100 per cent of their tariff lines at levels comparable to, or lower than, India's bindings.

Liberalization in respect of Non – Tariff Barriers (NTBs)

In the area of NTBs, the Agreements to abolish voluntary export restraints (VERs) and to phase out the Multi-fibre Arrangements (MFA) are regarded as landmark achievements for developing countries.

The phasing out of the existing VERs within four years and the MFA within ten years would scale back the coverage of NTBs on the trade of developing countries from 18 per cent of their 1992 exports'. As trade in derestricted product lines would tend to grow faster than other trade, this coverage could fall to 4.2 per cent by 2005.

The UR Agreement sought to phase out the MFA by 2005. According to some estimates the phasing out of MFA would contribute about 20 per cent of the total welfare gains from the UR. The largest gains went to the MFA importers who were able to import basic clothing and textiles from the more efficient suppliers in ASEAN, China, South Asian and other regions. By 2005, the total benefits to the European Community, the US and Canada were estimated at \$56 billion per year at 1992 prices.

Income gains of over \$13 billion were projected for highly competitive exporters such as China, Indonesia, Thailand and South Asian exporters, despite the loss of quota rents provided under the MFA. Some less competitive exporters suffered from the loss of their preferential access to industrial country markets unless they were able to increase their efficiency, and some currently unrestricted importers lost as the exports currently diverted toward them by restrictions elsewhere could flow freely to the other markets.

GATT/WTO Provisions Relating to Preferential Treatment of Developing Countries

The WTO Agreements contain special provisions which give developing countries special rights and which give developed countries

the possibility to treat developing countries more favorably than other WTO Members. These also specify that international trade should benefit the economic development of developing and least-developed countries.

These special provisions include, for example, longer time periods for implementing Agreements and commitments or measures to increase trading opportunities for developing countries.

These provisions are referred to as “special and differential treatment” provisions.

The special provisions include:

- Longer time periods for implementing Agreements and commitments,
- Measures to increase trading opportunities for these countries,
- Provisions requiring all WTO members to safeguard the trade interests of developing countries,
- Support to help developing countries build the infrastructure for WTO work, handle disputes, and implement technical standards, and
- Provisions related to Least-Developed country (LDC) Members.

The WTO Secretariat has made several compilations of the special and differential provisions and their use. In the Doha Declaration, member governments agreed that all special and differential treatment provisions should be reviewed with a view to strengthening them and making them more effective, and operational.

More specifically, the declaration (together with the Decision on Implementation-Related Issues and Concerns) mandates the Committee on Trade and Development to identify which of those special and differential treatment provisions are mandatory, and to consider the legal and practical implications of making mandatory those which are currently non-binding. In addition, the Committee is to consider ways in which developing countries, particularly the LDCs, may be assisted to make best use of special and differential treatment.

| Article | Provision for Developing Country Members |
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| Preamble | Recognition of special and differential treatment; in implementing their commitments on market access, developed country Members to take fully into account the needs and conditions of developing country Members by providing for a greater improvement of opportunities and terms of access for agricultural products of particular interest to those Members, including the fullest liberalization of trade in tropical agricultural products; the possible negative effects of the implementation of the reform program on least-developed and net-food importing developing countries to be taken into account. |
| 4.0 and Schedules | Average tariff reduction of 24 per cent, with minimum cut per tariff line of 10 per cent (<i>36 and 15 per cent, respectively</i>). Option to establish ceiling bindings for previously unbound agricultural tariffs. |
| 6.1 and Schedules | Trade-distorting domestic support (Total Aggregate Measurement of Support or Total AMS) to be reduced by 13.3 per cent (<i>20 per cent</i>). |
| 6.2 | Investment subsidies generally available to agriculture, agricultural input subsidies generally available to low-income or resource-poor producers, and domestic support to domestic producers to encourage diversification from illicit narcotic crops to be excluded from reduction commitments and not included in Total AMS. |
| 6.4 | <i>Deminimis</i> provision allowing exclusion of product-specific and non-product specific trade-distorting domestic support of less than 10 per cent of the total value of production of the product concerned or total agricultural production, respectively (<i>5 per cent</i>). |
| 8 and Schedules | Export subsidy reduction commitments of 14 per cent in terms of subsidized export volume and 24 per cent in terms of budgetary outlays (<i>21 and 36 per cent, respectively</i>). |
| 9.4 | During the implementation period, no requirement to undertake commitments in respect of subsidies to reduce the costs of marketing exports and of government-provided or mandated internal transport and freight charges on export shipments on terms more favourable than for domestic shipments. |

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| 12.2 | Disciplines on export prohibitions and restrictions not applicable, unless the developing country Member is a net-food exporter of the specific foodstuff concerned. |
| 15.1 | Recognition of differential and more favourable treatment for developing country Members, as set out in the relevant provisions of the Agreement and embodied in the Schedules of concessions and commitments. |
| 15.2 and Schedules | Developing country Members to implement reduction commitments over a period of 10 years (<i>6 years</i>). |
| 16 | Developed country Members to take action as provided for within the framework of the Decision on Measures Concerning the Possible Negative Effects of the Reform Program on Least-Developed and Net-Food Importing Developing Countries. Committee on Agriculture to monitor the follow-up to this Decision. |
| 20 | Special and differential treatment to developing country Members, to be taken into account in the continuation of the reform process. |
| Annex 2, para. 3 | Special and differential treatment with regard to public stockholding for food security purposes. |
| Annex 2, para. 4 | Special and differential treatment with regard to domestic food aid. |
| Annex Section B | Special and differential treatment in the context of the “Special Treatment” provisions of Annex 5, concerning market access conditions mentioned in Article 4.2. |
| Notifications | Certain annual notification requirements in the area of domestic may be set aside, on request, by the Committee on Agriculture. |
| Agreement on Sanitary and Phyto-sanitary Restrictions | |
| <i>Article</i> | <i>Provision for Developing Country Members.</i> |
| Preamble | Recognition of special difficulties developing countries may encounter in complying with SPS measures in importing markets and in formulating such measures on their territory. Desire to assist such countries in their endeavours in this regard. |
| 9 | Members to provide technical assistance. |

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| 10.1 | In the preparation and application of SPS Measures, Members to take into account special needs of Developing Country and LDC Members. |
| 10.2 | Possibility of longer time frames for compliance with new sanitary or phytosanitary measures. |
| 10.3 | SPS Committee enabled to grant specified, time-limited exemptions in whole or in part from obligations under the SPS Agreement.. |
| 10.4 | Members to encourage and facilitate participation of developing countries in relevant international Organizations. |
| 14 | May delay for up to 2 years implementation of most provisions of the Agreement relating to measures affecting imports (with the exception of measures not based on relevant or extant international standards). |
| Ann. B | Members to allow “reasonable” interval between announcement and introduction of measures. |
| Agreement on Textiles and Clothing | |
| <i>Article</i> | <i>Provision for Developing Country Members.</i> |
| 1.2 | Members agree to use provisions of Art. 2.18 and Art. 6.6(b) (below) to permit meaningful increases in access possibilities for small suppliers and new entrants. |
| 1.4 | Particular interests of cotton-producing exporting Members should, in consultation with them, be reflected in implementation. |
| 2.18 | “Meaningful improvements in access” through accelerated increases in growth rates, or through agreed changes with respect to the mix of base levels, growth and flexibility, for Members subject to restrictions on 31 December 1994 and whose restrictions account for less than 1.2 per cent of all restrictions imposed by relevant Member as of 31 December 1991. |
| 6.6 (b) | Members whose export volumes are small in comparison with the total volume of exports of other Members and represent a small percentage of imports of a product into importing Member shall be accorded differential and more favourable treatment in the fixing of economic terms of Articles 6.8, 6.13 and 6.14, i.e. in fixing levels of export restraint, growth and flexibility (see also Article 1.2). |

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| 6.6 (c) | Special consideration to be given to needs of wool exporters with wool dependent economies and accounting for small share of importing Members market, when quota levels, and growth rates and flexibility are considered. |
| Annex: para. 3) | Developing country cottage industry handlooms and hand made products, traditional handicraft textile and clothing products, when certified as such; certain “historically traded textile products” and products made of pure silk are not subject to the transitional safeguard provisions of Article 6. |
| Agreement on Technical Barriers to Trade | |
| Article | Provision for Developing Country Members. |
| Preamble | Recognition of the contribution which international standardization can made to the transfer of technology from developed to developing countries; recognition that by developing countries may encounter special difficulties in formulation and application of technical regulations and standards; and desiring to assist such countries in their endeavours in this regard. |
| 2.12 & 5.9 | Except in “urgent circumstances” Members to allow reasonable interval publication and entry into force of measures to allow producers in exporting Members, particularly developing country Members, opportunity to adapt their products or methods of production. |
| 11.1 | Members to advise other Members, especially developing countries, on request, regarding the preparation of technical regulations. |
| 11.2, 11.5 | Members shall, if requested, advise other Members, especially developing countries, and shall grant them technical assistance on mutually agreed terms and conditions: regarding the establishment of national standardizing bodies and participation in the international standardizing bodies and shall encourage their national standardizing bodies to do likewise (11.2); regarding the steps that should be taken by their producers to have access to conformity assessment systems within the territory of the Member receiving the request (11.5); |

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| 11.3, 11.4 | Members shall, if requested, take such reasonable measures as may be available to them to: arrange for the regulatory bodies within their territories to advise other Members, especially developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of regulatory bodies, or bodies for the assessment of conformity with technical regulations and the methods by which their technical regulations can best be met (11.3); arrange for advice to be given to other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of bodies for the assessment of conformity with standards adopted within the territory of the requesting Member (11.4). |
| 11.6 | Members, which are Members or participants of international or regional conformity assessment systems shall, if requested, advise and provide technical assistance on mutually agreed terms for establishment of legal framework and institutions to enable other Members, particularly developing Members, to meet obligations of membership or participation in such conformity assessment systems. |
| 12.2 | Members shall give particular attention to developing Members' rights and obligations and shall take into account the special development, financial and trade needs of developing Members in the implementation of the Agreement, both nationally and in the operation of the Agreement's institutional arrangements. |
| 12.3, 12.7 | Members shall, in preparing and applying technical regulations, standards and conformity assessment procedures, take account of the special development, financial and trade needs of developing Members with a view to ensuring that unnecessary obstacles to exports from developing countries are not created. Technical assistance to be provided by Members to that end, taking account of the stage of development of the requesting Members. |
| 12.4 | [Because] developing Members adopt certain technical regulations, standards or conformity assessment procedures aimed at preserving indigenous technology and production methods and processes compatible with their development, Members recognize that developing Members should not be expected to use international standards... which are not appropriate to their development, financial and trade needs. |

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| 12.5, 12.6 | Members shall take such reasonable measures as may be available to them to ensure: that international standardizing bodies and international systems for conformity assessment are organized and operated in a way which facilitates active and representative participation of relevant bodies in all Members, taking into account the special problems of developing country Members (12.5); that international standardizing bodies, upon request of developing Members, examine the possibility of, and if practicable prepare international standards concerning products of special interest to developing Members. (12.6). |
| 12.10 | TBT Committee to review application of special and differential provisions |
| Agreement on Trade-related Investment Measures (TRIMS) | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| Preamble | Taking into account trade, development and financial needs of developing countries and especially LDCs. |
| 4 | Permission to “deviate temporarily” from requirement to eliminate TRIMS inconsistent with Articles III and XI of GATT 1994, to the extent and in such a manner as Article XVIII of the GATT, the Understanding on the Balance of Payments provisions of GATT 1994, and the 1979 Declaration on Trade Measures Taken for Balance of Payments Purposes, permit deviation from Articles III and XI of GATT 1994. |
| 5.2 | 5 years (2 years) to eliminate TRIMS inconsistent with Agreement. |
| 5.3 | Possible extension of transitional period on the basis of demonstrated particular difficulties in implementation and taking into account the individual development, financial and trade needs of the Member in question, on agreement of Council for Trade in Goods. |
| Agreement on the Implementation of Article VI (Anti-Dumping) | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| 15 | Special regard to be given by developed countries to “special situation” of developing countries when considering application of anti-dumping measures Constructive remedies to be explored prior to imposition of antidumping measures. |

| Agreement on the Implementation of Article VII (Customs Valuation) | |
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| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| 20 | Establishment of special and differential treatment |
| 20.1 | Developing country Members not party to the Tokyo Round Agreement on Implementation of GATT Article VII may delay application of all provisions for up to 5 years after entry into force of WTO Agreement for such Members. |
| 20.2 | Developing country Members not party to the Tokyo Round Agreement may delay application of Articles 1.2(b) (iii) and 6 regarding the computed value method, for a period of up to three years following application of other provisions of the Agreement. |
| 20.3 | Provision by developed countries of technical assistance on mutually agreed terms. |
| Ann III.2 | Possibility of retaining existing system of minimum values under terms and conditions to be agreed by the Committee |
| Ann III.3 | Right to refuse importers' request to reverse order of Articles 5 and 6. |
| Ann III.4 | Right to reserve application of Art 5.2 in accordance with the provisions of the relevant note thereto whether or not requested by importer. |
| Ann. III.5 | If developing country experiences problems in applying Article I insofar as it relates to sole distributors/ importers, a study will be made on request to find appropriate solutions. |
| Agreement on Pre-shipment Inspection (PSI) | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| Preamble | Need recognized for developing countries to have recourse to PSI "for as long and insofar as it is necessary" to verify quality, quantity or price of imports. |
| 3.3 | Exporter Members shall offer to provide technical assistance to user Members, if requested, directed to achieving objectives of the Agreement on mutually agreed terms. Such assistance may be given on a bilateral, plurilateral or multilateral basis. |

| Agreement on Import Licensing | |
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| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| Preamble | Members to take into account trade, development and financial needs of developing countries. |
| 1.2 | Members shall ensure that administrative procedures used to implement licensing schemes conform to GATT 1994 provisions, taking into account development, financial and trade needs of developing country Members. |
| 2.2, foot-note 5 | Developing country Members that were not signatories to the corresponding Tokyo Round Agreement may delay by up to two years, following notification, of obligation to accept application for automatic licence on any working day before next day customs clearance, and to grant automatic licences within 10 working days of receipt of applications. |
| 3.5(a)(iv) | Developing countries “would not be expected” to incur additional administrative burden in order to provide import statistics for products subject to non-automatic licensing. |
| 3.5(j) | Special consideration to be given to importers importing products from developing countries in allocating non-automatic licences. |
| Agreement on Safeguards | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| 9.1, footnote 2 | Safeguards “shall not be applied” against products originating in developing countries if share of imports is not in excess of 3 per cent, and if developing country Members with less than 3 per cent share do not account collectively for more than 9 per cent of imports. |
| 9.2 | Safeguards may be maintained for up to 10 years (4-year initial period + 6 year extension) (8 years – 4+4). |
| 9.2 | Safeguards of more than 180 days in duration may be re-imposed after half the time they were in force (<i>full extent of the period in force</i>) has elapsed, subject to a minimum non-application period of two years. |
| Agreement on Subsidies and Countervailing Measures | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |

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| 27 | Recognition of principle of differential and more favourable treatment |
| 27.2 (a) | Developing countries with per capita income below US\$ 1,000 (and listed in Annex VII) exempted from prohibition on export subsidies. |
| 27.2 (b) and 27.4 | 8 year transition periods, within which subsidies phased out, preferably in a progressive manner. Consultations with Committee not later than one year before the expiry of the period of extension sought. Annual consultations if extension justified. Two year phase out if not justified. |
| 27.3 | Prohibition on subsidies contingent on export performance not applicable for 5 years. |
| 27.5 and 27.6 | Export Subsidies to be phased out within 2 years of attaining “export competitiveness” in any given product; 8 year phase out for Annex VII Members. “Export competitiveness” is defined as at least 3.25 % of world trade in the “product” (HS Section) for two consecutive calendar years. |
| 27.7 | “Remedy” provisions of Article 7 are applicable to developing country Members for subsidies in conformity with 27.2-27.5. Otherwise Article 4 applies. |
| 27.8 | Subsidies specified in Article 6.1 (i.e. ad valorem subsidization of product in excess of 5 per cent, to cover operating losses, of industries or enterprises, direct forgiveness of debts and grants to cover debt repayment not be presumed to cause serious prejudice; positive evidence must be supplied. |
| 27.9-10 | Subsidies actionable only if they cause injury or nullify or impair benefits to other Members under GATT 1994. Countervailing duty investigations to be terminated where share of total imports less than 4 per cent and where total import share of developing country Members, each with less than 4 per cent share, does not exceed 9 per cent. |
| 27.11 | <i>De minimis</i> subsidization provision requiring termination of countervailing inquiry 2 per cent (<i>1 per cent</i>) or 3 per cent if export subsidies eliminated before the end of 8 year period. |
| 27.13 | Certain subsidies granted in context of privatization programs are not actionable. |
| General Agreement on Trade in Services (GATS) | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |

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| Preamble | Recognition of particular need for developing countries to exercise right to regulate or introduce new regulations on supply of services within territory in order to meet development objectives, and desiring to facilitate increased participation of developing countries in trade in services and the expansion of their exports in services, <i>inter alia</i> through strengthening domestic capacity. |
| III:4 | “Appropriate flexibility” with respect to time limits for establishment of enquiry points may be agreed with individual developing country. |
| IV:1 | Increased developing country participation in services trade to be facilitated through negotiations of specific commitments relating to strengthening domestic services capacity, efficiency and competitiveness through access to technology on a commercial basis, improvement of market access to distribution channels and information networks, liberalization of market access in sectors and modes of supply of export interest. |
| IV:2 | Members to facilitate developing country access to market information through establishment of contact points. |
| V:3 | Flexibility in application of Article V:1 requirement for substantial sector coverage and elimination of discrimination between Members in context of an agreement entered into by Members with a view to liberalizing trade in services. |
| XV:1 | Provision for flexibility in use of subsidies in development programs. |
| XIX:2 | Flexibility for developing countries to open fewer sectors, liberalize fewer types of transaction, progressively extending market access in line with economic development. Flexibility for developing countries to attach conditions when providing market access to foreign suppliers, in order to facilitate increased participation by developing countries in trade in services. |
| XXVI:2 | Provision for technical assistance on a multilateral basis. |
| GATS Annex on Telecommunications | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| para 5 (g) | Provision for placing reasonable conditions of access to public telecoms transport networks and services consonant with need to strengthen domestic telecoms infrastructure and increase participation in international trade. |

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| para 6 (a) | In order to facilitate improvement of telecommunications infrastructure, Members and their suppliers encouraged to participate, to “fullest extent practicable” in development programs of international and regional organizations. |
| para 6 (c) | Members to provide information “where practicable” to developing countries regarding telecommunications services and technological developments. |
| Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| Preamble | Recognition that objectives of national systems of intellectual property protection include developmental objectives. |
| 65.2 and 65.4 | Four year transitional period additional to one year available to all original Members (applicable to most but not all TRIPS obligations). Further 5 year extension in cases where Agreement requires extending product patent protection to areas of technology not so protectable by end of general transition period. |
| Understanding on Rules & Procedures Governing Dispute Settlement | |
| <i>Article</i> | <i>Provision for Developing Country Members</i> |
| 3.12 | Right to invoke 1966 Decision regarding Procedures under Article XXIII in lieu of Arts 4, 5, 6 and 12 of the understanding. |
| 4.10 | Members to give “special consideration” to interests of developing countries during consultations. |
| 8.10 | Developing countries can require that at least 1 panelist in cases concerning them be a national of a developing country. |
| 12.10 | Possibility to extend length of time-limit for resolution. Panels to allow ‘sufficient time’ for developing countries to prepare defence. |
| 12.11 | Panel findings to make explicit reference to way in which special and differential treatment taken into account. |
| 21.2 | On surveillance of implementation of recommendations or rulings, particular attention should be paid to matters affecting the interests of developing country Members with respect to matters which have been subject to dispute settlement. |

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| 21.7 | If [a matter is raised] by a developing country Member, the DSB shall consider what further action it might take which would be appropriate to the circumstances. |
| 21.8 | If case brought by developing country, DSB when considering appropriate action, to take into account impact on economy of developing country concerned as well as trade coverage. |
| 27.2 | Provision by the Secretariat of services of qualified legal experts from the WTO technical cooperation services to any developing country Member that so requests. |

Provisions for Developing Country Members

Source: WTO Website.

Special and Differential (S&D) Provisions for Least Developed Countries (LDCs)

The WTO Work Program for the LDCs is the main platform through which the issues of interest to LDCs are being considered by the Members. Key issues in the Work Program are: (i) Market Access for LDCs; (ii) Trade-Related Technical Assistance and Capacity Building Initiatives for LDCs; (iii) Providing, as appropriate, support to agencies assisting with the diversification of LDCs' production and export base; (iv) Mainstreaming into the WTO's work, the trade-related elements of the LDC-III Program of Action, as relevant to the WTO's mandate; (v) Participation of LDCs in the Multilateral Trading System; (vi) Accession of LDCs to the WTO; and (vii) Follow-up to WTO Ministerial Decisions/Declarations.

Special and differential treatment (S&D) provisions can generally be classed in five main groups: provisions aimed at increasing trade opportunities through market access; provisions requiring WTO Members to safeguard the interest of developing countries; provisions allowing flexibility to developing countries in rules and disciplines governing trade measures; provisions allowing longer transitional periods to developing countries; and provisions for technical assistance. An overview of the implementation of S&D provisions of the WTO agreements and decisions is contained in document.

This document summarizes the S&D provisions relating to Least-Developed Countries (LDCs) and contains an Annex which provides specific document references to legal decisions in favour of LDCs. The provisions are categorized into three – those contained in the WTO legal texts, relevant Ministerial decisions and declarations and decisions of the General Council and other bodies. The document also includes a section on technical assistance for LDCs and the Integrated Framework.

WTO Agreements generally recognize the particular trade, development and financial needs of developing country Members, including the least-developed among them. A number of the WTO Agreements have specific provisions for taking into account the interests of LDCs, in addition to those of developing countries.

| WTO Agreement | S&D provisions for LDCs |
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| Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994 | Simplified consultation procedures may be used. |
| Agreement on Agriculture | LDCs are exempt from undertaking reduction commitments. |
| Application of Sanitary and Phytosanitary Measures | LDCs had the possibility of delaying for up to five years, the implementation of the provisions of the Agreement with respect to their sanitary and phytosanitary measures affecting imports. |
| Agreement on Textiles and Clothing | LDCs are accorded significantly more favourable treatment than other groups in the application of the transitional safeguard. |
| Agreement on Technical Barriers to Trade | Particular account to be taken of LDCs in the provision of technical assistance and in the preparation of technical regulations. |
| (T R I M S) Trade - r e l a t e d Investment Measures | LDCs had a seven-year transitional period to eliminate TRIMS that are inconsistent with the Agreement. |
| Agreement on Import Licensing | In allocating non-automatic licences, special consideration to be given to importers who import products from LDCs. |

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| Agreement on Subsidies and Countervailing Measures | LDCs are exempted from prohibition on export subsidies. Prohibition on subsidies that are contingent upon export performance is not applicable to LDCs for eight years. |
| General Agreement on Trade in Services (GATS) | Special priority given to LDCs in implementing Article IV of GATS (Increasing Participation of Developing Countries) and particular account to be taken of the difficulties encountered by LDCs in accepting negotiated commitments, owing to their particular needs. Special consideration is given to LDCs with regard to encouraging foreign suppliers to assist in technology transfers, training and other activities for developing telecommunications. |
| Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) | Delay for up to 10 years in implementing most of TRIPS obligations. Possibility of extension following duly motivated request. Members to provide incentives for encouraging the transfer of technology to LDCs. |
| Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) | Particular consideration should be given to the special situation of LDCs in all stages of a dispute involving an LDC. Members to exercise due restraint in raising matters involving an LDC. LDCs may request use of the good offices of the Director-General or the Chairman of the DSB. |
| Trade Policy Review Mechanism (TPRM) | Greater flexibility given to LDCs concerning the frequency of their reviews. Particular attention given to LDCs in the provision of technical assistance by the Secretariat. |

GATT/WTO Provisions Relating to Regional Groupings

Regional trade agreements (RTAs) have become increasingly prevalent since the early 1990s. As of 10 January 2013, some 546 notifications of RTAs (counting goods and services and accessions separately) had been received by the GATT/WTO. Of these, 354 were in force. What all RTAs in the WTO have in common is that they are reciprocal trade agreements between two or more partners. The WTO also receives notifications from WTO members regarding preferential trade arrangements (PTAs). In the WTO, PTAs are unilateral trade preferences. The European Union, the North American Free Trade Agreement, the Association of Southeast

Asian Nations, the South Asian Association for Regional Cooperation, the Common Market of the South (MERCOSUR), the Australia-New Zealand Closer Economic Relations Agreement, and so on.

Goals of RTAs are generally: Accelerate economic growth, Free trade among member states from trade barriers, Achieve social progress and cultural development and Promote regional peace and stability and Adhere to United Nations Charter are the general goals of RTAs.

Important RTAs

In general terms, regional trade groups are associations of nations at a governmental level to promote trade within the block and defend its members against global competition. Defense against global competition is obtained through established tariffs on goods produced by member states, import quotas, government subsidies, onerous bureaucratic import processes, and technical and other non-tariff barriers. Since trade is not an isolated activity, member states within regional blocks also cooperate in economic, political, security, climatic, and other issues affecting the region. In terms of their size and trade value, there are four major trade blocks and a larger number of blocks of regional importance. On 6 February 1996, the WTO created the Regional Trade Agreements Committee. Its purpose is to examine regional groups and to assess whether they are consistent with WTO rules. The committee is also examining how regional arrangements might affect the multilateral trading system, and what the relationship between regional and multilateral arrangements might be.

1. **ASEAN: Association of South East Asian Nations:** Established on 8th August, 1967, in Bangkok/Thailand the Member States include Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Within ASEAN, there is an AEC, (ASEAN Economic Community) to convert ASEAN into a single market and production base that is highly competitive and fully integrated into the global economy.
2. **EU – European Union:** Emerged from six neighboring states as the European Coal and Steel Community (ECSC) in 1951, into European Economic Community, then as European Community and later in 1992, as European Union. This is the regional block with the largest number of member states (27) comprising of:

Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, The Netherlands, and the United Kingdom. Goals of EU evolved from a regional free-trade association of states into a union of political, economic and executive connections.

3. **MERCOSUR** (Mercado, Comun del Cono Sul- Southern Cone Common Market) established in March 1991 with a Treaty among Argentina, Brazil, Paraguay, Uruguay, and Venezuela as full members and Bolivia, Chile, Colombia, Ecuador, and Peru as Associate members and Mexico as an observer. Goals include Integration of member states for acceleration of sustained economic development based on social justice, environmental protection, and combating poverty.
4. **NAFTA** (North American Free Trade Agreement): Agreement signed on 1 January 1994 with the Membership of Canada, Mexico, and the United States of America, pursuing the goals of eliminating trade barriers among member states, promoting conditions for free trade and investment opportunities and protection intellectual property rights.
5. **Other regional trade blocks:** These include regional economic partnerships and free trade associations as follows:
 - i. **ANDEAN** covering Members: Bolivia, Colombia, Ecuador, and Peru, Associate Members: Argentina, Brazil, Chile, Paraguay, and Uruguay and Observer Countries: Mexico and Panama.
 - ii. **CARICOM with** Antigua & Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Kitts & Nevis, Saint Lucia, Saint Vincent & The Grenadines, Surinam, and Trinidad & Tobago.
 - iii. **CIS:** Commonwealth of Independent States including Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.
 - iv. **COMESA:** Common Market for Eastern and Southern Africa covering Burundi, Comoros, Democratic Republic of

- the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, Zimbabwe.
- v. **ECOWAS:** Economic community of West African States including Benin, Burkina Faso, Cape Verde, The Gambia, Ghana, Guinea, Guinea Bissau, Ivory Coast, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo.
 - vi. **EFTA:** European Free Trade Association including Iceland, Liechtenstein, Norway, and Switzerland.
 - vii. **GCC:** Gulf Cooperation Council including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE).
 - viii. **MEFTA:** Middle East Free Trade Association covering Countries which have signed Free Trade Agreements (FTAs), Trade and Investment Framework Agreements (TIFAs), or receive active U.S. support for WTO accession namely Algeria, Bahrain, Egypt, Iraq, Israel, Jordan, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Tunisia, United Arab Emirates, and Yemen.
 - ix. **Pacific Community:** It comprised of the 22 Pacific island countries and territories of American Samoa, Cook Islands, Fiji Islands, French Polynesia, Guam, Kiribati, Marshall Islands, Micronesia, Nauru, New Caledonia, Niue, Northern Mariana Islands, Palau, Papua New Guinea, Pitcairn Islands, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, Vanuatu, Wallis and Futuna, and the founding countries of Australia, France, New Zealand and the United States of America.
 - x. **SAARC:** south Asian Association for Regional Cooperation consisting of Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
 - xi. **SADC:** Southern Africa Development Community consisting of Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.

Negotiations on RTAs

WTO Members agreed at Doha to initiate negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements, taking into account developmental aspects. Negotiations are taking place within the Negotiating Group on Rules (NGR) which reports to the Trade Negotiations Committee (TNC). With regard to negotiations on procedural issues relating to RTAs, the General Council established on a provisional basis a new transparency mechanism for all RTAs. The new transparency mechanism was negotiated in the Negotiating Group on Rules and is implemented on a provisional basis. Members are to review, and if necessary modify, the decision, and replace it by a permanent mechanism adopted as part of the overall results of the Doha Round. The Committee on Regional Trade Agreements conducts review of RTAs falling under Article XXIV of General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS).

WTO & RTAs – Is there a conflict?

WTO & RTAs seem to be contradictory, but often regional trade agreements can actually support the WTO's multilateral trading system. Regional agreements have allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally. In turn, some of these rules have paved the way for agreement in the WTO. Services, intellectual property, environmental standards, investment and competition policies are all issues that were raised in regional negotiations and later developed into agreements or topics of discussion in the WTO.

Article 24 says if a free trade area or customs union is created, duties and other trade barriers should be reduced or removed on substantially all sectors of trade in the group. Non-members should not find trade with the group any more restrictive than before the group was set up. Similarly, Article 5 of the GATS provides for economic integration agreements in services. Other provisions in the WTO agreements allow developing countries to enter into regional or global agreements that include the reduction or elimination of tariffs and non-tariff barriers on trade among themselves.

The groupings that are important for the WTO are those that abolish or reduce barriers on trade within the group. The WTO agreements recognize that regional arrangements and closer economic integration can benefit countries. It also recognizes that under some circumstances regional trading arrangements could hurt the trade interests of other countries. Normally, setting up a customs union or free trade area would violate the WTO's principle of equal treatment for all trading partners. But GATT's Article 24 allows regional trading arrangements to be set up as a special exception, provided certain strict criteria are met. In particular, the arrangements should help trade flow more freely among the countries in the group without barriers being raised on trade with the outside world. In other words, regional integration should complement the multilateral trading system and not threaten it.

GATT/WTO Provisions Relating to Subsidies

The UR Agreement deals with three categories of subsidies.

- i. Prohibited subsidies – those contingents upon export performance or the use of domestic instead of imported goods.
- ii. Actionable subsidies – those that have demonstrably adverse effects on other member countries.
- iii. Non actionable subsidies – including those provided (with stipulated limitations) to industrial research and pro competitive development activity to disadvantaged regions, or to existing facilities to adapt themselves to new environmental requirements.

The Agreement also puts restrictions on the use of countervailing measures against competitors' subsidies. To prevent undue hardship, developing countries and countries in transition from centrally planned to market economies are allowed extra time to bring the subsidies into conformity with the new rules.

While industrial economies are required to reduce, over six years, the volume of subsidies agricultural exports by at least 21 per cent and the value of subsidies at least by 36 per cent, the respective figures for developing countries are 14 per cent and 24 per cent. All countries are bound not to introduce new subsidies.

The UR agreement has brought the domestic support policies also under the multilateral trade discipline. However, domestic support measures that have almost a minimal impact on trade (“green box” policies) such as general government services in the areas of research, disease control, infrastructure and food security as also certain direct payments such as certain income support policies, structural adjustment assistance, payment under environmental programs and regional assistance programs are exempted.

The non exempted types of subsidies included in the aggregate measure of support (AMS) required to be reduced include assistance in the form of production limiting subsidies and assistance given for growth of agriculture and rural development like procurement at support prices and subsidies on inputs and credit. However, even these subsidies are required to be reduced only if their total amounts as a proportion of the value of agricultural production exceed five percent in case of developed countries and 10 per cent in case of developing countries. If the non exempted subsidies are above these limits, they are required to be reduced by 20 per cent in case of developed countries and by 13.3 per cent in developing countries by 1999.

According to government of India, India’s total AMS is negative (without taking into account exemptions available of input Subsidies to low income and resource poor Farmers) and there are no reduction commitments. Nor does India have any minimum market access commitments in agriculture (the UR Agreement provides for the establishment of minimum access tariff quotas, at reduced tariff rates, where the access is less than 3 per cent of the domestic consumption). The minimum access tariff quotas are to be expanded to five per cent over the implementation period).

Assistance for “food security” such as the food subsidy under the public distribution system (PDS) will be exempted to the extent they confine to the poor.

Non Agricultural Export Subsidies

Countries whose per capita income is less than US \$ 1000 are not bound to phase out export subsidies. (India’s per capita Income in 1994

was only \$ 310 and now). However, even such countries will have to phase out export subsidies on products where the share in the world exports is 3.25 per cent or more in two consecutive years. This is applicable to India in respect of exports of diamonds.

GATT/WTO Provisions Relating to Technical Standards

In recent years, the number of technical regulations and standards adopted by countries has grown significantly. Increased regulatory policy can be seen as the result of higher standards of living worldwide, which have boosted consumers' demand for safe and high-quality products, and of growing problems of water, air and soil pollution which have encouraged modern societies to explore environmentally-friendly products.

Impact on International Trade

Although it is difficult to give a precise estimate of the impact on international trade of the need to comply with different foreign technical regulations and standards, it certainly involves significant costs for producers and exporters. In general, these costs arise from the translation of foreign regulations, hiring of technical experts to explain foreign regulations, and adjustment of production facilities to comply with the requirements. In addition, there is the need to prove that the exported product meets the foreign regulations. The high costs involved may discourage manufacturers from trying to sell abroad. In the absence of international disciplines, a risk exists that technical regulations and standards could be adopted and applied solely to protect domestic industries.

From the Tokyo Round Standards Code to the WTO TBT Agreement: The provisions of the GATT 1947 contained only a general reference to technical regulations and standards in Articles III, XI and XX. A GATT working group, set up to evaluate the impact of non-tariff barriers in international trade, concluded that technical barriers were the largest category of non-tariff measures faced by exporters. After years of negotiations at the end of the Tokyo Round in 1979, 32 GATT Contracting Parties signed the plurilateral Agreement on Technical Barriers to Trade (TBT). The Standards Code, as the Agreement was called, laid down the rules for preparation, adoption and application of technical regulations, standards and conformity assessment procedures. The new

WTO Agreement on Technical Barriers to Trade, or TBT Agreement, has strengthened and clarified the provisions of the Tokyo Round Standards Code. The TBT Agreement, negotiated during the Uruguay Round is an integral part of the WTO Agreement. Before examining the Agreement in detail, it is necessary to define the meaning of “technical regulations”, “standards” and “conformity assessment procedures”.

Technical regulations and standards in the TBT Agreement: Technical regulations and standards set out specific characteristics of a product — such as its size, shape, design, functions and performance, or the way it is labeled or packaged before it is put on sale. In certain cases, the way a product is produced can affect these characteristics, and it may then prove more appropriate to draft technical regulations and standards in terms of a product’s process and production methods rather than its characteristics *per se*. The TBT Agreement makes allowance for both approaches in the way it defines technical regulations and standards.

Difference between a technical regulation and a standard: The difference between a standard and a technical regulation lies in compliance. While conformity with standards is voluntary, technical regulations are by nature mandatory. They have different implications for international trade. If an imported product does not fulfill the requirements of a technical regulation, it will not be allowed to be put on sale. In case of standards, non-complying imported products will be allowed on the market, but then their market share may be affected if consumers’ prefer products that meet local standards such as quality or colour standards for textiles and clothing.

Conformity assessment procedures: Conformity assessment procedures are technical procedures — such as testing, verification, inspection and certification — which confirm that products fulfill the requirements laid down in regulations and standards. Generally, exporters bear the cost, if any, of these procedures. Non-transparent and discriminatory conformity assessment procedures can become effective protectionist tools.

Protection of human safety or health through technical regulations and standards: The largest number of technical regulations and standards are adopted to aim at protecting human safety or health.

Numerous examples can be given. National regulations that require that motor vehicles be equipped with seat belts to minimize injury in the event of road accidents, or that sockets be manufactured in a way to protect users from electric shocks, fall under the first category. A common example of regulations whose objective is the protection of human health is labeling of cigarettes to indicate that they are harmful to health.

Protection of animal and plant life or health through technical regulations and standards: Regulations that protect animal and plant life or health are very common.

They include regulations intended to ensure that animal or plant species endangered by water, air and soil pollution do not become extinct. Some countries, for example require that endangered species of fish reach a certain length before they can be caught.

Protection of the environment through technical regulations and standards: Increased environmental concerns among consumers, due to rising levels of air, water and soil pollution, have led many governments to adopt regulations aimed at protecting the environment. Regulations of this type cover for example, the re-cycling of paper and plastic products, and levels of motor vehicle emissions.

Prevention of deceptive practices through technical regulations and standards: Most of these regulations aim to protect consumers through information, mainly in the form of labeling requirements. Other regulations include classification and definition, packaging requirements, and measurements (size, weight etc.), so as to avoid deceptive practices.

Other objectives of technical regulations and standards: Other objectives of regulations are quality, technical harmonization, or simply trade facilitation. Quality regulations — e.g. those requiring that vegetables and fruits reach a certain size to be marketable — are very common in certain developed countries. Regulations aimed at harmonizing certain sectors, for example that of telecommunications and terminal equipment, are widespread in economically integrated areas such as the European Union and EFTA.

Divergent regulations — costs for exporters

Loss of economies of scale: If a firm must adjust its production facilities to comply with diverse technical requirements in individual markets, production costs per unit are likely to increase. This imposes handicap particularly on small and medium enterprises.

Conformity assessment costs: Compliance with technical regulations generally needs to be confirmed. This may be done through testing, certification or inspection by laboratories or certification bodies, usually at the company's expense.

Information costs: These include the costs of evaluating the technical impact of foreign regulations, translating and disseminating product information, training of experts, etc.

Surprise costs: Exporters are normally at a disadvantage vis-à-vis domestic firms, in terms of adjustments costs, if confronted with new regulations.

GATT/WTO Provisions Relating to Antidumping Duties

Article VI of the GATT provides for the right of contracting parties to apply anti-dumping measures, i.e. measures against imports of a product at an export price below its “normal value” (usually the price of the product in the domestic market of the exporting country) if such dumped imports cause injury to a domestic industry in the territory of the importing contracting party. More detailed rules governing the application of such measures are currently provided in an Anti-dumping Agreement concluded at the end of the Tokyo Round. Negotiations in the Uruguay Round have resulted in a revision of this Agreement which addresses many areas in which the current Agreement lacks precision and detail.

Greater Clarity: The WTO provides greater clarity and more detailed rules concerning the method of determining dumping and injury, the procedure to be followed in anti – dumping investigations, and the duration of antidumping measures. It also clarifies the role of dispute settlement panels in conflicts relating to anti dumping actions taken by national authorities. On the methodology for determining that a product

is exported at a dumped price, the new Agreement adds relatively specific provisions on such issues as criteria for allocating costs when the export price is compared with a “constructed” normal value and rules to ensure that a fair comparison is made between the export price and the normal value of a product so as not to arbitrarily create or inflate margins of dumping.

The agreement strengthens the requirement for the importing country to establish a clear causal relationship between dumped imports and injury to the domestic industry. The examination of the dumped imports on the industry concerned must include an evaluation of all relevant economic factors bearing on the state of the industry concerned. The agreement confirms the existing interpretation of the term “domestic industry”. Subject to a few exceptions, “domestic industry” refers to the domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products.

Clear-cut procedures have been established on how anti-dumping cases are to be initiated and how such investigations are to be conducted. Conditions for ensuring that all interested parties are given an opportunity to present evidence are set out. Provisions on the application of provisional measures, the use of price undertakings in anti-dumping cases, and on the duration of anti-dumping measures have been strengthened. Thus, a significant improvement over the existing Agreement consists of the addition of a new provision under which anti-dumping measures shall expire five years after the date of imposition, unless a determination is made that, in the event of termination of the measures, dumping and injury would be likely to continue or recur.

A product regarded as dumped when its export price is less than the normal price in the exporting country or its cost of production plus a reasonable amount for administrative, selling and any other costs and for profits. For the purpose of this Agreement, a product is to be considered as being dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.

Anti dumping measures can be employed only if dumped imports are shown to cause serious damage to the domestic industry in the importing country. Further, antidumping measures are not allowed if the margin of dumping (i.e., the price differences) is de minimis (defined as 2 per cent of the export price of the product) or the volume of dumped imports is negligible (less than 3 per cent of imports of the product in question)

Dumping occurs when the price at which the goods are exported to India is lower than their normal value. The difference between this export price and the normal value is known as the margin of dumping. It is generally expressed as a percentage of the export price. In the ordinary course of trade, the normal value is the comparable price at which goods under complaint are sold in the domestic market of the exporting country or territory. If the normal value cannot be determined this way, the following two alternative methods are provided for

1. Comparable representative export price to an appropriate third country
2. Cost of production in the country of origin with reasonable addition for administrative, selling and general costs and for profits.

In India, anti – dumping actions are taken by the Directorate of Anti Dumping and Allied Duties, Ministry of commerce, as per the Customs Tariff Act, 1975, as amended in 1995, based on Article VI of GATT 1994. For the government to initiate anti dumping action, the Indian industry must be able to show that dumped imports are causing or threatening to cause material injury to the Indian domestic industry. Obviously, the ability of India to do so depends on proper environmental monitoring, database and procedural familiarity. Material retardation to the establishment of an industry is also regarded as injury. For anti dumping actions, a causal link between the material injury being suffered by the Indian industry and the dumped imports must be established.

The economic and financial impact of the dumped imports on the concerned Indian industry can be demonstrated, inter alia, by decline in output, loss of sales, loss of market share, reduced profits, decline in productivity, decline in capacity utilization, reduced return on investments, price effects, and adverse effects on cash flow, inventories, employment,

wages, growth, invested, ability to raise capital etc. Anti dumping action is not applicable if the margin of dumping is insignificantly small (less than two per cent of the export price) or the volume of imports is negligible (i.e., the volume from one country is less than three per cent of the total imports of that product), provided the aggregate imports from such countries do not account for more than seven per cent of total imports. Anti dumping duty shall not exceed the margin of dumping. It is suggested that it would be desirable of the appropriate authorities impose a lesser duty which is adequate to remove the injury caused to the domestic industry. The Government of India has accepted this principle. Anti dumping actions may be suspended or terminated if the exporter concerned furnishes an undertaking to revise the price to remove the dumping or the injurious effect of dumping. The rules also provide for retrospective measures in certain cases. The anti dumping investigation process is presented in table below.

| Anti Dumping Investigation Process | | |
|---|-----------|---|
| 1. Preliminary Screening | | |
| 2.a. Rejection unsubstantiated information, etc | OR | 2.b. Proceedings Initiation, if a case is suspected |
| | | 3. Exporting country allowed to modify practice |
| | | 4. Preliminary findings |
| | | 5. Final findings and measure |

Safeguard Actions

Members may take safeguard actions, i.e., import restrictions to protect a domestic industry from the negative effects of an unforeseen import surge, if a domestic industry is threatened with serious injury. The UR Agreement however, prohibits the use of such actions where they constitute grey area measures, including voluntary export restraints, orderly marketing arrangements or other similar measures applied on either exports or imports. The existing grey area measures are to be phased out by 1999. Further, the Agreement provides for discipline on the use of all safeguard measures, including time limits, requirements for safeguard investigation, and non discrimination (generally) among sources of supply.

Safeguard measures would not be applicable to developing countries where their share in the member country's imports of the product concerned is relatively small.

GATT/WTO Provisions Relating to Other Non-Tariff Barriers

A number of agreements deal with various **non-tariff barriers like** bureaucratic or legal issues that could involve hindrances to trade. Import licensing, Rules for valuation of goods at customs, Pre-shipment inspection, Rules of origin, etc are there.

Import Licensing Procedures: Although less widely used now than in the past, import licensing systems are subject to disciplines in the WTO. The **Agreement on Import Licensing Procedures** says import licensing should be simple, transparent and predictable. For example, the agreement requires governments to publish sufficient information for traders to know how and why the licences are granted. It also describes how countries should notify the WTO when they introduce new import licensing procedures or change existing procedures. The agreement offers guidance on how governments should assess applications for licences. Some licences are issued automatically if certain conditions are met. The agreement sets criteria for automatic licensing so that the procedures used do not restrict trade. Other licences are not issued automatically. Here, the agreement tries to minimize the importers' burden in applying for licences, so that the administrative work does not in itself restrict or distort imports. The agreement says the agencies handling licensing should not normally take more than 30 days to deal with an application— 60 days when all applications are considered at the same time.

Rules for valuation of goods at customs: For importers, the process of estimating the value of a product at customs presents problems that can be just as serious as the actual duty rate charged. The WTO agreement on customs valuation aims for a fair, uniform and neutral system for the valuation of goods for customs purposes— a system that conforms to commercial realities, and which outlaws the use of arbitrary or fictitious customs values. The agreement provides a set of valuation rules, expanding and giving greater precision to the provisions on customs valuation in the original GATT.

A related Uruguay Round ministerial decision gives customs administrations the right to request further information in cases where they have reason to doubt the accuracy of the declared value of imported goods. If the administration maintains a reasonable doubt, despite any additional information, it may be deemed that the customs value of the imported goods cannot be determined on the basis of the declared value.

Pre-shipment inspection: Preshipment inspection is the practice of employing specialized private companies (or “independent entities”) to check shipment details— essentially price, quantity and quality — of goods ordered overseas. Used by governments of developing countries, the purpose is to safeguard national financial interests (preventing capital flight, commercial fraud, and customs duty evasion, for instance) and to compensate for inadequacies in administrative infrastructures.

The Preshipment Inspection Agreement recognizes that GATT principles and obligations apply to the activities of preshipment inspection agencies mandated by governments. The obligations placed on governments which use preshipment inspections include non-discrimination, transparency, protection of confidential business information, avoiding unreasonable delay, the use of specific guidelines for conducting price verification and avoiding conflicts of interest by the inspection agencies. The obligations of exporting members towards countries using preshipment inspection include non-discrimination in the application of domestic laws and regulations, prompt publication of those laws and regulations and the provision of technical assistance where requested.

The agreement establishes an independent review procedure. This is administered jointly by the International Federation of Inspection Agencies (IFIA), representing inspection agencies, and the International Chamber of Commerce (ICC), representing exporters. Its purpose is to resolve disputes between an exporter and an inspection agency.

Rules of origin: “Rules of origin” are the criteria used to define where a product was made. They are an essential part of trade rules because a number of policies discriminate between exporting countries: quotas, preferential tariffs, anti-dumping actions, countervailing duty (charged to counter export subsidies), and more. Rules of origin are also used to compile trade statistics, and for “made in...” labels that are attached to

products. This is complicated by globalization and the way a product can be processed in several countries before it is ready for the market.

The Rules of Origin Agreement requires WTO members to ensure that their rules of origin are transparent; that they do not have restricting, distorting or disruptive effects on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard (in other words, they should state what *does confer origin rather than what does not*).

For the longer term, the agreement aims for common (“harmonized”) rules of origin among all WTO members, except in some kinds of preferential trade— for example, countries setting up a free trade area are allowed to use different rules of origin for products traded under their free trade agreement. The agreement establishes a harmonization work programme, based upon a set of principles, including making rules of origin objective, understandable and predictable. The work was due to end in July 1998, but several deadlines have been missed. It is being conducted by a Committee on Rules of Origin in the WTO and a Technical Committee under the auspices of the World Customs Organization in Brussels. The outcome will be a single set of rules of origin to be applied under non-preferential trading conditions by all WTO members in all circumstances.

GATT/WTO Provisions Relating to Customs Valuation

Customs valuation is a customs procedure applied to determine the customs value of imported goods. If the rate of duty is ad valorem, the customs value is essential to determine the duty to be paid on an imported good.

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Specific and ad valorem customs duties: Customs duties can be designated in either specific or ad valorem terms or as a mix of the two. In case of a specific duty, a concrete sum is charged for a quantitative description of the good, for example USD 1 per item or per unit. The customs value of the good does not need to be determined, as the duty is not based on the value of the good but on other criteria. In this case, no rules on customs valuation are needed and the Valuation Agreement does not apply. In contrast, an ad valorem duty depends on the value of a good. Under this system, the customs valuation is multiplied by an ad valorem rate of duty (e.g. 5 per cent) in order to arrive at the amount of duty payable on an imported item.

Article VII GATT

Article VII of the General Agreement on Tariffs and Trade laid down the general principles for an international system of valuation. It stipulated that the value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values. Although Article VII also contains a definition of “actual value”, it still permitted the use of widely differing methods of valuing goods. In addition, ‘grandfather clauses’ permitted continuation of old standards which did not even meet the very general new standard.

Brussels definition of value: Starting in the 1950s, customs duties were assessed by many countries according to the Brussels Definition of Value (BVD). Under this method, a normal market price, defined as “the price that a good would fetch in an open market between a buyer and seller independent of each other,” was determined for each product, according to which the duty was assessed. Factual unlimited upward deviations from this price and upto 10 per cent downward variations were

taken into account up to. This method caused widespread dissatisfaction among traders.

Tokyo Round Valuation Code: The Tokyo Round Valuation Code, or the Agreement on Implementation of Article VII of the GATT, concluded in 1979, established a positive system of Customs Valuation based on the price actually paid or payable for the imported goods. Based on the “transaction value”, it was intended to provide a fair, uniform and neutral system for the valuation of goods for customs purposes, conforming to commercial realities. This differs from the “notional” value used in the Brussels Definition of Value (BVD). As a stand-alone agreement, the Tokyo Round Valuation Code was signed by more than 40 contracting parties.

The new Agreement: The Tokyo Round Code was replaced by the WTO Agreement on Implementation of Article VII of the GATT 1994 following conclusion of the Uruguay Round. This Agreement is essentially the same as the Tokyo Round Valuation Code and applies only to the valuation of imported goods for the purpose of levying ad valorem duties on such goods. It does not contain obligations concerning valuation for purposes of determining export duties or quota administration based on the value of goods, nor does it lay down conditions for the valuation of goods for internal taxation or foreign exchange control.

Basic Principle: Transaction value: The Agreement stipulates that customs valuation shall, except in specified circumstances, be based on the actual price of the goods to be valued, which is generally shown on the invoice. This price, plus adjustments for certain elements listed in Article 8, equals the transaction value, which constitutes the first and most important method of valuation referred to in the Agreement.

Delay of application of the Agreement for five years for developing countries

Article 20.1 allows developing country Members, not party to the Tokyo Round Code, to delay application of the provisions of the Agreement for a period of five years from the date of entry into force of the WTO Agreement for the Member concerned.

Delay of application of the computed value method for three years following the application of all other provisions of the Agreement:

Article 20.2 allows developing country Members, not party to the Tokyo Round Codes to delay application of the computed value method for a period not exceeding three years following their application of all other provisions of the Agreement. In practice, this means that developing country Members, not party to the Tokyo Round Code, can delay the computed value method a total of 8 years.

Committee on Customs Valuation: The Agreement establishes a Committee on Customs Valuation composed of representatives from each of the Members for the purpose of affording Members the opportunity to consult on matters relating to the administration of the customs valuation system by any Member or the furtherance of the objectives of the Agreement.

Technical Committee on Customs Valuation: The Agreement also establishes a Technical Committee on Customs Valuation under the auspices of the World Customs Organization with a view to ensuring, at the technical level, uniformity in interpretation and application of the Agreement. The responsibilities of the Technical Committee include advising on specific technical matters as requested by Members or by a panel in a dispute.

GATT/WTO Provisions Relating to Dispute Settlement

A proper mechanism for settling disputes is essential for effective and smooth functioning of a rule based system. The WTO's procedure underscores the rule of law, and it makes the trading system more secure and predictable. The system is based on clearly defined rules, with timetables for completing a case.

WTO members have agreed that if they believe fellow members are violating trade rules, they will use the multilateral system of settling disputes instead of taking action unilaterally. That means abiding by the agreed procedures, and respecting judgments. Typically, a dispute arises when one country adopts a trade policy measure or takes some action that one or more fellow WTO members considers to be breaking the WTO agreements, or to be a failure to live up to obligations. A third

group of countries can declare that they have an interest in the case and enjoy some rights.

A procedure for settling disputes existed under the old GATT, but it had no fixed timetables, rulings were easier to block, and many cases dragged on for a long time inconclusively. The Uruguay Round agreement introduced a more structured process with more clearly defined stages in the procedure. It introduced greater discipline for the length of time a case should take to be settled, with flexible deadlines set in various stages of the procedure. The agreement emphasizes that prompt settlement is essential if the WTO is to function effectively. It sets out in considerable detail the procedures and the timetable to be followed in resolving disputes. If a case runs its full course to a first ruling, it should not normally take more than about one year – 15 months if the case is appealed. The agreed time limits are flexible, and if the case is considered urgent (e.g. if perishable goods are involved), then the case should take three months less.

The Uruguay Round agreement also made it impossible for the country losing a case to block the adoption of the ruling. Under the previous GATT procedure, ruling could only be adopted by consensus, meaning that a single objection could block the ruling. Now, ruling are automatically adopted unless there is a consensus to reject a ruling any country wanting to block a ruling has to persuade all other WTO members (including its adversary in the case) to share its view.

Although much of the procedure does resemble a country or tribunal, the preferred solution is for the countries concerned to discuss their problem and settle the dispute by themselves. The first stage is therefore consultations between the governments concerned, and even when the case has progressed to other stages, consultation and mediation are still always possible.

Implications of WTO to Important Sector – GATS

The General Agreement on Trade in Services (GATS) which extends multilateral rules and disciplines to services is regarded as a landmark achievement of the UR, although it achieved only little in terms of immediate liberalization.

Because of the special characteristics and the socio-economic and political implications of certain services, they have been generally subject to various types of national restrictions. Protective measures include visa requirements, investment regulations, restraints on repatriation, marketing regulations, restrictions on employment of foreigners, compulsions to use local facilities, etc. Heavily protected services in different countries include banking and insurance; transportation; television, radio, film and other forms of communication; and so on.

The GATS defines services as the supply of a service from the territory of one member (country) into the territory of any other member; in the territory of one member to the service consumer of any other member; by a service supplier of one member, through commercial presence in the territory of any other member; or by a service suppliers of one member in the territory of any other member.

In short, the GATS cover **four modes of international delivery of services**.

| |
|--|
| Cross border supply (transborder data flows, transportation services) |
| Commercial presence (provision of services abroad through FDI or representative offices) |
| Consumption abroad (tourism) |
| Movement of personnel (entry and temporary stay of foreign consultant) |

While industrial countries have offered market access commitment of some kind on over half (about 54 per cent) of their service activities, developing categories. Tourism and travel related services are the only activities in which substantial number o developing countries made commitments. The framework of GATS includes basic obligation of all member countries on international trade in services, including financial services, telecommunications, transport, audio visual, tourism, and professional services, as well as movement of workers.

Among the obligations is a most favoured nation (MFN) obligation that essentially prevents countries from discriminating amount foreign suppliers of services. Another obligation is the transparency requirements according to which each member country shall promptly publish all its relevant laws and regulations pertaining to services including

international agreements on trade in services to which the member is a signatory. Further, each member shall also respond promptly to all requests for specific information, by any other member, pertaining to any aspect of the service covered by the GATS. Each member shall also establish one or more enquiry points to provide specific information to other members. However no member needs to provide any confidential information, the disclosure of which would impede law enforcement, or otherwise be contrary to public interest, or which would prejudice legitimate commercial interests of particular enterprise, public or private.

The GATS lays down that increasing participation of developing countries in world trade shall be facilitated through negotiated commitments on access to technology, improvements in access to distribution channels and information networks and the liberalization of market access in sectors and modes of supply of export interest to them. With reference to domestic regulation, the Agreement lays down that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. There would be a requirement that parties establish ways and means for prompt reviews of administrative decisions relating to the supply of services.

It is recognized that particular pressures on the balance of payments of a Member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, inter alia, the maintenance of a level of financial reserves adequate for the implementation of its program of economic development or economic transition. A member country may, therefore, apply restrictions on international transfers and payments for current transactions under certain circumstances envisaged under the GATS. In the event of serious balance of payments and external financial difficulties or threat thereof, a member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments including on payments or transfers for transactions related to such commitments. The commitments of member countries under the GATS also include national treatment (that is, to treat foreign suppliers of service like domestic suppliers) and provision of market access. The Agreement on Trade in Services also establishes the basis for progressive liberalization of trade in services through successive rounds of negotiations, which also applies to other agreements under the Final Act.

As stated earlier, the fear of the developing countries is that the liberalization of trade in services will lead to the domination of the services sector of the developing countries by the multinationals of the industrialized countries. As a matter of fact, the trade in services is already dominated by the developed countries. The developing countries are net importers of services and their deficit has been growing. The apprehension is that a liberalization of trade in services will accentuate the problem.

Although many services are labour intensive and, therefore, the developing countries should be expected to have an advantage here, there have been several constraints in benefiting from this advantage. These include, technical, organizational, financial and legal. Moreover, immigration laws of developed countries restrict the manpower flow from the developing to developed countries. This severely limits the scope of developing countries in benefiting from their comparative advantage. It may be noted that the industrial countries did not like to bring this issue in the Uruguay Round.

Implications of WTO to Important Sector – TRIPS

One of the most controversial outcomes of the UR is the Agreement of Trade Related Aspects of Intellectual Property Rights including trade in counterfeit Goods (TRIPS). TRIPs along with TRIMs and services were called the “new issues” negotiated in the Uruguay Round.

Protection of intellectual property rights has become an issue of wide and serious discussion with the formation of the General Agreement on Trade Related Aspects of Intellectual property Rights (TRIPs) under the Uruguay Round (UR) Agreement of the GATT (now the WTO). Intellectual property rights may be defined as “information with commercial value”. IPRs have been characterized as a composite of “ideas, inventions and creative expression” plus the “public willingness to bestow the status of property” on them and give their owners the right to exclude others from access to or use of protected subject matter.” According to the WTO, intellectual property rights are the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time.

Patents Act, 1970 of India

Patents Act, 1970 of India underwent drastic reforms in 2005 with WTO provisions coming onto force with the passing of the transition time. A gist of the main provisions is presented below starting with definitions.

A. *Definitions*

“Invention” means a new product or process involving an inventive step and capable of industrial application; an invention, in order to be patentable, must be capable of being made or used in some kind of industry. In this context, “industry” should be understood in its broadest sense as including any useful, practical activity as distinct from purely intellectual or aesthetic activity, and does not necessarily imply the use of a machine or the manufacture of an article. An “invention” within the meaning of the Act is an invention for a manner of new manufacture that is in some way associated with trade and commerce; meaning traffic in goods, i.e., exchange of commodities for money or other commodities. Trade or commerce is carried with profit motive.

The expression “invention” has, therefore, been defined in the Act, to mean manner of manufacture; machine; substance produced by manufacture. The invention relates to the skill (art), series of action (process) or the particular way (method) or the way (manner) of making a product or thing. It also relates to machine or apparatus by which a thing is made and also the product which is the result of act of making. All these are associated with **“manufacture”**, which word: denotes either a thing made which is useful for its own sake and vendible as such; or means an engine or instrument to be employed either in the making of some previously known article or in some useful purpose or extending to new process to be carried on by known implements or elements acting upon known substances and ultimately producing some other known substance, but producing it in a cheaper or more expeditious manner, or of a better or more useful kind. An invention, to be patentable, must satisfy the following three conditions. **1. It is new. 2. It is useful to the society. 3. It is non-obvious to a person possessed of average skill in the art.** Exclusion of an invention from patentability for commercial exploitation is dealt below.

- i. **“Inventive Step”** means a feature of an invention that involves technical advance as compared to the existing knowledge or having economic significance or both and that makes the invention not obvious to a person skilled in the art
- ii. **“New Invention”** ‘means any invention or technology which has not been anticipated by publication in any document or used in the country or elsewhere in the world before the date of filing of patent application with complete specification, i.e. the subject matter has not fallen in public domain or that it does not form part of the state of the art’.
- iii. **“Patent”** means a patent for any invention granted under this Act. Patent is a grant or right to exclude others from making, using or selling one’s invention and includes right to license others to make, use or sell it. It is an official document conferring a right or privilege, letters patent; writing securing to an inventor for a term of years (now 20 years) the exclusive right to make, use and sell his invention; the monopoly or right so granted. The effect of the grant of patent is *quid pro quo*. The ‘*quid*’ is the knowledge disclosed to the public and ‘*quo*’ is the monopoly granted for the term of the patent. Patent once granted confers upon the patentee the exclusive privilege of making, selling and using the invention throughout India and of authorising others so to do. This is *quo*. The *quid* is compliance with the various provisions resulting in the grant of patent
- iv. **“Patentee”** is he to whom a patent has been granted. The term is usually applied to one who has obtained letter of patent for a new invention. Patentee includes assignee of patent whose name is entered into the register of patents.
- v. **“Patent Agent”** means a person for the time being registered under this Act as a patent agent;
- vi. **“Patented Article”** and **“Patented Process”** mean respectively an article or process in respect of which a patent is in force;
- vii. **“Patent Co-operation Treaty”** means the Patent Cooperation Treaty done at Washington on the 19th day of June, 1970 as amended and modified from time to time;

viii. “International Application” means an application for patent made in accordance with the Patent Cooperation Treaty;

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

B. Inventions Not Patentable

The following are not patentable Indian Patents Act, 1970-

1. Not considered as inventions

- (a) An invention which is frivolous or which claims anything obviously contrary to well established natural laws;
- (b) An invention the primary or intended use of which would be contrary to law or morality or injurious to public health;
- (c) Mere discovery of a scientific principle or the formulation of an abstract theory;
- (d) the mere discovery of any new property or new use for a known substance or of the mere use of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant;
- (e) A substance obtained by a mere admixture resulting only in the aggregation of the properties of the components thereof or a process for producing such substance;
- (f) Mere arrangement or re-arrangement or duplication of known devices each functioning independently of one another in a known way;
- (g) A method or process of testing applicable during the process of manufacture for rendering the machine, apparatus or other equipment more efficient or for the improvement or restoration of the existing machine, apparatus or other equipment or for the improvement or control of manufacture;
- (h) A method of agriculture or horticulture;

- (i) Any process for the medicinal, surgical, curative, prophylactic or other treatment of human beings or any process for a similar treatment of animals or plants to render them free of disease or to increase their economic value or that of their products.
- 2. *Inventions relating to atomic energy not patentable*: No patent shall be granted in respect of an invention relating to atomic energy falling within sub-section (1) of section 20 of the Atomic Energy Act, 1962 (33 of 1962).
- 3. *Inventions where only methods or processes of manufacture patentable*
 - i. In the case of inventions-
 - (a) Claiming substances intended for use, or capable of being used, as food or as medicine or drug, or
 - (b) Relating to substances prepared or produced by chemical processes (including alloys, optical glass, semi-conductors and inter-metallic compounds), no patent shall be granted in respect of claims for the substances themselves, but claims for the methods or processes of manufacture shall be patentable.
 - ii. Notwithstanding anything contained in section (i) above mentioned, a claim for patent of an invention for a substance itself intended for use, or capable of being used, as medicine or drug, is considered under certain circumstances.

C. Scope of IPRs

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

The UR Agreement on TRIPs, described under the two broad categories mentioned above, covers seven intellectual properties, viz.

- i. Copyright and related rights (i.e. the rights of performers, producers of sound recordings and broadcasting organization)
- ii. Trademarks including service marks
- iii. Geographical indication including appellations of origin
- iv. Industrial designs
- v. Patents including the protection of new varieties of plants
- vi. The layout designs of integrated circuits
- vii. Undisclosed information, including trade secrets and test data.

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

Objectives of Protection of Intellectual property

Encourage and regard creative work. The main social purpose of protection of copyright and relating rights is to encourage and reward creative work. This is also relevant to protection in other areas (e.g. industrial designs and patents).

Technological innovation. Intellectual property rights are designed to provide protection for the results of investment in the development of new technology, thus giving the incentive and means to finance research and development activities.

Fair competition: The protection of distinctive signs and other IPRs aims to stimulate and ensure fair competition among producers.

Consumer protection: The protection of distinctive signs should also protect consumers, by enabling them to make informed choices between various goods and services.

Transfer of technology: A functioning intellectual property regime should also facilitate the transfer of technology in the form of foreign direct investment, joint ventures and licensing.

Balance of right and obligations. While the basic social objectives of intellectual property protection are as outlined above, it should also be noted that the exclusive rights given are generally subject to a number of limitations and exceptions, aimed at fine tuning the balance that has to be found between the legitimate interests of right holders and of users.

Implications of WTO to Important Sector –TRIMS

Trade Related Investment Measures (TRIMs) refers to certain conditions or restrictions imposed by a government in respect of foreign investment in the country. TRIMs were widely employed by developing countries. The Agreement on TRIMs provides that no contracting party shall apply any TRIM which is inconsistent with the WTO Articles. An illustrative list identifies the following TRIMs as inconsistent.

- i. Local content requirement (i.e., a certain amount of local inputs be used in Products).
- ii. Trade balancing required (i.e., imports shall not exceed a certain proportion of exports)
- iii. Trade and foreign exchange balancing requirements
- iv. Domestic sales requirement (i.e., a company shall sell a certain proportion of its output locally)

The Agreement requires the notification of all WTO inconsistent TRIMs and their phasing out within two, five and seven years by industrial, developing and least developed countries respectively. Transition period can be extended for developing and least developed countries if they face difficulties in eliminating TRIMs. A number of TRIMs were employed in India prior to the liberalization ushered in 1991 and many of them have been phased out since then.

The **Trade-Related Investment Measures (TRIMs) Agreement** applies only to measures that affect trade in goods. It recognizes that certain measures can restrict and distort trade, and states that no member shall apply any measure that discriminates against foreigners or foreign products (i.e. violates “national treatment” principles in GATT). It also outlaws investment measures that lead to restrictions in quantities (violating another principle in GATT). An illustrative list of TRIMs

agreed to be inconsistent with these GATT articles is appended to the agreement. The list includes measures which require particular levels of local procurement by an enterprise (“local content requirements”). It also discourages measures which limit a company’s imports or set targets for the company to export (“trade balancing requirements”).

Under the agreement, countries must inform fellow-members through the WTO of all investment measures that do not conform to the agreement. Developed countries had to eliminate these in two years (by the end of 1996); developing countries had five years (to the end of 1999); and least-developed countries seven. In July 2001, the Goods Council agreed to extend this transition period for a number of requesting developing countries. The agreement establishes a Committee on TRIMs to monitor the implementation of these commitments. The agreement also says that WTO members should consider, by 1 January 2000, whether there should also be provisions on investment policy and competition policy. This discussion is now part of the Doha Development Agenda.

Self Assessment Questions

1. Give an account of the Regulatory Framework of WTO
2. Explain the Basic principles and Charter of GATT/WTO
3. Examine the GATT/WTO provisions on preferential treatment of developing countries
4. Discuss the compatibility of Regional groupings vis-à-vis WTO.
5. Give an account of the Regional Trade Associations and their role in promoting WTO’s goals.
6. Examine the WTO provisions on granting, reducing and removing Subsidies
7. What are the WTO provisions on Technical standards? Examine their purpose and opposition thereto.
8. What are dumping and antidumping? How are anti-dumping duties levied?
9. How does WTO go about complaints of dumping?
9. Explain the different non-tariff barriers? State the WTO provisions thereto?

10. Explain the WTO's provisions as to Custom valuation? What are the different methods of valuation and agreed agreements that prevail?
11. Explain the functions and propriety of Dispute settlement body of the WTO.
12. Examine the Implications of WTO in respect of GATS.
13. Examine the Implications of the provisions of WTO in respect of TRIPs.
14. Discuss Implications of WTO in regard to TRIMs.

CASE STUDY

Stylo Garments, one of the Pakistan's largest exporters of ready-made garments was recently hurt by the quota allocations imposed by the U.S. Because the U.S. was the firm's largest customer, its sales decreased by 40%. In order to counter balance this drastic sales drop Mr.Khan, the Company's Chairman, decided to enter the EEC market. The problem was that this market was highly fragmented, thus only a large number of relatively small orders were available.

Question

Evaluate the Pros and Cons of several alternatives that Mr.Khan might consider.

UNIT - III

Regulation & Treaties In International Business

Learning Objectives

The learning objectives from this lesson are as follows:

- To understand the concept and international treaty/legal provisions relating to Licensing in Global Business
- To understand the concept and international treaty/legal provisions relating to of Franchising in Global Business
- To understand the concept and international treaty/legal provisions relating to Joint Ventures in International Business
- To understand the concept and international treaty/legal provisions relating to Patents
- To understand the concept and international treaty/legal provisions relating to Trade Marks
- To understand the concept and international treaty/legal provisions relating to Technology Transfer
- To understand the concept and international treaty/legal provisions relating to Telecommunications
- To understand the international treaty/legal framework relating to Electronic Commerce

Concept and International Treaty/Legal Provisions Relating to Licensing in Global Business

Business licenses, permits and registrations are a necessary requirement for a business to operate, within or outside its country of origin. Business licensing fulfills several functions in our society. As a general rule, business licensing is part of its compliance and accountability

to its stakeholders which can include local, country, state and federal government as well as customers and vendors. Depending on the business location, the necessary licensing process can be complicated and costly, fraught with liability exposure for the business owner. On top of that, it may not be easy for the new business to find out about all of the licenses, permits and registrations it needs just to open its door and to keep its door open. The licenses, permits, registrations vary by location of the business including where its product are produced and sold and by the business' industry.

Definition of Licensing

Licensing can be defined as a contractual arrangement whereby one company (the licensor) makes an asset available to another company (the licensee) In exchange for royalties; license fees, or some other form of compensation. The licensed assume may be a patent, trade secret, or company name. Licensing is a form of global market entry and an expansion strategy with considerable appeal. A company with advanced technology, know-how, or a strong brand image can use licensing agreements to supplement its bottom-line profitability with little initial investment. Licensing can offer an attractive return on investment for the life of the agreement, providing the necessary performance clauses are in the contract. The only cost is the cost of signing the agreement and of policing its implementation.

Need for Business Licenses

Business licenses, permits and registrations serve the purpose of advising the licensing authorities that the business is functioning and meeting safety, soundness and tax regulations for the authorities. This is especially important if the business has employees or sells taxable goods and services. This means the business intends to comply with governing laws and regulations and intends to report to the authorities, the information the authorities require for the business to operate. An example is that a business generally needs to procure a tax identification number (TIN), so that the tax authorities can levy and collect taxes on the profits of the business. Failure to do so can have far-reaching civil and criminal penalties for the business and its owners significantly impacting the corporate liability protection for the owners. Another example is that

most local governments require a business to procure a business license in order to open their operation. Failure to do so means that the business will not be allowed to operate which also can significantly impact the profits and corporate liability protection for the owners.

If, for example, a when a restaurant in Pondicherry opens it needs to obtain the necessary licenses and permits from the local authority, the city administration, and various environmental and health and sanitation bodies. The city will probably insist on a basic business license and may be the licensing authority to issue a health permit and a license to sell alcoholic beverages. However, in some states, or county authority may be the authority to issue these permits and licenses. The restaurant will need to register with the State so it can collect sales tax receipts and withhold payroll taxes.

For accountability purposes: The business licenses, permits, and registrations can assure customers and vendors that it is capable of providing the service or product they are expecting. For a customer, an example is a patient would be interested in going to a physician licensed to practice medicine. In many cases, not only does a doctor have a personal professional license, but his practice may be part of a medical institution required to obtain a state issued occupational license for the practice. For a vendor, most local, county, and state governments offer lists of business licenses, permits and registrations. Vendors can obtain these lists and contact the business to sell their product or service, helping the business to succeed.

International Licensing as a Globalization Strategy

In its most general sense, licensing is a key mode of entry for firms considering international expansion. A licensing agreement gives a foreign company the rights to produce and/or sell another firm's goods in their country. The agreement also may include production and sales in more than one country. The licensee takes the risks and makes the investment in facilities for handling the manufacturing of the goods, as well as managing other supply chain linkages to deliver and even sell the goods to the final consumer. The licensor is normally paid a royalty on each unit produced and sold. Because there is little investment for the licensor, this method is seen as an easier way to become an international or global company.

Licensing is growing as manufacturers and retailers build their core businesses and change their strategies to include more licenses. Pharmaceuticals, Beverages, Foods, Cosmetics, Toiletries, White Goods, Hot Movies, etc are examples where licenses are granted globally. For example, Merck and Upjohn have licensed organizations in other parts of the world to manufacture and sell their pharmaceutical products. Other firms using licensing agreements in this way include McDonald's, Nestlé, Anheuser-Busch, and KFC.

The release of hot movies like the *Lord of the Rings* trilogy also triggers many license agreements and ties between mass merchandisers and licensors for toys, games, and children's apparel. Some retailers go so far as to demand exclusive agreements for licensed apparel and movie tie-in products in order to pursue marketplace differentiation strategies.

Service-based businesses also can benefit from licensing arrangements. Within the airline industry, many of the code-sharing arrangements that allow air-lines to sell each other's seats are much like licensing agreements. Airlines and other firms enter such agreements when they need help commercializing a new technology, expanding a brand franchise globally, or building a marketing image. Rather than entering a new or international market alone, licensing is a faster way to grow a market and achieve market-share dominance. It also may allow firms to gain a larger market for their non-licensed products.

In the early 2000s a growing number of technology companies began launching intellectual property (IP) licensing programs in order to turn dormant projects into revenue, penetrate new markets, and evaluate potential business partners. These firms conducted inventories of their knowledge bases and patent families, and identified technologies that were outside the core business yet still offered some potential for development. They then sought to license these technologies to other firms.

In *Licensing Journal*, George A. Frank explained: "Patents that some corporations had obtained for reasons not directly related to the development or transfer of technology were proving to be a vast untapped resource. IP licensing has now become a tremendous income source, and indeed is not an important benchmark by which a corporation's success is measured" (2004). IBM, for example, earns more than \$1 billion per year from its IP licensing program.

Every Licensing is Unique

There is no such thing as a standard license. Every arrangement is unique and has its own special requirements, aims and objectives. All licenses should be read and re-read and should be placed before a licensing professional or IP professional before being signed.

Needless to say, every license should be clear to all parties concerned. The individual parties should be aware of the obligations that the contract places on them, the conditions that have to be met and the time lines by which specific functions are to be performed. All of these features should be transparent and measurable. Each party should also be acutely aware of the other parties' responsibilities.

Territorial or geographical boundaries should be made clear, as should all payment obligations and the amounts that are to be paid (and how they are calculated). All payment, dates should be clearly laid out, preferably in a schedule.

Penalties, such as default payments, breach of contract conditions, rights to assign, the term of the contract, and the rights to renew are also important considerations that are often overlooked or not fully understood. Bonus conditions might also be negotiated and should not be dismissed in a licensing agreement

Features of Every License

There are, though certain features that should be considered in the development of every license. The following is a list of some of the things that should be considered:

- Is the license exclusive, i.e. granted to only one person, or non-exclusive?
- Can the licensee sub-license?
- Are there any limitations to the license e.g., geographic or territorial?, minimum sales, minimum production requirement etc?
- What is the amount, frequency, and form of payment, e.g. either lump sum or by way of royalty, or both, or other payment schedule?

- Who pays for prosecution and maintenance of any Intellectual Property (IP) (patents, trademarks, designs)?
- How are any developments, modifications or improvements to be protected and who owns them?
- Who is responsible for filing for further improvement patents?
- In whose name will the applications be made in?
- Are there specific clauses relating to co-operation of licensor in matters relating to the IP such as infringement?
- Who pays for any matters such as preparation of the license, record of licensee, etc?
- Is there a required commitment on the part of the licensee to fully exploit the invention?
- Does the license contain a clause which allows for the license to be cancelled if the IP is not being used?
- What is the term of license?
- Is there a right to renew?
- What are the conditions of termination?
- When are royalty or other payments due?
- If sub-licensing is permitted what payment does the licensor receive?
- What information is the licensee committed to providing to the licensor?
- What happens if the IP under which the license is granted is refused, infringed, opposed, revoked or other?
- Is copyright a consideration?
- Does the licensee agree not to challenge the validity of the patent?
- Does the licensor agree to provide essential “know-how”?
- What provisions for any “hardware”, should the license be terminated?
- How will any disputes be resolved?
- What happens in the event of death of one of the parties?

Difference Between a License and Distribution Agreements

Distribution agreements, licenses and franchise agreements are all legal vehicles which allow business to be conducted efficiently and the business interests of both parties to be identified and protected. The agreements do not have to be complicated documents shrouded in mystery. They should be simple scripts which are easily understood and simple to read. Ideally the agreements should lay a platform for the success of the business arrangement and should be reviewed at a regular basis. No agreement should be entered into without seeking the advice of an IP professional or franchising lawyer.

A license arrangement is a business arrangement where a licensor via a monopoly right such as a Patent, a Trade Mark, a design or a copyright has to exclusive right which prevents others from exploiting the idea, design, name or logo commercially. The license allows the licensee to use make and sell, the product or name for a fee without censure. In a Trade Mark license, for example, the licensee will be granted full privilege to use the Trade Mark on goods or services provided that the use is in accordance with agreed signage protocols and quality guidelines. There is usually no training component, product development strategy and limited marketing support.

A distribution agreement is a contract between a manufacturer, producer or importer and the seller or distributor. The majority of distributorships are non-exclusive. As a consequence a franchise may offer significant advantages in terms of market presence dominance. The distributor may be an exclusive agent selling only those goods belonging to the producer or, as is normally the case, the exclusive agent is the only distributor of particular producer's goods in the market. And exclusive distributorship may allow the distributor to grant sub-distribution licenses.

Concept And International Treaty/Legal Provisions Relating To Of Franchising In Global Business

Franchising is a system of business that has grown steadily since early 1960s and is estimated to account for more than one-third of the world's retail sales. There are very few of us who are not touched by the

results of franchising. Franchises range from the ubiquitous McDonalds' to valet services, medical and dental services, to book keeping services and even to services helping us to prepare our tax forms. Franchising is a term which can be applied to just about any area of economic endeavour. Franchising encompasses products and services from the manufacture, supply for manufacture, processing, distribution and sale of goods, to the rendering of services, the marketing of those services, their distribution and sale. There are now franchises for mentoring managers and sportspeople and franchises for internet shopping. Successful franchises are the result of innovation, initiative, investment and industry. A good franchise is always sparked by a good idea which fills a market need.

Definition and Features of Franchising

Franchising may be defined as a "business arrangement which allows for the reputation, (goodwill) innovation, technical know-how and expertise of the innovator (franchisor) to be combined with the energy, industry and investment of another party (franchisee) to conduct the business of providing and selling of goods and services". Franchise arrangements have grown so rapidly in the last 20 years or so, world- wide, simply due to the fact that franchises are an effective way of combining the strengths, skills and needs of both the franchisor and the franchisee. To be truly successful, the one is reliant on the other. In most instances, franchising combines the know-how of the franchisor with the where-withal of the franchisee and, in the more successful franchising systems, the energy of both.

There are a number of reasons why franchises have become the fastest growing way of doing business but the most worthy explanation is that franchising and franchises are simply filling a market need. The 1980's and 1990's brought radical changes to the employment market and the way people worked. A series of oil-shocks and severe stock market corrections, a freeing up of the world economy, reduction in subsidies, government deregulation and downsizing has thrust into the job market capable, energetic and resourceful people who want to work for themselves. Franchisees are, in the majority of cases, people who have previously been employed by someone else and a franchise opportunity is seen as a more relaxed way of making the transition from working for an employer to being self employed. The risk factor of a proven business is also seen as a

better option than breaking totally new ground. Franchises are invariably taken up by people who are prepared to invest in themselves, their personality and their skills - those fleeing the angst of office or corporate politics and looking for employment freedom and the rewards that hard work will bring.

Because franchises are a personal investment, not only in the equity invested in the business, but also in the time and energy required to achieve success, it is important when choosing a franchise to take that a few commonsense precautions. Who knows what the future will bring? The only thing that we can be sure of, is that if there is a need in the market place, it is more than likely going to be filled by an innovative and creative business which is seeking to capitalize on its market lead and Intellectual Property advantage through some form of franchising scheme.

Modes Operandi of Franchising

In a basic franchising arrangement the franchisor has developed a system for conducting business. The system has been found to be successful. The franchisor wishing to emulate the success of that business system, usually in a different geographic area, establishes a blueprint for others also wishing to emulate this success to operate the same business using the same name and same systems. You know the franchised businesses will have similar outlets, colours, contours and contexts, so that any one at the first sight of the outlet will immediately associate with the franchisor business. In franchise business, a **blueprint “system”** for repeating success was established, developed, updated and monitored requiring the investment of time, money – and innovation. This innovation ensured that client expectations are met, anticipated and managed and, of course – the innovation resulted in a unique, memorable and exclusive name being devised and a unique brand established.

The franchise arrangement is an arrangement whereby the franchisor permits – licenses the franchisee, in exchange for a fee, to exploit the system developed by the franchisor. The franchised system is generally a package including the intellectual property rights – such as the rights to use the Trade Mark, trade names, logos, “get-up” and contours and even colours associated with the business; any inventions such as patents or designs, trade-secrets, and know-how of the business and

any relevant brochures, advertising or copyrighted works relating to the manufacture, sale of goods or the provision of services to customers. The Intellectual Property is unique to the business and provides the business with its competitive advantage and market niche.

Types of Franchising

A typical franchise system will generally include: license to use the system, shared development and improvement obligation or franchisor's right to determine how the business operates.

i. A license to use the System

In return for an agreed amount the franchisee is granted a license to conduct his or her business along the lines prescribed by the franchisor. This will usually include the use of all relevant Intellectual Property, marketing and advertising publications, store design and "get-up", as well specialized equipment necessary to operate the systems and on-going or development and improvements to the system.

ii. A Shared Development and Improvement Obligation

Most franchising arrangements have an on-going shared development and improvement obligation which is dependent on both the franchisor and franchisee. This requires a mutual trust and respect and a sharing of the overall aims and goals of the franchise. The basic tenant for this approach is that what is good for one must be good for the other. The franchisor is also obligated in the arrangement to nurture, encourage and provide assistance to the franchisee. The franchisee for their part is required to maintain and promote the franchise and to conduct business prescribed in the system manuals and best practice guidelines. The franchisee also has the continuing obligation to pay maintenance fees to the franchisor in accordance with the franchise arrangement. These fees usually include an advertising / marketing component an on-going service fee.

iii. The Franchisor's Right to Determine how the Business Operates

Most Franchise arrangements contain a component which stipulates that the franchisee is to conduct the business along prescribed

guidelines and in accordance with the franchise best operating practice. The franchisor for his part is required to maintain, distribute and update the manuals, operating procedures and quality requirements when changes are made – and to provide on-going training. The franchise arrangement will usually also require the franchisee to protect the Intellectual Property of the franchise system, and to operate in accordance with territorial or geographical obligations agreed. Both parties will be required to conform to the agreed accounting disclosure provisions. The franchising arrangement is a legal document relying on contract law and inevitably on mutual trust between both parties.

Advantages of Franchising

- Freedom of employment
- Proven product or service outcomes
- Semi-monopoly; defined territory or geographical boundaries
- Proven brand, trade mark, recognition
- Shared marketing, advertising, business launch campaign costs
- Industry know-how
- Reduced risk of failure
- Access to proprietary products or services
- Bulk buying advantages
- On-going research and development

Legal Aspects in Franchising

There are three main legal aspects in franchising which makes clear certain grey areas in modes of operation of franchise.

- a. **Substantial Association with Trademark leads to creation of a franchise:** The business must be substantially associated with the franchisor's trademark or other commercial symbol for the business to be a franchise. This usually takes the form of a license to use the franchisor's name. Because franchise laws were enacted to remedy perceived abuses in the treatment of franchisees, courts will often interpret those laws broadly. One California court found that there was substantial association with a company's trademark even though

its use was prohibited and the mark was never communicated to the customers of the business. The contract between an operator of an office building employee cafeteria and its licensor involved substantial association with the licensor's trademark because the property owner was familiar with the reputation of the licensor, and that, the court found, was sufficient to render the contract a franchise agreement.

- b. Payment of a Fee need not be labeled as Franchise fee:** A payment by a franchisee does not have to be labeled a franchise fee to satisfy this element of the definition. Ongoing royalty payments or payments characterized otherwise, such as consulting fees, training fees, or site assistance fees, are sufficient, as long as they are for the right to operate the business. In one puzzling case, the required ongoing purchases of sales and service manuals by a franchisee that exceeded a certain threshold over a 20-year relationship resulted in a finding that a franchise had been created. Each of the franchise laws exempts payments for goods for resale if the purchaser pays a bona fide wholesale price and if the purchaser is not required to purchase more than an amount that a reasonable businessperson would for his or her inventory.
- c. Marketing Plan/Community of Interest/Significant Control:** Most states follow California's lead and adopt as a third element a requirement that a franchisor prescribe a marketing plan in substantial part. Whether or not a marketing plan is present is a fact-driven analysis: Does the licensor provide promotional materials? Is there an operation manual? Does the licensor provide training that must be completed to its satisfaction? Is the putative franchisee free to make most decisions without first obtaining the licensor's consent? The types of controls that the licensor exerts must be substantial, and not just with respect to a small part of the business.
- d. Unusual Condition for Franchise:** In some countries, a franchise needs just two conditions, the franchise fee element and either the trademark element or the marketing plan element.
- e. Elaborate Requirement for establishing existence of Franchise:** Some countries employ a somewhat different standard to prove

whether or not a franchise existed between two parties. These are:

The parties must have a **community of interest** in the operation of the business. This concept is difficult to define with precision. At a minimum, there must be a **continuing financial interest** between the parties and they must be interdependent. Factors that are salient in determining whether a community of interest exists include the **length of time the parties have been involved** with one another; the **extent and nature** of their obligations; the relative amount of **time and revenue** attributable to the licensor's products or services; the percentage of revenues received from the licensor's products or services; any **territorial grant**; the **use of the licensor's trademarks** by the putative franchisee; the investment in inventory, facilities, and goodwill; the proportion of **the putative franchisee's personnel** that work on this part of the business; **advertising expenditures** for the licensor's products or services; and the extent of any supplemental services.

- f. **Regulation of Franchising:** Regulation of the offer and sale of franchises need to be legalized. Franchise Regulation may mandate disclosure or registration or both. There are Uniform Franchise Offering Circular Guidelines for the disclosure of format of choice, and disclosure documents. Franchisors' disclosure documents are now referred to as franchise disclosure documents or FDDs. The legal requirements range from requiring filing of an annual notice to a full-fledged review of a franchise registration application and a renewal registration application on an annual basis.
- g. **Rights of Franchisees Relationship Laws:** There are also laws that are focused on the rights of franchisees in existing franchise relationships. There are also other statutes addressing specific industries, most notably petroleum dealers, automobile dealers, farm equipment dealers, and alcoholic beverage distributorships. These laws also restrict the power of franchisors over franchise terminations, renewals, transfers, and certain other aspects of the franchise relationship. The statutes usually require good cause for termination, which is defined as a material breach of the franchise agreement. The laws often impose a requirement of a notice of default and an opportunity to cure. These statutes also can restrict a franchisor's right to refuse to consent to a transfer by the franchisee to situations in which the franchisor has good cause. They often

make it unlawful for a franchisor to interfere with franchisees' right to form a franchise association. Finally, a number of nations do not allow a franchisor to require that litigation be conducted in an out-of-state forum.

- h. Exemptions and Exclusions:** There are various exemptions adopted which are far from uniform from nation to nation. Some provide for exemption from registration and disclosure; others from registration only. Among the more typical exemptions are those for high net worth franchisors, often paired with an experience component; sophisticated franchisee exemptions, based on the franchisee's net worth, experience, or investment; and fractional franchises, which involve situations in which the franchised business comprises a small part of the franchisee's overall business.
- i. Business Opportunity Laws:** Like franchise laws, business opportunity laws are broad in the transactions they cover and their registration and disclosure requirements are generally less uniform among nations than those in the franchise arena. The transactions covered involve payment of a fee for products or services to conduct a business in which the seller makes at least one of several types of representations.

Disclosure Issues

Franchisors must present information on scores of different disclosure topics in their FDDs: These are as follows:

- i. Franchisor and its parents, predecessors, and affiliates;
- ii. Business experience of its principal officers, directors, and managers;
- iii. Litigation;
- iv. Bankruptcy;
- v. Initial fees that the franchisee must pay;
- vi. Other fees;
- vii. An estimate of the franchisee's initial investment;
- viii. Restrictions that the franchisor imposes on products and services;

- ix. Franchisee's obligations during the relationship;
- x. Financing that might be available through the franchisor;
- xi. Franchisor's obligations to provide assistance and information about advertising, computer systems, and training;
- xii. Territorial rights that the franchisee will receive;
- xiii. Franchisor's trademarks; its patents, copyrights, and proprietary information;
- xiv. Franchisee's obligation to participate in the actual operation of the franchise business;
- xv. Restrictions on what the franchisee may sell;
- xvi. Information about renewal, termination, transfer, and dispute resolution;
- xvii. Any public figures who endorse the franchise;
- xviii. Optional financial performance representations;
- xix. Information about outlets and franchisees;
- xx. Franchisor's financial statements;
- xxi. List of contracts required of the franchisee;
- xxii. Receipt form.

Issues in the Franchise Relationship

Following is a summary of some of the **hot-button** issues that have occupied franchisors, franchisees, and the courts over the past decades.

- a. **Franchisor's Right to be explicitly provided for:** Franchisors almost always retain the right to deliver the goods and services associated with the brand through other outlets, whether owned by the franchisor or another franchisee. Franchisors also may distribute goods through alternate channels of distribution such as the Internet, mail order, catalog sales, or sales of branded products through supermarkets. Franchisees have challenged such rights as encroachment upon their franchise rights. It was held that even where a franchisor provided a **non-exclusive** territory to a franchisee, the franchisor did not necessarily retain an unfettered right to place other units in the surrounding area unless that right was expressly retained.

- b. Inconsistent results in use of alternate channels of distribution:** Inconsistent results have been obtained in cases challenging the franchisor's use of alternate channels of distribution, usually turning on the specific language in the franchise agreement. Internet sales by franchisors also have proven nettlesome. In many circumstances, Internet sales have been upheld.
- c. System-wide Change by Franchisors upheld:** Franchise relationships are usually long-term relationships that, with renewals, can span generations. As times change, franchisors change their systems to remain competitive: system-wide changes are usually established by changes in the operations manual. Franchisees are not always happy with system-wide changes dictated by the franchisor and this issue is often litigated. Generally, the right of franchisors to make changes in their systems has been upheld. The franchisor's right to change the system may be limited where it directly benefits the franchisor at the franchisees' expense.
- d. Antitrust or anti-competition Issues:** At one time, the battle between franchisors and franchisees was waged primarily in the antitrust arena. Franchisors have right to force franchisees to source supplies from the franchisor and in the process eliminate other authorized suppliers and designate itself as the sole authorized supplier of relevant ingredients without creating an unlawful tie/association.
- e. Not a Fiduciary Relationship:** Courts for the last 25 years have held that the franchise relationship is not a fiduciary relationship.
- f. Vicarious Liability:** Franchisors are often sued by persons who allege that they were injured on franchised premises. Generally, franchisors are not liable for such claims if they do not control the day-to-day operations of the location.
- g. Noncompetition:** A frequent source of contention in the franchise relationship arises from covenants against competition. Laws across nations vary widely on this issue. Generally, in-term covenants are considered to be enforceable, with post-term covenants enforceable in some states and against strong public policy in others. In some nations, covenants will be enforced if they impose reasonable geographical or temporal limits on competition. Some nations will

blue-pencil defective noncompetition provisions to bring them into compliance with the law, while others decline to do so.

- h. **Trade Secrets and Trade Dress:** Franchisors may freely enforce their rights to protect trade secrets and trade dress. Many states have adopted the Uniform Trade Secrets Act. The Act generally protects information, methods, and processes that have independent economic value because they are not generally known to the public, and where there have been reasonable efforts to maintain secrecy.
- i. **Transfer of System by the Franchisor:** Franchisors generally retain an unlimited right to sell franchise systems. Franchisees have frequently challenged these sales, with little success. In *Century Pacific v. Hilton*, 528 F. Supp. 2d 206 (S.D.N.Y. 2007, USA), the court held that a franchisor had the right to exercise its contractually retained right to sell the Red Lion franchise system, despite franchisee claims that they had been promised it would never be exercised.
- j. **Violation of Brand Standards:** Where franchisees fail to adhere to minimum brand standards, franchisors may bring suit to terminate the franchise. The right to do so may be limited by both contractual and statutory limitations, including notice and an opportunity to cure. Suit also may be brought against a terminated franchisee for continued use of trademarks.
- k. **International Franchising:** Some nations have laws with broad jurisdictional provisions that could extend to international transactions. Franchisors expanding into other countries also have to contend with an increasing number of non-domestic jurisdictions that regulate franchising, as well as with laws on such wide-ranging matters as commercial agency, technology transfer and language, choice of law, and venue restrictions.

Conclusion

The law of franchising has burgeoned into a complex international web of statutes, regulations, and cases. The field of franchise law draws upon a wide range of disciplines and contains many traps for the unwary.

Difference among a Distribution, License and Franchise Agreement

Distribution agreements, licenses and franchise agreements are all legal vehicles which allow business to be conducted efficiently and the business interests of both parties to be identified and protected. Ideally the agreements should lay a platform for the success of the business arrangement and should be reviewed at a regular basis. No agreement should be entered into without seeking the advice of an IP professional or franchising lawyer.

Distribution Agreement: The majority of distributorships are non-exclusive. As a consequence a franchise may offer significant advantages in terms of market presence dominance. A distribution agreement is a contract between a manufacturer, producer or importer and the seller or distributor. The distributor may be an exclusive agent selling only those goods belonging to the producer or, as is normally the case, the exclusive agent is the only distributor of particular producer's goods in the market. And exclusive distributorship may allow the distributor to grant sub-distribution licenses.

License Agreement: As already dealt, a license arrangement is a business arrangement where a licensor via a monopoly right such as a Patent, a Trade Mark, a design or a copyright has to exclusive right which prevents others from exploiting the idea, design, name or logo commercially. The license allows the licensee to use make and sell, the product or name for a fee without censure. In a Trade Mark license, for example, the licensee will be granted full privilege to use the Trade Mark on goods or services provided that the use is in accordance with agreed signage protocols and quality guidelines. There is usually no training component, product development strategy and limited marketing support.

Franchise Agreement: As previously discussed, a franchising arrangement might be considered to be a more robust arrangement for new entrants into a line of business. The franchise agreement covers obligations on both parties and includes a training, mentoring and technical advice component for the franchisee. A franchise agreement is a specialized license and will cover all aspects of IP, user obligations and use provisions. Franchising is in many ways as knowledge industry. The franchisor has as a result of innovation, intensive system development and

product refinement gained market acceptance and customer loyalty. The franchisor wishing to exploit his market position, shares his knowledge with the franchisee. The platform on which the franchise is built is its Intellectual Property. Franchisors gain their income by parting with this knowledge. The franchisor would be wise therefore to protect the Intellectual Property involved in the franchise and ensure the monopoly position is not eroded by seeking the advice of an IP professional with the aim of (where appropriate) giving Trade Marks, Patent or Design rights. The franchisor in order to successfully impart his knowledge and to assist franchisees also run successful businesses using his methods will communicate his methods via basic operating procedures manual, quality assurance manuals and training manuals. The strongest most durable franchise invariably has the most comprehensive work manuals and maintenance programs.

Concept and International Treaty/Legal Provisions Relating to Joint Ventures (JVS) in International Business

To meet the challenge of this trade liberalization, private business groups, particularly small and medium enterprises (SMEs), now no longer look merely at their parochial arenas but at the regional and world markets. Indeed, they must now manufacture, procure and sell goods and services that can stand competition with the best in the world. The battle cry is: Be the best or perish! To be sure, companies can meet the challenges of trade liberalization in various ways: by mergers, consolidations, absorption and partnerships. But for those entities not wanting to lose their separate identities or personalities, joint ventures present the more enticing solution.

Definitions of JVs

Of recent common-law origin, the term “joint ventures” has been defined in various ways and given various synonyms in the following legal references.

As per the International Trade Center Thesaurus of International Trade Terms, joint venture *is*, ‘the joining of forces between two or more enterprises, of the same or different countries, for the purpose of carrying out a specific operation (industrial, commercial, investment, production

or trade). This includes consortia, export consortia, export marketing groups, joint export marketing groups’.

According to *Corpus Juris Secundum*, A joint adventure is, ‘a legal relation of recent origin and is generally described as an association of persons to carry out a single business enterprise for profit. Joint enterprise, joint venture, and syndicate are terms similar to joint adventure and are sometimes used interchangeable with it’. A special combination of two or more persons, where in some specific venture a profit is jointly sought without any actual partnership or corporate designation, or as an association of persons to carry out a single business enterprise for profit, for which purpose, they combine their property, money, effects, skill, and knowledge.

According to *American Jurisprudence*, ‘joint venture is an association of persons with intent, by way of contract, express or implied, to engage in and carry out a single business venture for joint profit, for which purpose they combine their efforts, property, money, skill, and knowledge, without creating a partnership or a corporation pursuant to an agreement that there shall be a community of interest among them as to the purpose of the undertaking, and that each joint venturer shall stand in the relation of principal, as well as agent, as to each of the other co-venturers, with an equal right of control of the means employed to carry out the common purpose of the venture.

To constitute a **joint venture** there must be an agreement to enter into undertaking in objects of which parties have community of interest and common purpose in performance and control over agencies used therein, though one may entrust performance to others.

General Characteristics of JVs

The following are general characteristics of JVs:

- i. An association of persons or companies is established to undertake jointly some commercial enterprise or to achieve a common purpose or objective.
- ii. These persons or companies contribute money, property, industry, knowledge, skill or some other identifiable asset.

- iii. These parties have (a) a community of interest in the performance of the subject matter; (b) a right to direct and govern management; and (c) an agreement, express or implied, to share in the profits, risks and losses.

Joint Venture vs. Partnership

It will be observed that the foregoing characteristics closely resemble, if not exactly duplicate, those of a partnership relation. However, the definitions quoted above betray the fact that a joint venture is not a partnership, but a status short of a partnership, at least not a formal partnership in the legal or technical sense; although, as will be discussed later, the general principles of partnership may be applicable in certain circumstances in determining the rights and liabilities of parties as between them and as against third parties. Nevertheless, a “pronouncement that the rights and liabilities of joint venturers *inter se* and as to third persons are general governed by the laws of partnership is not tantamount to saying that a joint venture is a legal entity in the same sense that a partnership is, a case verdict says.

Significantly, joint ventures differ from partnerships in the following ways:

- i. A joint venture does not have a legal personality distinct and separate from the parties composing it, while a partnership does.
- ii. A joint venture usually has for its object an undertaking of a single or ad hoc nature, although it may entail a series of transactions and may last for a considerable period of time; a partnership usually has for its object a general business of a particular kind, although there may be a partnership for a single transaction.
- iii. Corporations may enter into joint ventures; but corporations are not eligible for membership in a partnership.
- iv. The legal concept of a joint venture is of common law origin. It has no precise legal definition, but it has been generally understood to mean an organization formed for some temporary purpose. It is in fact hardly distinguishable from the partnership, since elements are similar -- community of interest in the business, sharing of profits and losses, and a mutual right of control.

The main distinction cited by most opinions in common law jurisdictions is that the partnership contemplates a general business with some degree of continuity, while the joint venture is formed for the execution of a single transaction, and is thus of a temporary nature. This observation is not entirely accurate in this jurisdiction, since under the Civil Code, a partnership may be particular or universal, and a particular partnership may have for its object a specific undertaking.

Types of Joint Ventures

According to International Trade Center of UNCTAD/GATT, joint ventures may be classified and described as follows:

Equity Joint Ventures

- i. **Formation of a New Company:** Creation of a new company possessing a separate and distinct legal personality where each partner owns a certain portion of the equity.
- ii. **Equity participation in Existing Company:** Equity in existing company is shared with and transferred to the other party in the JV.

Contractual Joint Ventures

There is no equity participation between the partners and their relations, rights and liabilities, as among themselves and in respect of third parties, are principally governed by contract or agreement. Contractual joint ventures may be further classified into the following:

Technology-Oriented

- a. **Licensing agreement:** A contract between a licensor and a licensee in which the former grants the latter legal access to technology and know-how for the manufacture and marketing of a product in return for lumpsum fees, royalties, etc.
- b. **Manufacturing contracts:** A contract whereby one party manufactures components or finished products for and in accordance with the specifications of the other party which in turn sells the product under its name and through its distribution network.

- c. **International subcontracting:** Involves a foreign principal/contractor (such as a multinational firm, trading company, importer or wholesaler) which places an order with a subcontractor in a developing country for the manufacture of components or the assembly of finished products utilizing the inputs that it provides. The final product is sold by the principal either in his home market or in third-country markets.
- d. **Production sharing and risk service contracts.** Extensively used in the petroleum sector, a production sharing contract involves oil exploration in a specific area by one company with the condition that if oil is found, production will be undertaken (normally, in conjunction with the host country's state-owned company) for a given period of time in return for a predetermined share of the output.
- e. **Risk service contract** - Similar to production-sharing, but the main difference is that the exploring company's share of output is paid in cash.
- f. **Turnkey contracts** - Contracts involving setting up a plant and putting it into operation.
- g. **Management contracts** - Contracts whereby a party, for a specified fee, performs various functional responsibilities related to the operation of an enterprise or a project and assures that its managerial technical skills and other services are made available during the contract period.
- h. **Technical assistance and know-how agreements--** Agreements where one party provides technical assistance and know-how to another party for the manufacture of certain products, which may not be destined for exports, in return for payment of a fixed fee or royalty.
- i. **Franchising** - A particular type of licensing or technical assistance agreement wherein a franchisee provides a franchisee with a complete package consisting of trademarks, know-how, local exclusivity and management support in return for down payment fees, royalties, etc.
- j. **Leasing** - In a financial lease, the lessee acquires the use of a leased property for the majority of its usable life and has the option to

purchase it at the expiration of the lease period. An operating lease, on the other hand, has shorter lease period and the lessor is responsible for repairs and maintenance, technical service, etc.

Marketing-Oriented

Joint ventures which focus on the marketing aspects of business relationships, come in this class.

- a. **Buy-back arrangements** - Buy-back arrangements can be classified under either technology or marketing-oriented joint ventures. Commonly found in the sale of capital plant and equipment, in a buy-back arrangement a supplier agrees to purchase or consider as payment, partly or fully, the resultant output of the plant or the equipment supplied.
- b. **Long-term purchase contracts** - An undertaking by one party to supply the other party with raw materials (such as minerals) on a relatively long-term basis, ranging from 3 to 10 years, specifying the quantities involved.
- c. **Sales commission agreement** - An agreement between two or more parties in which one party provides the other with marketing assistance and services in return for a fee or a commission on sales generated.
- d. **Consortia** - They are created when two or more companies pool their resources to achieve a certain objective without the need for creating a new company. The participating enterprises each make a contribution or assume a specific responsibility in the implementation of the project.
- e. **Counter purchase** - A form of countertrade in which the exporter undertakes to purchase goods or services from the importer for a given percentage of the value of the sales contract.
- f. **Procurement or marketing co-operation** - Joint procurement involves the pooling of the buying requirements of two or more enterprises in order to obtain more information, better prices, improved conditions or payment, etc. Inversely, joint marketing arrangements enable particularly the small and medium enterprises

in developing countries to pursue common marketing strategies, share promotional costs, coordinate transport arrangements, etc., as well as meet relatively large export orders which cannot be handled by one enterprise.

- g. Marketing tie-ups** - A company enters into a long term arrangement to manufacture a certain product based on the design and specifications provided by another company (such as a large wholesaler/distributor or a manufacturer with his own distribution channel) and to sell the product to the latter on an exclusive basis.
- h. Product exchange** - A horizontal arrangement in which one company provides parts and components to another company in exchange for other parts and components which latter manufacturers.

Formalities in JVs

Generally, there are no formalities required before individuals and/or entities can and establish a joint relationship among them. The existence of a joint venture may be established either by direct evidence of an agreement, express or implied, between the parties or a showing of facts and circumstances which prove that such a relationship was indeed into.

The main idea is: between parties, a contract (as the term is defined in the Civil Code), express or implied, is essential to create a joint venture relationship. There is no specific or formal agreement required. What is required is intent to form a joint venture. Thus, whether or not an agreement between the parties constitutes one of joint venture depends largely upon the terms of the particular agreement, upon the construction which the parties have given it, as indicated by the manner in which they acted under it, upon the nature of the undertaking, and upon the facts. The rule is different as far as third persons are concerned. As against these persons, parties may be estopped from denying the existence of a joint venture although there was no intention to constitute one between them, if the undertakings intended indeed constitutes a joint venture.

This is not to say that no formalities shall ever be involved in a joint venture transaction. First, once the vehicle that will implement

the object of the joint venture has been chosen, say, a new joint venture corporations as in the case of equity joint ventures, compliance with the formal requirements of the appropriate regulatory agencies, such as the Securities and Exchange Commissions/Boards (SECs/Bs), will certainly be required. Then, to avail oneself of certain incentives available to those enterprises registered with the Board of Investments (“BOI”) one has to comply with said agency’s registration requirements. There are also various permits, licenses and the like that have to be secured from other regulatory agencies, such as the Bureau of Internal Revenue, the local government concerned, etc. A brief discussion on these requirements is contained in another portion hereof.

In view of the heightened complexity of commercial transactions today, most joint ventures are now embodied in some form of document. More often than not, these are legal documents. Initially, parties would execute a memorandum of understanding or a memorandum of agreement or a “heads of agreement.” This summarizes the basic agreement between the parties -- the objectives, terms and conditions of the joint venture. This is usually followed by one or more contracts that will define in detail the intricacies of the project; the respective, rights and liabilities of the parties; and dispute settlement mechanisms including arbitration procedures. It may also contain special protective clauses that the parties may wish to incorporate, as well as other common provisions found in most documents. The extensive enumeration of the different types of joint ventures in an earlier portion hereof reflects the variety of legal documents that may be executed by the parties to memorialize their particular agreement.

Concept and International Treaty/Legal Provisions Relating to Patents

[Regarding Patents there are elaborate provisions in the WTO which are presented in Unit II earlier. Readers are requested to refer the same in addition to those given below under different UN Treaties.]

WIPO Convention

Intellectual Property Organization (WIPO) is an intergovernmental organization that became in 1974 one of the specialized agencies of the United Nations system of organizations. The WIPO Convention, the

constituent instrument of the **World Intellectual Property Organization** (WIPO), signed at Stockholm on July 14, 1967, came into force in 1970 and was amended in 1979. The origins of WIPO go back to 1883 and 1886 when the Paris Convention for the Protection of Industrial Property and the Berne Convention for the Protection of Literary and Artistic Works, respectively, were concluded. Both Conventions provided for the establishment of an “International Bureau.” The two bureaus were united in 1893 and, in 1970, were replaced by the World Intellectual Property Organization, by virtue of the WIPO Convention.

WIPO’s two main objectives are:

- (i) To promote the protection of intellectual property worldwide; and
- (ii) To ensure administrative cooperation among the intellectual property Unions established by the treaties that WIPO administers.

In order to attain these objectives, WIPO, in addition to performing the administrative tasks of the Unions, undertakes a number of activities, including:

- i. Normative activities, involving the setting of norms and standards for the protection and enforcement of intellectual property rights through the conclusion of international treaties;
- ii. Program activities, involving legal and technical assistance to States in the field of intellectual property;
- iii. International classification and standardization activities, involving cooperation among industrial property offices concerning patent, trademark and industrial design documentation
- iv. Registration activities, involving services related to international applications for patents for inventions and for the registration of marks and industrial designs.

The WIPO Convention establishes three main organs: The WIPO General Assembly, the WIPO Conference and the WIPO Coordination Committee. The WIPO General Assembly is composed of the Member States of WIPO which are also members of any of the Unions. Its main functions are, *inter alia*, the appointment of the Director General upon

nomination by the Coordination Committee, review and approval of the reports of the Director General and the reports and activities of the Coordination Committee, adoption of the biennial budget common to the Unions and adoption of the financial regulations of the Organization.

The WIPO Conference is composed of the States party to the WIPO Convention. It is, *inter alia*, the competent body for adopting amendments to the Convention, for all matters relating to legal and technical assistance, and it establishes the biennial program of such assistance. It is also competent to discuss matters of general interest in the field of intellectual property, and it may adopt recommendations relating to such matters. The WIPO Coordination Committee is composed of members elected from among the members of the Executive Committee of the Paris Union and the Executive Committee of the Berne Union.

The Organization benefits from the privileges and immunities granted to international organizations and their officials in the fulfilment of its objectives and exercise of its functions, and has concluded a headquarters agreement with the Swiss Confederation to that effect.

The Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (1977)

The main feature of the Treaty is that a Contracting State that allows or requires the deposit of microorganisms for the purposes of patent procedure must recognize, for such purposes, the deposit of a microorganism with any “international depositary authority,” irrespective of whether that authority is on or outside the territory of the said State.

Disclosure of the invention is a requirement for the grant of patents. Normally, an invention is disclosed by means of a written description. Where an invention involves a microorganism not available to the public, or the use of it, disclosure is not possible in writing but can only be effected by the deposit, with a specialized institution, of a sample of the microorganism. In practice, the term “microorganism” is interpreted in a broad sense, covering biological material the deposit of which is necessary for the purposes of disclosure, in particular regarding inventions relating to the food and pharmaceutical fields.

It is in order to eliminate the need to deposit in each country in which protection is sought that the Treaty provides that the deposit of a microorganism with any “international depositary authority” suffices for the purposes of patent procedure before the national patent offices of all of the Contracting States and before any regional patent office (if such a regional office declares that it recognizes the effects of the Treaty). The European Patent Organisation (EPO), the Eurasian Patent Organization (EAPO) and the African Regional Intellectual Property Organization (ARIPO) have made such declarations.

What the Treaty calls an “international depositary authority” is a scientific institution – typically a “culture collection” – capable of storing microorganisms. An institution acquires “international depositary authority” status through the furnishing, by the Contracting State of the territory in which it is located, of assurances to the Director General of WIPO to the effect that the said institution complies and will continue to comply with certain requirements of the Treaty. The Treaty makes the patent system of the Contracting State more attractive, because it is primarily advantageous to depositors if they are applicants for patents in several Contracting States. The deposit of a microorganism under the procedures provided for in the Treaty will save depositors money and increase their security. It saves depositors money because, instead of depositing the microorganism in each and every Contracting State in which they file a patent application referring to that microorganism, they deposit it only once with one depositary authority.

The Treaty increases the security of the depositor by establishing a uniform system of deposit, recognition and furnishing of samples of microorganisms. The Treaty does not provide for the institution of a budget, but it does create a Union and an Assembly whose members are the States party to the Treaty. The main task of the Assembly is the amendment of the Regulations under the Treaty. No State can be requested to pay contributions to the International Bureau of WIPO on account of its membership in the Budapest Union or to establish an “international depositary authority.” The Budapest Treaty was concluded in 1977. The Treaty (the full text of which is available at www.wipo.int/treaties) is open to States party to the Paris Convention for the Protection of Industrial Property (1883). Instruments of ratification or accession must be deposited with the Director General of WIPO.

The Paris Convention for the Protection of Industrial Property, (1883)

The Convention applies to industrial property in the widest sense, including patents, trademarks, industrial designs, utility models (a kind of “small-scale patent” provided for by the laws of some countries), service marks, trade names (designations under which an industrial or commercial activity is carried out), geographical indications (indications of source and appellations of origin) and the repression of unfair competition.

The substantive provisions of the Convention fall into three main categories: national treatment, right of priority and common rules.

- (A) Under the provisions on **national treatment**, the Convention provides that, as regards the protection of industrial property, each Contracting State must grant the **same** protection to nationals of other Contracting States that it grants to its own nationals. Nationals of non-Contracting States are also entitled to national treatment under the Convention if they are domiciled or have a real and effective industrial or commercial establishment in a Contracting State.
- (B) The Convention provides for the **right of priority** in the case of patents (and utility models where they exist), marks and industrial designs. This right means that, on the basis of a regular first application filed **in one** of the Contracting States, the applicant may, within a certain period of time (12 months for patents and utility models; 6 months for industrial designs and marks), apply for protection **in any of the other** Contracting States. These subsequent applications will be regarded as if they had been filed on the same day as the first application. In other words, they will have priority (hence the expression “right of priority”) over applications filed by others during the said period of time for the same invention, utility model, mark or industrial design. Moreover, these subsequent applications, being based on the first application, will not be affected by any event that takes place in the interval, such as the publication of an invention or the sale of articles bearing a mark or incorporating an industrial design. One of the great practical advantages of this provision is that applicants seeking protection in several countries are not required to present

all of their applications at the same time but have 6 or 12 months to decide in which countries they wish to seek protection, and to organize with due care the steps necessary for securing protection.

(C) The Convention lays down a few **common rules** that all Contracting States must follow. The most important are:

- (i) **Patents.** Patents granted in different Contracting States for the same invention **are independent of each other**: the granting of a patent in one Contracting State does not oblige other Contracting States to grant a patent; a patent cannot be refused, annulled or terminated in any member on the ground that it has been refused or annulled or has terminated in any other member State.

The inventor has **the right to be named** as such in the patent. The grant of a patent may not be refused, and a patent may not be invalidated, on the ground that the sale of the patented product, or of a product obtained by means of the patented process, is subject to restrictions or limitations resulting from the domestic law.

Each Contracting State that takes legislative measures providing for the grant of compulsory licenses to prevent the abuses which might result from the exclusive rights conferred by a patent may do so only with **certain limitations**. Thus, a compulsory license (a license not granted by the owner of the patent but by a public authority of the State concerned) based on failure to work or insufficient working of the patented invention may only be granted pursuant to a request filed after three years from the grant of the patent or four years from the filing date of the patent application, and it must be refused if the patentee gives legitimate reasons to justify this inaction. Furthermore, forfeiture of a patent may not be provided for, except in cases where the grant of a compulsory license would not have been sufficient to prevent the abuse. In the latter case, proceedings for forfeiture of a patent may be instituted, but only after the expiration of two years from the grant of the first compulsory license.

- (ii) **Marks.** The Paris Convention does not regulate the conditions for the **filing and registration of marks** which are determined in each Contracting State by domestic law. Consequently, no application for the registration of a mark filed by a national of a Contracting State may be refused, nor may a registration be invalidated, on the

ground that filing, registration or renewal **has not been effected in the country of origin**. The registration of a mark obtained in one Contracting State is **independent** of its possible registration in any other country, including the country of origin; consequently, the lapse or annulment of the registration of a mark in one Contracting State will not affect the validity of the registration in other Contracting States. Where a mark has been **duly registered in the country of origin**, it must, on request, be accepted for filing and protected in its original form in the other Contracting States. Nevertheless, registration may be refused in well-defined cases, such as where the mark would infringe the acquired rights of third parties; where it is devoid of distinctive character; where it is contrary to morality or public order; or where it is of such a nature as to be liable to deceive the public. If, in any Contracting State, the use of a registered mark is compulsory, the registration cannot be cancelled for non-use until after a reasonable period, and then only if the owner cannot justify this inaction.

Each Contracting State must refuse registration and prohibit the use of marks that constitute a reproduction, imitation or translation, liable to create confusion, of a mark used for identical and similar goods and considered by the competent authority of that State to be **well known in that State** and to already belong to a person entitled to the benefits of the Convention. Each Contracting State must likewise refuse registration and prohibit the use of marks that consist of or contain, without authorization, armorial bearings, **State emblems** and official signs and hallmarks of Contracting States, provided they have been communicated through the International Bureau of WIPO. The same provisions apply to armorial bearings, flags, other emblems, abbreviations and names of certain intergovernmental organizations. **Collective marks** must be granted protection.

- (iii) Industrial Designs. Industrial designs must be protected in each Contracting State, and protection may not be forfeited on the ground that articles incorporating the design are not manufactured in that State.
- (iv) Trade Names. Protection must be granted to trade names in each Contracting State without there being an obligation to file or register the names.

- (v) **Indications of Source.** Measures must be taken by each Contracting State against direct or indirect use of a false indication of the source of goods or the identity of their producer, manufacturer or trader.
- (f) **Unfair Competition.** Each Contracting State must provide for effective protection against unfair competition. The Paris Union, established by the Convention, has an Assembly and an Executive Committee. Every State member of the Union which has adhered to at least the administrative and final provisions of the Stockholm Act (1967) is a member of the Assembly. The members of the Executive Committee are elected from among the members of the Union, except for Switzerland, which is a member *ex officio*. The establishment of the biennial program and budget of the WIPO Secretariat – as far as the Paris Union is concerned – is the task of its Assembly. The Paris Convention, concluded in 1883, was revised at Brussels in 1900, at Washington in 1911, at The Hague in 1925, at London in 1934, at Lisbon in 1958 and at Stockholm in 1967, and was amended in 1979. The Convention (the full text of which is available at www.wipo.int/treaties) is open to all States. Instruments of ratification or accession must be deposited with the Director General of WIPO.

The Patent Cooperation Treaty (PCT) (1970)

The patent offices of Australia, Austria, Brazil, Canada, China, Finland, Japan, the Republic of Korea, the Russian Federation, Spain, Sweden, the United States of America, the European Patent Office and the Nordic Patent Institute act as International Searching Authorities under the PCT (status on January 1, 2011). Agreements enabling the offices of Egypt and Israel to act as ISAs have been signed; however, these offices have not yet commenced operations.

The Patent Cooperation Treaty makes it possible to seek patent protection for an invention simultaneously in each of a large number of countries by filing an “international” patent application. Such an application may be filed by anyone who is a national or resident of a PCT Contracting State. It may generally be filed with the national patent office of the Contracting State of which the applicant is a national or resident

or, at the applicant's option, with the International Bureau of WIPO in Geneva. If the applicant is a national or resident of a Contracting State party to the European Patent Convention, the Harare Protocol on Patents and Industrial Designs (Harare Protocol), the Bangui Agreement, or the Eurasian Patent Convention, the international application may also be filed with the European Patent Office (EPO), the African Regional Intellectual Property Organization (ARIPO), the African Intellectual Property Organization (OAPI) or the Eurasian Patent Office (EAPO), respectively.

The Treaty regulates in detail the formal requirements with which international applications must comply. Filing a PCT application has the effect of automatically designating all Contracting States bound by the PCT on the international filing date. The effect of the international application is the same in each designated State as if a national patent application had been filed with the national patent office of that State. The international application is subjected to an international search. That search is carried out by one of the competent International Searching Authorities (ISA) under the PCT¹ and results in an international search report, that is, a listing of the citations of published documents that might affect the patentability of the invention claimed in the international application. In addition, a preliminary and non-binding written opinion on whether the invention appears to meet patentability criteria in light of the search report results is also issued. The international search report and written opinion are communicated to the applicant who, after evaluating their content, may decide to withdraw the application, in particular where the content of the report and opinion suggests that the granting of patents is unlikely, or the applicant may decide to amend the claims in the application.

If the international application is not withdrawn, it is published by the International Bureau, together with the international search report. The written opinion is not published at that time. Before the expiration of 19 months from the priority date, the applicant has the option to request a Supplementary International Searching Authority (SISA) (an ISA willing to offer this service) to carry out an additional search of relevant documentation, specifically focusing on documents in the particular language in which that Authority specializes. The goal of this additional search is to reduce the likelihood of further documents coming to light in the national phase that would make granting the patent unlikely.

An applicant that decides to continue with the international application with a view to obtaining national (or regional) patents can, in relation to most Contracting States, wait until the end of the thirtieth month from the priority date to commence the national procedure before each designated office by furnishing a translation (where necessary) of the application into the official language of that office, paying to it the necessary fees and acquiring the services of local patent agents.

If the applicant wishes to make amendments to the application – for example, in order to address documents identified in the search report and conclusions made in the written opinion – and to have the potential patentability of the “as-amended” application reviewed – an optional international preliminary examination may be requested. The result of the preliminary examination is an international preliminary report on patentability (IPRP Chapter II) which is prepared by one of the competent International Preliminary Examining Authorities (IPEA) under the PCT² and which contains a preliminary and non-binding opinion on the patentability of the claimed invention.

It provides the applicant with an even stronger basis on which to evaluate the chances of obtaining a patent and, if the report is favorable, a stronger basis on which to continue with the application before national and regional patent offices. If no international preliminary examination has been requested, the International Bureau establishes an international preliminary report on patentability (IPRP Chapter I) on the basis of the written opinion of the ISA and communicates this report to the designated offices.

The procedure under the PCT has great advantages for applicants, patent offices and the general public:

- (i) Applicants have up to 18 months more than if they had not used the PCT to reflect on the desirability of seeking protection in foreign countries, appoint local patent agents in each foreign country, prepare the necessary translations and pay national fees;
- (ii) Applicants can rest assured that, if their international application is in the form prescribed by the PCT, it cannot be rejected on formal grounds by any designated office during the national phase;

- (iii) On the basis of the international search report and the written opinion, applicants can evaluate with reasonable probability the chances of their invention being patented;
- (iv) Applicants have the possibility, during the optional international preliminary examination, to amend the international application and thus put it in order before processing by the various patent offices;
- (v) The search and examination work of patent offices can be considerably reduced or eliminated thanks to the international search report, the written opinion and, where applicable, the international preliminary report on patentability which are communicated to designated offices together with the international application;
- (vi) Since each international application is published with an international search report, third parties are in a better position to formulate a well-founded opinion about the potential patentability of the claimed invention; and
- (vii) For applicants, international publication puts the world on notice of their applications, which can be an effective means of advertising and looking for potential licensees.

Ultimately, the PCT:

- Brings the world within reach;
- Postpones the major costs associated with international patent protection;
- Provides a strong basis for patenting decisions; and
- Is used by the world's major corporations, research institutions and universities in seeking international patent protection.

Patent Law Treaty (PLT), (2000)

The aim of the Patent Law Treaty (PLT) is to harmonize and streamline formal procedures in respect of national and regional patent applications and patents and, thus, to make such procedures more user friendly. With the significant exception of filing date requirements, the PLT

provides maximum sets of requirements that the office of a Contracting Party may apply. This means that a Contracting Party is free to provide for requirements that are more generous from the viewpoint of applicants and owners, but that the requirements under the PLT are mandatory as to the maximum an office can require from applicants or owners.

The Treaty contains, in particular, provisions on the following issues:

Requirements for obtaining a filing date: Requirements for obtaining a filing date were standardized in order to minimize the risks that applicants could inadvertently lose the filing date, which is of utmost importance in the patent procedure. The PLT requires that the office of any Contracting Party must accord a filing date to an application upon compliance with three simple formal requirements: first, an indication that the elements received by the office are intended to be an application for a patent for an invention; second, indications that would allow the office to identify or to contact the applicant (however, a Contracting Party is allowed to require indications on both); third, a part which appears to be a description of the invention. No additional elements can be required for according a filing date. In particular, a Contracting Party cannot include one or more claims or a filing fee in a filing date requirement. As mentioned above, these requirements are not maximum requirements but constitute absolute requirements, so that a Contracting Party would not be allowed to accord a filing date unless all those requirements are complied with.

Formal requirements for national and regional applications: A set of formal requirements for national and regional applications was standardized by incorporating into the PLT the requirements relating to form or content of international applications under the PCT, including the contents of the PCT request Form and the use of that request Form accompanied by an indication that the application is to be treated as a national application. This eliminates or reduces procedural gaps between national, regional and international patent systems.

Standardized Model International Forms: The standardized Model International Forms that have to be accepted by the offices of all Contracting Parties were established.

Simplification of Procedures: A number of procedures before patent offices were simplified, which contributes to a reduction in costs for applicants as well as for offices.

Examples of such procedures are exceptions from mandatory representation, the restriction on requiring evidence on a systematic basis, the requirement that offices accept a single communication covering more than one application or patent in certain cases (e.g., a single power of attorney) or the restriction on the requirement to submit a copy of an earlier application and a translation thereof.

Procedures for avoiding the unintentional loss of substantive rights: The PLT provides procedures for avoiding the unintentional loss of substantive rights resulting from failure to comply with formality requirements or time limits. These include the obligation that offices notify the applicant or other concerned person, extensions of time limits, continued processing, reinstatement of rights, and restrictions on revocation/invalidation of a patent for formal defects, where they were not noticed by the office during the application stage.

Electronic filing facilitated: The implementation of electronic filing is facilitated, while ensuring the co-existence of both paper and electronic communications. The PLT provides that Contracting Parties were allowed to exclude paper communications and to fully switch to electronic communications as of June 2, 2005.

However, even after that date, they have to accept paper communications for the purpose of obtaining a filing date and for meeting a time limit. In this connection, the Agreed Statement stipulates that industrialized countries will continue to furnish support to developing countries and countries in transition for the introduction of electronic filing. The PLT was concluded on June 1, 2000, and entered into force on April 28, 2005.

Concept and International Treaty/Legal Provisions Relating to Trade Marks

There are many international treaties on registration and protection of trade marks. These are dealt below.

The Madrid Agreement Concerning the International Registration of Marks (1891) and the Protocol Relating to that Agreement (1989)

The Madrid System for the International Registration of Marks is governed by two treaties, namely:

- a. **Madrid Agreement**, concluded in 1891 and revised at Brussels (1900), Washington (1911), The Hague (1925), London (1934), Nice (1957) and Stockholm (1967), and amended in 1979, and
- ii. **Protocol** relating to that Agreement, concluded in 1989, which aims to make the Madrid system more flexible and more compatible with the domestic legislation of certain countries or intergovernmental organizations that had not been able to accede to the Agreement. States and organizations party to the Madrid system are collectively referred to as Contracting Parties.

The system makes it possible to protect a mark in a large number of countries by obtaining an international registration that has effect in each of the designated Contracting Parties.

Probable Users

An application for international registration (international application) may be filed only by a natural person or legal entity having a connection – through establishment, domicile or nationality – with a Contracting Party to the Agreement or the Protocol.

A mark may be the subject of an international application only if it has already been registered with the trademark office (referred to as the office of origin) of the Contracting Party with which the applicant has the necessary connections.

However, where all the designations are effected under the Protocol (see below), the international application may be based simply on an application for registration filed with the office of origin. An international application must be presented to the International Bureau of WIPO through the intermediary of the office of origin.

International Application

An application for international registration must designate one or more Contracting Parties in which protection is sought. Further designations can be effected subsequently. A Contracting Party may be designated only if it is party to the same treaty as the Contracting Party whose office is the office of origin. The latter cannot itself be designated in the international application.

The designation of a given Contracting Party is made either under the Agreement or the Protocol, depending on which treaty is common to the Contracting Parties concerned. If both Contracting Parties are party to the Agreement and the Protocol, the designation will be governed by the Protocol. This follows the repeal of the so-called “safeguard clause”, which took effect on January 1, 2008. Also, from September 1, 2008, a full trilingual regime (English, French and Spanish) became operative – that is, an international application can now be filed in any of the three languages, irrespective of which treaty or treaties govern the application, unless the office of origin restricts that choice to one or two of these languages. The filing of an international application is subject to the payment of a basic fee (which is reduced to 10 per cent of the prescribed amount for international applications filed by applicants whose country of origin is an LDC, in accordance with the list established by the United Nations), a supplementary fee for each class of goods and/or services beyond the first three classes, and a complementary fee for each Contracting Party designated. However, a Contracting Party to the Protocol may declare that, when it is designated under the Protocol, the complementary fee is replaced by an individual fee, whose amount is determined by the Contracting Party concerned but may not be higher than the amount that would be payable for the registration of a mark with its office.

International Registration

Once the International Bureau receives an international application, it carries out an examination for compliance with the requirements of the Agreement, the Protocol and their Common Regulations. This examination is restricted to formalities, including the classification and comprehensibility of the list of goods and/or services. If there are no irregularities in the application, the International Bureau records the

mark in the International Register, publishes the international registration in the **WIPO Gazette of International Marks** (hereinafter referred to as “the Gazette”), and notifies it to each designated Contracting Party. Any matter of substance, such as whether the mark qualifies for protection or whether it is in conflict with an earlier mark in a particular Contracting Party, is determined by that Contracting Party’s trademark office under the applicable domestic legislation. From January 2009, the paper version of the Gazette was discontinued and replaced by a web-based version (e Gazette) on the Madrid system website.

Statement of Grant of Protection or Refusal of Protection

From January 1, 2011, the office of each designated Contracting Party shall issue a statement of grant of protection under Rule 18ter of the Common Regulations. However, when designated Contracting Parties examine the international registration for compliance with their domestic legislation, and if some substantive provisions are not complied with, they have the right to refuse protection in their territory. Any such refusal, including an indication of the grounds on which it is based, must be communicated to the International Bureau, normally within 12 months from the date of notification. However, a Contracting Party to the Protocol may declare that, when it is designated **under the Protocol**, this time limit is extended to 18 months. That Contracting Party may also declare that a refusal based on an opposition may be communicated to the International Bureau even after the 18-month time limit. The refusal is communicated to the holder of the registration or the holder’s representative before the International Bureau, recorded in the International Register and published in the Gazette. The procedure subsequent to a refusal (such as an appeal or a review) is carried out directly by the competent administration and/or court of the Contracting Party concerned and the holder, without the involvement of the International Bureau. The final decision concerning the refusal must, however, be communicated to the International Bureau, which records and publishes it.

Effects of an International Registration

The effects of an international registration in each designated Contracting Party are, from the date of the international registration, the same as if the mark had been deposited directly with the office of

that Contracting Party. If no refusal is issued within the applicable time limit, or if a refusal originally notified by a Contracting Party is subsequently withdrawn, the protection of the mark is, from the date of the international registration, the same as if it had been registered by the office of that Contracting Party. An international registration is effective for 10 years. It may be renewed for further periods of 10 years on payment of the prescribed fees. Protection may be limited with regard to some or all of the goods or services or may be renounced with regard to only some of the designated Contracting Parties. An international registration may be transferred in relation to all or some of the designated Contracting Parties and all or some of the goods or services indicated.

Advantages of the Madrid System

The Madrid system offers several advantages for trademark owners. Instead of filing a separate national application in each country of interest, in several different languages, in accordance with different national or regional procedural rules and regulations and paying several different (and often higher) fees, an international registration may be obtained by simply filing one application with the International Bureau (through the office of the home country), in one language (English, French or Spanish) and paying one set of fees.

Similar advantages exist for maintaining and renewing a registration. Likewise, if the international registration is assigned to a third party, or is otherwise changed, such as a change in name and/or address, this may be recorded with effect for all designated Contracting Parties by means of a single procedural step.

To facilitate the work of the users of the Madrid system, the International Bureau publishes: a **Guide to the International Registration of Marks under the Madrid Agreement and the Madrid Protocol**. The Madrid Agreement and Protocol are open to any State party to the Paris Convention for the Protection of Industrial Property (1883). The two treaties are parallel and independent, and States may adhere to either or both of them. In addition, an intergovernmental organization that maintains its own office for the registration of marks may become party to the Protocol. Instruments of ratification or accession must be deposited with the Director General of WIPO.

The Strasbourg Agreement Concerning the International Patent Classification (1971)

This agreement specifically deals with trade mark protection, along with WTO and other treaties cited above and later below.

The Agreement establishes the International Patent Classification (IPC) which divides technology into eight sections with approximately 70,000 subdivisions. Each subdivision is denoted by a symbol consisting of Arabic numerals and letters of the Latin alphabet. The appropriate IPC symbols are indicated on patent documents (published patent applications and granted patents), of which over 1,000,000 are issued each year. The appropriate symbols are allotted by the national or regional industrial property office that publishes the patent document. Classification is indispensable for the retrieval of patent documents in the search for “prior art.” Such retrieval is needed by patent-issuing authorities, potential inventors, research and development units and others concerned with the application or development of technology.

Although only 61 States are party to the Agreement, the IPC is used by the patent offices of more than 100 States, four regional offices and the Secretariat of WIPO in administering the Patent Cooperation Treaty (PCT) (1970). In order to keep the IPC up to date, it is continuously revised and a new edition is published each year on January 1. Revision work is carried out by a Committee of Experts set up under the Agreement. All States party to the Agreement are members of the Committee of Experts. The Strasbourg Agreement created a Union. The Union has an Assembly. Every State member of the Union is a member of the Assembly. Among the most important tasks of the Assembly is the adoption of the biennial program and budget of the Union. The Agreement – commonly referred to as the IPC Agreement – was concluded in 1971 and amended in 1979 (the full text is available at www.wipo.int/treaties). It is open to States party to the Paris Convention for Protection of Industrial Property (1883) (see the relevant **Summary** in this series). Instruments of ratification or accession must be deposited with the Director General of WIPO.

Standardize and streamline national and regional trademark registration procedures: The aim of the TLT is to standardize and streamline national and regional trademark registration procedures.

This is achieved through the simplification and harmonization of certain features of those procedures, thus making trademark applications and the administration of trademark registrations in multiple jurisdictions less complex and more predictable. The great majority of the provisions of the TLT concern the procedure before a trademark office which can be divided into three main phases: application for registration; changes after registration; and renewal. The rules concerning each phase are constructed so as to clearly define the requirements for an application or a specific request.

As to the **first phase – application for registration** – the Contracting Parties to the TLT may require, as a maximum, the following indications: a request, the name and address and other indications concerning the applicant and the representative; various indications concerning the mark, including a certain number of representations of the mark; the goods and services for which registration is sought classified in the relevant class of the International Classification (established under the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (1957) and, where applicable, a declaration of intention to use the mark. Each Contracting Party must also allow that an application can relate to goods and/or services belonging to several classes of the International classification. As the list of permissible requirements is exhaustive, a Contracting

Party cannot require, for example, that the applicant produce an extract from a register of commerce, an indication of a certain commercial activity, or evidence to the effect that the mark has been registered in the trademark register of another country.

The **second phase of the trademark procedure** covered by the TLT concerns changes in names or addresses and changes in the ownership of the registration. Here too, the applicable formal requirements are exhaustively listed. A single request is sufficient even where the change relates to more than one – possibly hundreds – of trademark applications or registrations, provided that the change to be recorded pertains to all registrations or applications concerned. As to the third phase, renewal, the TLT standardizes the duration of the initial period of registration and the duration of each renewal to 10 years each.

The Nice Agreement Concerning the International Classification of Goods and Services for The Purposes of the Registration of Marks (1957)

The Agreement establishes a classification of goods and services for the purposes of registering trademarks and service marks (the Nice Classification). The trademark offices of Contracting States must indicate, in official documents and publications in connection with each registration, the numbers of the classes of the Classification to which the goods or services for which the mark is registered belong. The Classification consists of a list of classes – 34 for goods and 11 for services – and an alphabetical list of the goods and services. The latter comprises some 11,000 items. Both lists are amended and supplemented periodically by a Committee of Experts in which all Contracting States are represented. The current edition of the Classification is the ninth, which entered into force on January 1, 2007. Although only 83 States are party to the Nice Agreement, the trademark offices of about 65 additional States, as well as the International Bureau of WIPO, the African Intellectual Property Organization (OAPI), the African Regional Intellectual Property Organization (ARIPO), the Benelux Organisation for Intellectual Property (BOIP) and the European Union Office for Harmonization in the Internal Market (Trade Marks and Designs) (OHIM), actually use the Classification.

The Nice Agreement created a Union, which has an Assembly. Every State member of the Union which has adhered to the Stockholm Act or the Geneva Act of the Nice Agreement is a member of the Assembly. Among the most important tasks of the Assembly is the adoption of the biennial program and budget of the Union. The Agreement, concluded in 1957, was revised at Stockholm in 1967 and at Geneva in 1977, and was amended in 1979. The Agreement (the full text of which is available at www.wipo.int/treaties) is open to States party to the Paris Convention for the Protection of Industrial Property (1883). Instruments of ratification or accession must be deposited with the Director General of WIPO.

The Singapore Treaty on the Law of Trademarks (2006)

The Singapore Treaty was concluded on March 27, 2006, and entered into force on March 16, 2009. The objective of the Singapore Treaty is to create a modern and dynamic international framework for the harmonization of administrative trademark registration procedures.

Building on the **Trademark Law Treaty** of 1994 (TLT), the Singapore Treaty has a wider scope of application and addresses new developments in the field of communication technologies. The Singapore Treaty is applicable to all types of marks registrable under the law of a given Contracting Party. Contracting Parties are free to choose the means of communication with their offices (including communications in electronic form or by electronic means of transmittal).

Relief measures in respect of time limits as well as provisions on the recording of trademark licenses are introduced, and an Assembly of the Contracting Parties is established. However, other provisions of the Singapore Treaty (such as the requirements to provide for multiclass applications and registrations and the use of the International (“Nice”) Classification) closely follow the TLT. The two treaties are separate, and may be ratified or adhered to independently. Unlike the TLT, the Singapore Treaty applies generally to all marks that can be registered under the law of a Contracting Party. Most significantly, it is the first time that non-traditional marks are explicitly recognized in an international instrument dealing with trademark law.

The Treaty is applicable to all types of marks, including non-traditional visible marks, such as holograms, three-dimensional marks, color, position and movement marks, as well as non-visible marks such as sound, olfactory or taste and feel marks. The Regulations provide for the mode of representation of these marks in applications, which may include non-graphic or photographic reproductions. The Singapore Treaty leaves Contracting Parties the freedom to choose the form and means of transmittal of communications and whether to accept communications on paper, in electronic form or in another form. This has consequences on formal requirements for applications and requests, such as the signature on communications with the office. The Treaty maintains a very important provision of the TLT, namely that the authentication, certification or attestation of any signature on paper communications cannot be required. However, Contracting Parties are free to determine whether and how they wish to implement a system of authentication of electronic communications. The Treaty provides for relief measures when an applicant or holder has missed a time limit in an action for a procedure before an office. Contracting Parties must make available, at their choice, at least one of the following relief measures: extension of the time limit;

or continued processing and reinstatement of rights, if the failure to meet the time limit was unintentional or occurred in spite of due care required by the circumstances.

The Singapore Treaty includes provisions on the recording of trademark licenses, and establishes maximum requirements for requests for recordal, amendment or cancellation of the recordal of a license. The creation of an Assembly of the Contracting Parties introduced a degree of flexibility in defining the details of administrative procedures to be implemented by national trademark offices, where it is anticipated that future developments in trademark registration procedures and practices will warrant amendments to those details. The Assembly is endowed with powers to modify the Regulations and the Model International Forms, where necessary, and can also address – at a preliminary level – questions relating to the future development of the Treaty.

Diplomatic Conference adopted a Resolution Supplementary to the Singapore Treaty on the Law of Trademarks and the Regulations Thereunder, with a view to declaring an understanding by the Contracting Parties on several areas covered by the Treaty, namely: that the Treaty does not impose any obligations on Contracting Parties to (i) register new types of marks, or (ii) implement electronic filing systems or other automation systems.

Special provisions are made to provide developing and least developed countries with additional technical assistance and technological support to enable them to take full advantage of the provisions of the Treaty. It was recognized that LDCs shall be the primary and main beneficiaries of technical assistance by Contracting Parties. The Assembly monitors and evaluates, at every ordinary session, the progress of the assistance granted. Any dispute arising in relation to the interpretation or application of the Treaty is to be settled amicably through consultation and mediation under the auspices of the Director General of WIPO.

The Trademark Law Treaty (TLT) (1994)

The **Trademark Law Treaty** provides that a power of attorney may relate to several applications or registrations by the same person or entity. It also provides that, if requests are made on forms corresponding

to the forms attached to the TLT, they must be accepted, subject to their being completed in a language accepted by the office, and that no further formalities may be required.

Most notably, the TLT does not allow a requirement as to the attestation, notarization, authentication, legalization or certification of any signature, except in the case of the surrender of a registration. The TLT (the full text of which is available at www.wipo.int/treaties) was concluded in 1994 and is open to States members of WIPO and to certain intergovernmental organizations. Instruments of ratification or accession must be deposited with the Director General of WIPO.

Concept and International Treaty/ Legal Provisions Relating to Technology Transfer

Global development takes place through propagation of resources across borders. Among the resources technology has become most precious that by its spread helps evening development world-over. Be it IT technology, Telecom technology, biotic technology or so, benefits have spread world over by the transfer of technology. Transfer of technology must help the technology suppliers in furthering more technology with adequate return on technology investment and the users by improving their lot by exploiting the same.

Forms in Which Technology May Be Transferred: Technology is primarily transferred in three forms.

First, Technology can be transferred via **machinery or other intermediate goods**. This is normally adequate for manufacturing purposes where the nature of the technology is not complex and where no proprietary techniques or processes are involved.

Second, technology can also be transferred **through individual experts**. Although this technique is employed relatively often, it normally goes unpublicized. Transferring technology via a competent expert has the advantage of cost-savings to the recipient, but it is generally suitable only for small and medium-sized projects where the technology is simple and unpatented.

Third and final, technology can be transferred **through technical know-how, patented or unpatented, or other information** subject to proprietary rights.

Methods of Transferring Technology: There are many methods of transferring technology.

- a. **Direct foreign investment:** The traditional method of transferring technology has been through investment in wholly owned and controlled subsidiaries. Not surprisingly, this is the form of transfer that TNCs favor. TNCs invest in developing markets in order “to protect the existing market, to create new markets, to bypass prohibitive barriers and import restrictions, to take advantage of cheap labor and skills, and to discover or protect raw materials. These interests can best be fulfilled by retaining ownership and control of the technology transferred to a foreign market incident to an investment in that market. Actually transferring the production technology to the foreign country would simply create unnecessary and unwanted competition and diminish profitability.
- b. **Turn-key packages:** Transfers of technology in the 1970s were often in the form of complete packages. The supplier provided machinery, buildings, management expertise, and production plans. Thus the name “turn-key” – all the recipient had to do was walk up to the plant and turn the key. TNCs sold the entire technology package, giving the developing countries no opportunity to select only the parts of that package that they actually needed.
- c. **Technology license agreements:** Licensing covers the broad spectrum of permissions that are granted for the use of patents, technology, and trademarks. Of the various methods of transferring technology internationally, licensing is the most versatile. It offers flexibility in technology choice and an opportunity for the source and the receiving institution to negotiate. Technology license agreements also enable a foreign licensor to reap profits from the transfer of technology without risking capital in a sometimes volatile foreign market. International license agreements may be divided into the following general categories:
 - i. **Patent Licenses:** Patent licenses are generally used for a specific process or method of manufacture

- ii. **Know-How Agreements:** Such agreements often cover information that may be classified and therefore difficult to obtain other-wise and
- iii. **Technical Assistance Agreements:** These agreements involve the supply of scientific and engineering assistance, training, and management assistance.
- d. **Joint ventures:** Joint ventures are long-term relationships involving the pooling of assets, joint management, profit and risk sharing, joint marketing, servicing, and production. In a typical agreement, technology is transferred primarily through technical liaisons, training, and continuing operational support. Perhaps most valuable, the transferring firm generally provides the recipient with on-going technical changes as they are developed during the life of the agreement. Foreign investors have recently become increasingly willing to participate in joint ventures and partnerships with firms in developing countries, so long as the majority of the equitable ownership remains in the hands of the TNC.
- e. **Purchase of equipment:** The outright purchase of equipment is one of the dominant methods of transferring technology. These purchases occur continuously; buyers make initial capital investments and then pay for the maintenance and upgrade of the purchased technology.
- f. **Management contracts:** Employment of foreign experts usually involves management contracts. Depending on employer's needs, experts demonstrate the machine operations, production processes, and other more technical operations. Technology transferred through this method is normally in the form of know-how.
- g. **International Organizations:** A growing number of international organizations, multilateral, bilateral, NGO and others now exist to facilitate technology transfer. Few of these organizations are taken up.
- i. **United Nations Conference on Trade and Development (UNCTAD):** First, the United Nations Conference on Trade and Development ("UNCTAD") was established to help deal with the problems caused by the technological gap that existed

among member states of the United Nations. UNCTAD summarized its general guidelines in a joint declaration drafted by the developing countries in the General Assembly in 1983. The major functions of UNCTAD were: to promote international trade between countries at different stages of development; and to formulate principles and policies on international trade and related problems of economic development. UNCTAD has assumed an active role in promoting the transfer of technology from developed to developing countries. It has conducted a number of studies not only outlining the problem of technological disparity among nations, but also recommending particular strategies for alleviating the problem. UNCTAD has now been given a direct mandate by the UN General Assembly to examine and recommend modalities for favorable access to, and transfer of... technologies, in particular to developing countries, including on concessional and preferential terms.

- ii. **Advisory Service on Transfer and Development of Technology (ASTT):** Second, international organization established to promote transfers of technology is the Advisory Service on Transfer and Development of Technology (“ASTT”). The AS’IT was established in 1976 within UNCTAD’s Transfer of Technology Division to provide advice, technical assistance, and operational assistance to developing countries on the transfer and development of technology.
- iii. **R&D centres:** Third, many R&D centres are established in developing countries by world leaders in most industries to incubate and develop technology. For example, in just the last two years, 100 companies such as Panasonic, Airbus Innovation, Facebook, LinkedIn have opened R&D centers in India.
- h. **Government aid:** Technical assistance is also provided by governments of developed countries. The most significant sources of this assistance are technical cooperation grants, the major components of which are technical assistance and fellowships for students. 5° Such assistance has increased in recent years but is relatively insignificant when compared to the transfer potential of TNCs.

International Legal Scheme for monitoring Technology Transfer

Attempts at enacting international legal schemes to regulate the international transfer of technology are directed both within the structures of the United Nations and through national activity. The most significant attempt was the International Code of Conduct on the Transfer of Technology (“the Code”) drafted by the United Nations. In 1977 the General Assembly decided to convene a Conference on the Code 77 to negotiate “all measures necessary for its adoption. To the developing countries, the critical sections of the Code are those which encourage technology transfer and promote arrangements for transferring only what the receiving country needs.

According to its own terms, the Code is applicable to all countries. However the United Nations failed to reach agreement on a number of key provisions of the Code. Furthermore, there is no agreement on applicable law and dispute settlement or even on the definition and the underlying concept of the term ‘international transfer of technology transactions’. Given the length of time that the Code has been under consideration and the fundamental nature of some of the provisions that have still not been agreed upon, it may never be given effect by the General Assembly. Even if the General Assembly does vote favorably on the Code, there is little reason to believe it will fare any better than the NIEO.

Some developing countries have also advocated revising the international law on patents, which is currently embodied in the Paris Convention of 1833. The Convention defines certain rights that holders of industrial property have within signatory countries; Third world countries contend that the present patent system limits their access to technology crucial to their development. Instead they propose less protective international standards with which national laws should comply,

Nationalization of Property Already Within Third World Borders

Frustrated at what they perceived to be technological colonialism and excessive dependence on TNCs, a number of developing countries have nationalized foreign-owned industrial property within their territory. The media now reports that there are fears that these countries will be unable to handle their debts and will eventually default on them.

Unilateral Regulation of Technology Transfers

Unsatisfied with the conditions of technology transfer agreements between TNCs and recipient firms within their territory, some developing nations have begun to oversee and regulate the import of technology. Regulation is accomplished via legislation requiring registration of all international agreements contemplating transfer of technology. The government can then examine the agreements and determine whether it feels that they are in the developmental interest of the industry

International Legal Framework for Technology Transfer

There are many treaties that govern Technology Transfer in form or other in one field or other. 70 such treaties are listed below.

A. Multilateral Instruments

1. Paris Convention for the Protection of Industrial Property
2. Berne Convention for the Protection of Literary and Artistic Works
3. International Convention for Protection of New Varieties of Plants
(UPOV) 1961
4. International Convention for Protection of New Varieties of Plants (UPOV) 1991
5. United Nations Convention on the Law of the Sea
6. The Vienna Convention for the Protection of the Ozone Layer
7. Montreal Protocol on Substances that Deplete the Ozone Layer
8. Basel Convention on the Control of Trans-boundary Movements of Hazardous Wastes and their Disposal
9. Convention on Biological Diversity
10. Cartagena Protocol on Bio-safety to the Convention on Biological Diversity
11. Convention on Trans-boundary Effects of Industrial Accidents

12. United Nations Framework Convention on Climate Change
13. Kyoto Protocol to the United Nations Framework Convention on Climate Change
14. United Nations Conference on Environment and Development: Statement of Principles for a Global Consensus on the Management, Conservation and Sustainable Development of all Types of Forests
15. United Conference on Environment and Development: Rio Declaration on Environment and Development
16. Establishment Agreement for the Center for International Forestry Research.
17. The Energy Charter Treaty
18. General Agreement on Trade in Services
19. Agreement on the Application of Sanitary and Phytosanitary Measures
20. Agreement on Subsidies and Countervailing Measures
21. Agreement on Trade-Related Investments Measures (TRIMs)
22. Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
23. Agreement on Technical Barriers to Trade
24. United Nations Convention to Combat Desertification in those Countries Experiencing Serious Drought and/or Desertification, particularly in Africa
25. International Tropical Timber Agreement
26. United Nations Protocol to the 1979 Convention on Long Range Trans-boundary Air Pollution on Further Reduction of Sulphur Emissions
27. Energy Charter Protocol on Energy efficiency and Related Environmental Aspects
28. Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade

B. Other Multilateral Instruments

1. United Nations General Assembly Resolution 3201 (S-VI). Declaration on the Establishment of a New International Economic Order
2. United Nations General Assembly Resolution 3202 (S-VI). Program of Action on the Establishment of a New International Economic Order
3. United Nations General Assembly Resolution 1803 (XVII). Permanent Sovereignty over Natural Resources
4. ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy
5. The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices
6. International Undertaking on Plant Genetic Resources
7. Agenda 21 of the Earth Summit in Rio
8. WTO Decision on Measures in Favour of Least Developed Countries
9. OECD Guidelines for Multinational Enterprises
10. UNCTAD X Plan of Action
11. Program of Action for the Least Developed Countries for the Decade 2001-2010
12. Third Summit of the Americas – Plan of Action

C. Regional Level

1. The Treaty Establishing the European Community
2. European Commission Regulation (EC) No 240/96
3. Treaty establishing the Caribbean Community
4. Protocol III and Protocol V Amending the Treaty Establishing the Caribbean Community
5. Decision 406 - Codification of the Andean Sub-regional Integration Agreement (Cartagena Agreement)

6. Decision 291 of the Commission of the Cartagena Agreement: Regime for the Common Treatment of Foreign Capital and on Trademarks, Patents, Licensing Agreements and Royalties
7. Decision 345 – Common Provisions on the Protection of the Rights of Breeders of New Plant Varieties
8. North American Free Trade Agreement (NAFTA)
9. Plan of Action for the Sustainable Development of the Americas - Summit of the Americas on Sustainable Development Santa Cruz de la Sierra, Bolivia, December 7-8, 1996
10. Charter on a Regime of Multinational Industrial Enterprises (MIEs) in the Preferential Trade Area for Eastern and Southern African States
11. Treaty Establishing the African Economic Community
12. Organization of African Unity: Bamako Convention on the Ban of the Import into Africa and the Control of Trans-boundary Movement and Management of Hazardous Wastes within Africa
13. Treaty of the Southern African Development Community
14. Treaty of Economic Community of West African States (ECOWAS)
15. Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA)
16. Agreement on ASEAN Energy Cooperation
17. Protocol Amending the Agreement on ASEAN Energy Cooperation
18. Framework Agreements on Enhancing ASEAN Economic Cooperation
19. Memorandum of Understanding on ASEAN Cooperation and Joint Approaches in Agriculture and Forest Products Promotion Scheme
20. ASEAN Framework Agreement on Intellectual Property Cooperation
21. Ministerial Understanding on ASEAN Cooperation in Transportation
22. Framework Agreement on the ASEAN Investment Area
23. The Hanoi Plan of Action

D. Interregional Level

1. European Union – Mercosur: Interregional Framework Cooperation Agreement
2. Interregional Framework Cooperation Agreement between the European Community and its Member States, of the One part, and the Southern Common Market and its Party States, of the Other Part
3. Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States of the One Part, and the European Community and its Members States, of the Other Part

E. Bilateral Level

1. Project Agreement Between the Department of State, Agency for International Development (AID), an Agency of the Government of the United States of America, and an Agency of His Majesty's Government of Nepal
2. The Republic of Tunisia (Cooperating Country) and the USA, acting through the Agency for International Development (AID)
3. Agreement between the Government of Australia and the Government of the Islamic Republic of Pakistan on Development Co-operation
4. Agreement between the Government of Australia and the Government of the United Mexican States Concerning Cooperation in Peaceful Use of Nuclear Energy and the Transfer of Nuclear Material

Concept and International Treaty/ Legal Provisions Relating to Telecommunications

To operate telecommunication facility in any nation licence for the same is needed. A licence is a document that permits or authorises an act for which a licence is required. The legal requirement of a licence necessarily limits the operation of the licensed act, since the act can only be performed with a licence, which may have conditions attached to it. In the context of the regulation of the telecommunications industry, a

'licence' granted by the relevant authority defines the rights and duties of a particular telecommunications service provider, radio frequency user, or equipment supplier.

National Laws' Provisions in Telecommunications Acts

Every nation's Telecommunications Act is couched in prohibitive terms and mostly states that:

- (i) Subject to the provisions of this Act, no person shall provide a telecommunication service except under and in accordance with a telecommunication service licence issued to that person in terms of this Act or Chapter in the Act
- (ii) A licence shall confer on the holder the privileges and subject him or her to the obligations provided in this Act or specified in the licence.

The Act also defines terms like telecommunication, telecommunication system and the like. A 'telecommunication service' is defined in the Act as 'any service provided by Means of a telecommunication system'. A 'telecommunication system' is defined as any system or series of telecommunication facilities or radio, optical or other electromagnetic apparatus or any similar technical system used for the purpose of telecommunication, whether or not such telecommunication is subject to rearrangement, composition or other processes by any means in the course of their transmission or emission or reception.

A 'telecommunication facility' is defined as including 'any wire, cable, antenna, mast or other thing which is or may be used for or in connection with telecommunication'. 'Telecommunication' is defined as the emission, transmission or reception of a signal from one point to another by means of electricity, magnetism, radio or other electromagnetic waves, or any agency of a like nature, whether with or without the aid of tangible conductors.

A telecommunication service is therefore a service involving the emission, transmission or reception of a signal from one point to another.

Types of Telecom Licenses

Telecommunications Act of nations depending on their development and policy, usually points out the categories of licences that may be granted for the provision of telecommunication services are the following:

- Public switched telecommunication services (PSTS);
- Mobile cellular telecommunication services (MCTS);
- National long-distance telecommunication services;
- International telecommunication services;
- Multi-media services;
- Local access telecommunication services;
- Public pay-telephone services;
- Value-added network services (Vans);
- Under-serviced area licences (USAL); and
- Private telecommunication networks (PTN)

Purposes of Telecommunication Licensing

A telecommunication service licence serves primarily two purposes: it authorises a telecommunications service provider to provide a specified service or operate telecommunication facilities, and it defines the scope and ambit of that authority.

The objects of telecommunication of most nations and the WTO's GATS requirements that are sought to be achieved through proper licensing process are:

- (a) Promote the universal and affordable provision of telecommunication services;
- (b) Promote the provision of a wide range of telecommunication services in the interest of the economic growth and development of the Republic;
- (c) Make progress towards the universal provision of telecommunication services;

- (d) Encourage investment and innovation in the telecommunications industry;
- (e) Encourage the development of a competitive and effective telecommunications manufacturing and supply sector;
- (f) Promote the development of telecommunication services which are responsive to the needs of users and consumers;
- (g) Ensure that, in relation to the provision of telecommunication services, the needs of the local communities and areas are duly taken into account;
- (h) Ensure that the needs of disabled persons are taken into account in the provision of telecommunication services;
- (i) Ensure compliance with accepted technical standards in the provision and development of telecommunication services;
- (j) Ensure fair competition within the telecommunications industry;
- (k) Promote the stability of the telecommunications industry;
- (l) Encourage ownership and control of telecommunication services by persons from historically disadvantaged groups;
- (m) Protect the interests of telecommunications users and consumers;
- (n) Encourage the development of human resources in the telecommunications industry;
- (o) Promote small, medium and micro-enterprises within the telecommunications industry;
- (p) Ensure efficient use of the radio frequency spectrum;
- (q) Promote the empowerment and advancement of women in the telecommunications industry;
- (r) Promote and facilitate convergence of telecommunication, broadcasting and information technology; and
- (s) Develop the Information, Communication and Technology (ICT) strategy for the Republic, in order to bridge the digital divide.

GATS of the WTO and Telecommunication Services

GATS of the WTO, together with the Telecommunications Annex and the Fourth Protocol on Basic Telecommunications contain trade rules relating to telecommunications licensing. Every nation under WTO is obliged to ensure that its regulatory policies, laws and practices comply with these WTO rules and its own commitments.

Principles of GATS: The principles of GATS itself that relate directly to licensing are: Most Favoured Nation Treatment (MFN), Transparency, Barriers to trade, Applicability of Domestic Regulation (Reasonable Regulation), Space for Monopoly Providers (with Competition Safeguards) and Business Practices

In the context of telecommunications, this principle requires that access to telecommunication services be granted to operators from WTO member states on terms 'no less favourable' to those granted to service providers from the nation concerned or other nations, unless there are exemptions in a particular country's schedule of commitments.

GATS Article II: Most Favoured Nation Treatment - No discrimination among services or service suppliers of other Members

GATS Article III: Transparency - Promptly publish, or make otherwise publicly available, all relevant measures and international Agreements. Article III of GATS requires all laws and rules affecting trade in services to be published. Article 4 of the Telecommunications Annex specifically requires that information be published on:

- Tariffs and other terms and conditions of service;
- Specifications of technical interfaces with networks and services;
- Information on bodies responsible for the preparation and adoption of standards affecting access and use; and
- Conditions applying to attachment of terminal or other equipment; and notifications, registration or licensing requirements, if any.

This means that all information that a potential service provider would require must be readily available to that potential service provider.

For example, there must be ready access to information regarding what regulations have been made under the Act. The requirement in the Telecommunications Act that regulations must be published in the Government Gazette means that they are available to the public and therefore to a potential service provider.

GATS Article XVII: National Treatment: No discrimination against foreign services or service suppliers in relation to domestic ones is ensured by this article.

Annex on Telecommunications: Ensure public availability of conditions affecting access to and use of public telecommunications. E.g. tariffs, technical interfaces, standards bodies, attachment of terminal equipment & notification, registration or licensing requirements.

GATS Article VI: Domestic Regulation: In services where commitments are undertaken: Administer all measures applicable to services or service sectors in a reasonable, objective and impartial manner.

Independent telecom regulator: Appoint a regulator separate from, and not accountable to, any basic telecom supplier to prescribe and enforce adoption of decisions and procedures impartial with respect to all market participants.

In services or sectors where commitments are undertaken: Licensing, qualifications and standards be objective and based on transparent criteria and not more burdensome than necessary. Standards of relevant international organizations, e.g. the ITU or the ISO are to be taken into account. In services or sectors where commitments are undertaken: Licensing procedures must not restrict service supply. Inform the applicant of the decision within a reasonable time. Upon request, promptly inform of the status of the application

Spectrum Management: Allocate scarce resources, e.g. frequencies, numbers and rights of way in an objective, timely, transparent and non-discriminatory manner. Make publicly available the current state of allocated frequency bands. Although spectrum/frequency management can affect the number of suppliers, it is not, per se, a market access limit: Members have the right to exercise spectrum/frequency management

in a manner consistent with additional commitments & relevant GATS provisions.

GATS Article VIII deals with Monopolies and Exclusive Service Providers and is intended to **Ensure monopoly or exclusive suppliers do not** act in a manner inconsistent with MFN and scheduled commitments, in supply of their reserved services and abuse their position in a manner inconsistent with commitments on services in which they can compete.

GATS Article XIX: All Suppliers: Business Practices Upon request: Engage in consultations with a view to eliminating anti-competitive practices of service suppliers

Major Suppliers: The suppliers with control over essential facilities or dominant in the relevant market for basic telecom services defined as major supplies, **must maintain measures to prevent major suppliers from engaging in anti-competitive practices affecting trade in telecom, like** engaging in anti-competitive cross-subsidization, abusing information obtained from competitors, not promptly providing other suppliers the technical information on essential facilities & other commercially relevant information needed.

No unnecessary barriers to trade by Licensing: Licensing conditions must not operate as unnecessary barriers to trade, requires the GATS. This means that a licence may only restrict trade in telecommunication services where there are valid and justifiable reasons for doing so.

Interconnection Guarantees: Ensure interconnection with a major supplier is provided:

- i. At any technically feasible network point;
- ii. Under non-discriminatory terms, conditions and rates;
- iii. Of a quality no less favourable than provided for its own like services, those of non-affiliated suppliers or subsidiaries or other affiliates;
- iv. In a timely fashion;
- v. On terms, conditions and cost-oriented rates;

- vi. Sufficiently unbundled so that the supplier need not pay for network components it does not need;
- vii. On request, at network termination points other than those offered most users, subject to reasonable charges
- viii. Public availability of procedures for negotiations be available to ensure that the procedures applicable for interconnection to a major supplier are made publicly available;
- ix. Transparency of arrangements to ensure a major supplier makes publicly available either its interconnection agreements or model interconnection offer

Amendment of Licences

The Telecommunications Act of nations provide for amendments to licences already granted, only in the circumstances set out in relevant sections of the Act which may be as follows:

- A licence to provide a Public Switched Telecommunication Network may be amended if the amendment relates to universal access or universal service obligations provided it is considered the amendment is necessary as a result of changed circumstances or an amendment of the definition of universal access or universal service.
- Telecom's licence may be amended if the amendment is necessitated by the introduction of competition to Telecom in national long distance telecommunication services, local access telecommunication services or public pay-telephone services.
- All telecommunications service licences may be amended to make the conditions of the licence consistent with conditions being imposed generally in respect of all licences issued in the same category, for the purpose of ensuring fair competition between licensees in that category.
- All telecommunications licences may be amended to the extent necessitated by technological change.
- All telecommunications licences may be amended to the extent requested by the licensee.

United Nation's (UN) International Telecommunication Regulations (ITRs)

The **International Telecommunication Union (ITU)**, originally founded as the **International Telegraph Union**, is a specialized agency of the UN that is responsible for issues that concern information and communication technologies. The ITU coordinates the shared global use of the radio spectrum, promotes international cooperation in assigning satellite orbits, works to improve telecommunication infrastructure in the developing world, and assists in the development and coordination of worldwide technical standard.

ITU also organizes worldwide and regional exhibitions and forums, such as ITU TELECOM WORLD, bringing together representatives of government and the telecommunications and ICT industry to exchange ideas, knowledge and technology.

The ITU is active in areas including broadband Internet, latest-generation wireless technologies, aeronautical and maritime navigation, radio astronomy, satellite-based meteorology, convergence in fixed-mobile phone, Internet access, data, voice, TV broadcasting, and next-generation networks.

ITU, based in Geneva, Switzerland, is a member of the UN Development Group. Its membership includes 193 Member States and around 700 Sector Members and Associates.

In addition to the ITU-T Recommendations, which have non-mandatory status until they are adopted in national laws, **ITU-T is also the custodian of a binding international treaty, the International Telecommunication Regulations**. The ITRs go back to the earliest days of the ITU when there were two separate treaties, dealing with telegraph and telephone. The ITRs were adopted, as a single treaty, at the World Administrative Telegraphy and Telephone Conference held in Melbourne, 1988 (WATTC-88).

In line with the current Constitution and Convention of ITU, the ITRs can be amended through a World Conference on International Telecommunications (WCIT), and the next is scheduled for 2012. Before then a process of review of the ITRs, which began in 1998, will continue.

The ITRs comprise ten articles which deal, inter alia, with the definition of international telecommunication services, cooperation between countries and national administrations, safety of life and priority of telecommunications and charging and accounting principles. The adoption of the ITRs in 1988 is often taken as the start of the wider liberalization process in international telecommunications, though a few countries, including United States and United Kingdom, had made steps to liberalize their markets before 1988.

At the December, 2012, World Conference on International Telecommunications, ITU secretary-general Hamadoun Youre will convene member-state delegations in Dubai to renegotiate the ITR treaty.

“The sprawling document, which governs telephone, television, and radio networks, may be extended to cover the Internet, raising questions about who should control it, and how”, assessed one journalist looking forward to the conference earlier that year

World Conference on International Telecommunications 2012 (WCIT-12)

In December 2012, the ITU facilitated The World Conference on International Telecommunications 2012 (WCIT-12) in Dubai. WCIT-12 was a treaty-level conference to address on International Telecommunications Regulations (ITRs). ITRs govern international rules for telecommunication, including international tariffs. The previous conference to update the Regulations (ITRs) was held in Melbourne in 1988.

In August 2012, ITU called for a public consultation on a draft document ahead of the conference. It is claimed the proposal would allow government restriction or blocking of information disseminated via the internet and create a global regime of monitoring internet communications – including the demand that those who send and receive information identify themselves.

It would also allow governments to shut down the internet if there is the belief that it may interfere in the internal affairs of other states or that information of a sensitive nature might be shared.

Changes to International Telecommunication Regulations

The current regulatory structure was based on voice telecommunications, when the internet was still in its infancy. In 1988, telecommunications operated under regulated monopolies in most countries. As the Internet has grown, organizations such as ICANN (The **Internet Corporation for Assigned Names and Numbers**) have come into existence to manage key resources such as internet addresses and Domain Names. Some outside the United States believe that the United States exerts too much influence over the governance of the Internet.

Proposed Changes to the Treaty and Concerns

Current proposals look to take into account the prevalence of data communications. Proposals under consideration would establish regulatory oversight by the U.N. over security, fraud, traffic accounting as well as traffic flow, management of Internet Domain Names and internet protocol addresses and other aspects of the Internet that are currently governed either by community-based approaches such as Regional Internet Registries or largely national regulatory frameworks. The move by the ITU and some countries has alarmed many within the United States and within the Internet community. Indeed some European telecommunication services have proposed a so-called “sender pays” model that would require sources of Internet traffic to pay destinations, similar to the way funds are transferred between countries using the telephone.

On 14 December 2012, an amended version of the ITRs was signed by 89 of the 152 countries. Countries that did not sign included the USA, UK, India, Japan, Canada, Germany, New Zealand, etc. The reason voiced by these nations is predominantly is pivoted on the fact that the new ITRs are not supportive of the multi-stakeholder model of Internet governance.

Concept and Framework of International Treaty/Legal Provisions Relating to Electronic Commerce

E-commerce or electronic commerce, in its widest sense, means consumer and business transactions conducted over a network, using computers and telecommunications. In other words, e-commerce refers to the exchange of goods or services for value on the internet. E-commerce is

the use of electronic systems to engage in commercial activities. Businesses use e-commerce to buy and sell goods and services create greater corporate awareness and provide customer service. It includes, *inter alia*, on-line shopping, on-line trading of goods and services, electronic fund transfers, electronic data exchanges and on-line trading of financial instruments.

E-Commerce Components

E-commerce is a method of conducting business transactions but not a business transaction by itself. Therefore, the contents of a business transaction done through e-commerce are no different from that of a business transaction carried out through traditional means. Divergence however arises in two dimensions - the business methods and the business concepts. In e-commerce there are three distinct means of doing business: **electronic advertising, electronic sales and electronic delivery. The presence of anyone or more of these is sufficient to characterize the business as e-commerce.**

Electronic advertising: Advertising is done on the open networks, through websites. Potential customers access the websites and obtain the information they need which enables them thereafter to proceed with the transaction in suitable cases. If the e-commerce business is restricted to putting up a website alone, then the rest of the transaction is completed through traditional means; i.e. the placing of orders by telephone or mail, the making of payment by cheque and credit card and the delivery of goods through a carrier, the telephone etc. being referred to as intermediaries.

Electronic sales: This is done through 'smart' resources which enable the potential customer to place an order on the internet. The payment is effected through a closed network by means of credit cards.

Electronic delivery: This is of course possible only for goods and services that can be fully digitized, but this range is quite wide and ever expanding. Texts, visual materials, audio materials and computer software are digitized. Therefore products like journals, books, music, plans, designs, drawings and games to mention a few, would be goods available in digitized form. Besides goods, services like diagnostic services, could also be available in digitized form. Therefore a whole host of goods and services could be delivered electronically.

Kinds of E-Commerce Business Models

A new lexicon has developed for the different e-commerce business models. **“Brick and mortar”** companies are those that have a presence only in the physical world and are without a commercial Internet presence (virtually every major company now has a website but a brick and mortar company typically uses its site for passive promotional purposes rather than to engage in online commercial activity). **“Bricks and clicks”** companies are brick and mortar companies that combine a physical offline presence with one online. Examples in the United States include Barnes and Noble and Wal-Mart who sell from both their physical stores and their web stores. **“Pure-play Companies” or “Dot-Coms”** operate exclusively online. Examples include Amazon.com, which operates websites in the United States, United Kingdom, France and Japan and Monster.com, a global online job search service with sites in India, Singapore, Australia, Europe and North America.

Different E-Commerce Market Categories

Yes. Business-to-consumer companies (B2C) are involved with individual consumers in a retail or service setting. Business-to-business companies (B2B) provide goods or services to other businesses. Although B2B has less public prominence than B2C, most analysts agree that the B2B sector garners a much higher volume of business than does B2C. Consumer-to-consumer companies (C2C) facilitate transactions between individual consumers. eBay, an online auction site that serves the C2C market, generates revenue from transactional fees, ancillary services and advertizing. Also relevant are government-to-business (G2B) and government-to-consumer/citizen (G2C).

United Nations Convention on the Use of Electronic Communications in International Contracts (ECC).

The ‘Electronic Communications Convention’ or ECC) is a treaty that aims at facilitating the use of electronic communications in international trade. It was prepared by the **United Nations Commission on International Trade Law (UNCITRAL)** and adopted by the United Nations General Assembly on 23 November 2005.

Background and Policy Goals

UNCITRAL has been active in formulating uniform legislative standards for the use of electronic communications in trade since the 1980s. A first result of such work was the adoption of the UNCITRAL Model Law on Electronic Commerce, 1996 (MLEC), followed by the UNCITRAL Model Law on Electronic Signatures (MLES), 2001. However, a number of issues remained unsolved, namely, the possibility to enable to use of electronic communications in cases where a formal written requirement is mandated by another treaty, usually drafted before the widespread use of electronic means. Moreover, as model laws may be enacted with variations in the various jurisdictions, it was felt that establishing a core of common provisions would increase uniformity and therefore predictability in international trade law. Finally, it was felt that some of the provisions of the MLEC and of the MLES could be outdated and complemented.

Policy Goals of ECC

As a result, the **Electronic Communications Convention** addresses different policy goals:

- i) It removes obstacles arising from formal requirements contained in other international trade law treaties;
- ii) It provides a common substantive core to the law of electronic communications, thus ensuring a higher level of uniformity both in the legislative text and in its interpretation;
- iii) It updates and complements the provisions of the MLEC and of the MLES; 4) it provides core legislation on electronic communications to those States not having yet any, or having partial and insufficient provisions.

General Provisions

With respect to substantive provisions, the Electronic Communications Convention builds extensively, on the fundamental principles of the uniform law of electronic commerce developed by UNCITRAL (non-discrimination, technological neutrality, functional equivalence, and irrelevance of place of origin) as well as on several specific articles of the MLEC and of the MLES.

The Electronic Communications Convention is also inspired by a number of provisions of the CISG, especially in the parts relating to scope of application, to general principles and to final clauses. Thus, article 3 ECC corresponds to article 6 **Contracts for the International Sale of Goods** (CISG), giving effect to the principle of party autonomy. [The CISG was developed by the UNCITRAL and was signed in Vienna in 1980. The CISG is sometimes referred to as the **Vienna Convention** (but is not to be confused with other treaties signed in Vienna)]. Article 5 ECC is the equivalent of article 7 CISG, introducing a duty of uniform interpretation of the treaty, and defining the ancillary criteria for interpretation.

Article 6 builds on the notion of “place of business” introduced by the CISG and adapts it to the electronic environment. In particular, it is specified that the location of equipment and technology supporting an information system, or the location where the information system may be accessed by other parties, are not, as such, decisive to determine the place of business. Those elements may, however, concur to determine the place of business. Similar considerations apply to the use of a domain name or electronic mail address connected to a specific country. The sources of paras. 2 and 3 of article 6 ECC are found in article 15(4) (a) and (b) MLEC.

Scope of Application of the Convention

Article 1 ECC defines the scope of application of the Convention. The source of inspiration of that article is clearly article 1 of the UN convention of CISG. However, a major difference lies in the fact that the ECC, unlike the CISG, does not require that the concerned parties have their places of business in States parties to the ECC. Therefore, the ECC applies if the law applicable to the communications is the law of a State party to the ECC, or if the parties have validly chosen as the law applicable to their communications the law of a State party to the ECC. A third option is the application of the substantive provisions of the ECC if chosen by virtue of agreement of the parties.

According to art. 4(a) ECC “Communication” means any statement, declaration, demand, notice or request, including an offer and the acceptance of an offer, that the parties are required to make or choose to make in connection with the formation or performance of a contract; it is therefore not necessary that the contract is concluded. Moreover, it

is possible that only some or one clause of the contract are in electronic form, including, for instance, the arbitration clause. Moreover, according to art. 4(b) ECC “Electronic communication” means any communication that the parties make by means of data messages; the notion of data message is defined in art. 4 (c) ECC along the lines of the same definitions contained in the MLEC and MLES. The outcome of such broad approach is that the notion of electronic communication encompasses the use of different technologies, including, e.g., SMS, but also digital audio and video recording.

Art. 2(1)(a) ECC is inspired by article 2(a) CISG. Both provisions aim at excluding consumers’ transactions from the scope of application of the respective conventions. Art. 2(1)(b) ECC excludes from the scope of application of the convention certain fields that already enjoy uniform legal provisions, contractually (e.g., international payments systems) or otherwise (e.g., treaties relating to securities held with an intermediary). Art. 2(2) ECC excludes from the scope of application of the convention electronic transferable records. These are electronic records that entitle the entity controlling them to the delivery of goods or the payment of a sum, as evidenced in the record. This exclusion is due to the fact that uniform legal standards for the functional equivalence of notions such as “possession” in the electronic world have yet to be developed. Since 2011, UNCITRAL Working Group IV (Electronic Commerce) is tasked with defining those standards.

States may vary the scope of application of the Convention by lodging declarations. Thus, the declaration foreseen in article 19(1)(a) limits the application of the Convention to cases when all the States where the parties involved in the transaction have their place of business are contracting States. This is the same mechanism envisaged in article 1(1) (a) CISG. Article 19(1)(b) limits the application of the Convention to cases when the parties so choose.

Article 19(2) ECC gives States the possibility to exclude certain matters from the scope of application of the ECC. These exceptions could be similar to those made in corresponding national legislation: Singapore has lodged this type of declaration upon ratification of the Electronic Communications Convention.

Last, but not least, parties may vary or derogate from any provision of the Convention under its article 3. This is a provision common in international trade law treaties, where freedom of contract is considered an overarching principle. However, in practice there might be limits of public order, or other mandatory provisions, that might limit the freedom of the parties.

Substantive Provisions of the Convention

Article 8 ECC sets forth at the international level the principle of non-discrimination of electronic communications already established, for national legislation, in article 5 MLEC.

Article 9 ECC is the core provision establishing the parameters for functional equivalence between electronic and paper-based communications.

In particular, article 9(2) ECC deals with functional equivalence of the notion of “written form”. The provision follows that of article 6(1) MLEC.

Article 9(3) ECC deals with functional equivalence for “signature”. In practice, this provision enables cross-border recognition of all types of electronic signatures. To do so, art. 9(3) ECC departs from both UNCITRAL relevant precedents, i.e. article 7(1) MLEC and article 12 MLES. It should be noted that two major innovations were introduced with respect to article 7(1) MLEC: a) the notion of “person’s approval” was substituted with that of “party’s intention” in order to better capture the various functions associated with signatures, which go well beyond mere approval; and b) a safety clause was introduced in article 9(3)(b)(ii) ECC to ensure that electronic signatures that provide for a method to identify the party and to indicate the party’s intention, and that have indeed fulfilled that function by themselves or together with other evidence, may not be repudiated. In other words, if it is possible to identify the signatory of an electronic communication, that signatory may not challenge the signature on the basis of the signature’s method or nature.

Article 9(4) and (5) ECC provides for the functional equivalent of original, along the lines of article 8(1) and (3) MLEC.

Article 10 ECC deals with time and place of dispatch and receipt of electronic communications. Its predecessor is article 15 MLEC.

Article 10(1) ECC innovates on article 15(1) MLEC: in the ECC, the electronic communication is dispatched when it leaves the system under the control of the originator, while in the MLEC it (or, better, the data message in the terminology of that Model Law) has to enter a system outside the control of the originator: the rule has been changed in order to avoid consequences for the originator when the message may not enter the information system for reasons not under control of the originator (e.g., firewall; filter; system down...).

Article 10(2) ECC follows article 15(2) MLEC in introducing the difference between designated and non-designated electronic address for determining the time of receipt of an electronic communication. Article 10(2) ECC contains a novel element by requiring that the recipient should be aware that the communication was sent (and the communication is capable of being retrieved), while the provision of the MLEC requires actual retrieval by the addressee, which might again expose the originator to liability for circumstances under the addressee's control. Article 10(3) ECC corresponds to article 15(4) MLEC. This provision must be read in conjunction with article 6 ECC, as must be article 10(4) ECC.

Final Clauses

The Electronic Communications Convention contains, in its Chapter IV, rather elaborate final clauses. Final clauses aimed at modifying the scope of application of the Convention are discussed above.

a. Relation to Regional Legislation

Article 17 ECC sets forth the applicable rules for those cases where electronic communications fall under the legislative authority of a Regional Economic Integration Organization (**REIO**). The rationale of article 17 is, on the one hand, to ensure that the Convention will not be applied to commercial relations falling under the scope of application of the legislation of the REIO and, on the other hand, to clarify the distribution of legislative power between REIOs (and therefore unaffected by the Convention) and national States (and therefore under the scope of

the Convention in case of cross-border exchanges). In other words, the Convention does not intend to interfere with regional regimes.

In particular, article 17(2) ECC requires the REIO that intends to become a party to the ECC to deposit a declaration on the distribution of competences between the REIO and its member States. The REIO member States are supposed to do the same. Article 17(4) contains the “disconnection clause” that should ensure that REIOs’ legal regimes are unaffected by the operation of the Electronic Communications Convention.

The matter has important practical consequences. In fact, the absence of an agreed declaration on the distribution of competences between the European Union and its member States has prevented those States from signing or becoming a party to the Electronic Communications Convention, among the 19 States that are signatory or party to the Convention, none is an EU member State.

b. Interaction with Other International Trade Law Treaties

One major goal of the Electronic Communications Convention is the removal of obstacles to international trade arising from the insertion of formal requirements in treaties concluded before the broad adoption of electronic means. Article 20 ECC lists several treaties prepared by UNCITRAL as treaties that will be “electrified” by the adoption of the ECC. In other words, by virtue of adoption of the ECC formal requirements contained in those treaties, especially written form requirements, will be satisfied with the use of electronic communications under the conditions set forth in the ECC.

It should be noted that some UNCITRAL treaties are excluded from the list in article 20, in particular, the United Nations convention in the Carriage of goods by Sea, 1978 (the “Hamburg Rules”) and the United Nations Convention on International Bills of Exchange and International Promissory Notes, 1988. The reason for the exclusion is that those two treaties contain provisions on negotiable documents, which are excluded from the scope of the ECC (art. 2(2)). The United Nations Convention on for the International Carriage of Goods Wholly or Partly by Sea, 2008 (the “Rotterdam Rules”), which was also prepared by UNCITRAL and

contains provisions on electronic transferable records, was concluded after the ECC.

Article 20(2) ECC indicates that the Convention will apply also to all other treaties where the exchange of electronic communications is relevant, unless a State declares not to be bound by this provision. Even if this “opt out” declaration is made, the declaring State may still choose, under article 20(3) ECC, certain treaties to which the ECC will apply.

Article 20(4) ECC gives the possibility of a State to prevent the interaction of the ECC with a given treaty even if the State has not lodged any other declaration regarding the Convention’s scope of application. In other words, under article 20(3) ECC the State makes a general opt out and a selective opt in, while under article 20(4) the State makes a general opt in, and a selective opt out.

Self Assessment Questions

1. Present the concept and international treaty/legal provisions relating to Licensing in Global Business
2. Elucidate the international treaty/legal provisions relating to of Franchising in Global Business
3. Explain the concept and international treaty/legal provisions relating to Joint Ventures in International Business
4. Present the international treaty/legal provisions relating to Patents
5. Examine the concept and international treaty/legal provisions relating to Trade Marks
6. Present the international treaty/legal provisions on Technology Transfer
7. What are the international treaty/legal provisions relating to Telecommunications
8. To understand the framework relating to Electronic Commerce.
9. Explain United Nations Convention on the Use of Electronic Communications in International Contracts (ECC).
10. Present the United Nation’s (UN) International Telecommunication Regulations (ITRs)

11. Explain the Budapest Treaty on the International Recognition of The Deposit of Microorganisms For The Purposes of Patent Procedure.
12. Explain in detail the Legal Aspects in Franchising
13. Give an overview of international treaties relevant to global businessd.

UNIT - IV

Regulatory Framework and Taxation

Learning Objectives

The learning objectives from this lesson are as follows:

- To learn the Regulatory Framework of Electronic Commerce
- To discuss the Regulatory Framework of Cross Border Transactions
- To present Regulatory Framework of On-line Financial Transfers and Legal safeguards
- To understand the International Business Taxation and Tax Laws Regarding Electronic Commerce and Cross Border Transactions
- To study the Multilateral and Bi-lateral treaties and Sharing of Tax revenues

Regulatory Framework for Electronic Commerce

The Regulatory Framework of Electronic Commerce is elaborate, with international treaty arrangements, international laws, national laws and so on. These are dealt here. The UN Treaty is already dealt in the previous unit.

The most important elements of e-commerce law relate to the fundamental components of commercial transactions – how to ensure that an online contract is as valid and enforceable as one consummated offline. The building blocks of e-commerce law therefore focus on both enforcing the validity of electronic contracts and ensuring that the parties can be held to their bargains.

Once the contractual issues have been addressed, e-commerce law analysis shifts to a series of legal issues that may govern the transaction. These include jurisdiction (which court or arbitral tribunal can adjudicate

a case), consumer protection issues, taxation, privacy, domain name disputes, as well as the role and potential liability of intermediaries such as Internet service providers.

Parties Addressing E-Commerce Law at the International Level

As discussed in greater detail below, several organizations contribute to the development of global e-commerce law at the international level. Different organizations, namely **UNCITRAL**, **OECD**, **WIPO**, **ICANN**, **AEPC**, **The Hague Conference on Private International Law** and **WTO** have tended to take the lead on different issues. These are dealt here.

i. *UNCITRAL (UN Commission on International Trade Law)*

UNCITRAL (UN Commission on International Trade Law) has played a leading role in developing model laws for e-commerce transactions. UNCITRAL focuses on law reform and creating model commercial laws that are both accessible and predictable. This is accomplished through:

- Conventions, model laws and rules which are acceptable worldwide
- Legal and legislative guides and practical recommendations
- Updated information on case law and enactments of uniform commercial law
- Technical assistance in law reform projects
- Regional and national seminars on uniform commercial law.

The Commission has established six working groups to perform the substantive preparatory work on a range of topics, including: international sale of goods; international transport of goods; international commercial arbitration; public procurement and infrastructure development; construction contracts; international payments; cross-border insolvency and, most important for current purposes, electronic commerce.

UNCITRAL's involvement with e-commerce: UNCITRAL created a Model Law on Electronic Commerce in 1996 to enhance the use of paperless communication. In 2001, it created a Model Law on Electronic Signatures. Future electronic commerce work will focus on: electronic contracting, with a view to creating a draft convention; online dispute

settlement; dematerialization of documents of title; and a convention to remove legal barriers to the development of electronic commerce in international trade instruments.

ii. *OECD (Organization for Economic Cooperation and Development)*

OECD has been at the forefront of Internet taxation, e-commerce consumer protection and privacy. The Organization for Economic Cooperation and Development (OECD) grew out of the Organization for European Economic Cooperation, which administered American and Canadian aid to Europe after World War II.

Established in 1961, OECD today has 30 member countries and maintains active relationships with 70 more. Its goals are to build strong economies in its member countries, improve market systems, expand free trade and contribute to development in both industrialized and developing countries. The governing body of OECD, the Council, is led by a secretary-general and is made up of representatives of member countries, who provide guidance on the work of OECD committees and decide on the annual budget.

Tasks of OECD: OECD facilitates the creation of international instruments, decisions and recommendations in areas where multilateral agreements may create progress for individual countries in a globalized economy. Its various directorates and committees analyze issues, identify policies and deal with a wide range of economic and social issues from macroeconomics to trade, education, development and science and innovation.

OECD's Involvement With E-Commerce

E-commerce has become an area of focus for OECD because of its trans-border nature and its potential for all countries in the areas of economic growth, trade and improved social conditions. It has developed policy in areas ranging from telecommunication infrastructure and services to taxation, consumer protection, network security, privacy and data protection, as well as emerging markets and developing economies. Following its "OECD Action Plan for Electronic Commerce", endorsed by its members in 1998, its work program focus is to build trust for users and

consumers; establish ground rules for the digital marketplace; enhance the information infrastructure for e-commerce; and maximize the benefits of e-commerce.

Some of the activities currently under way in the area of e-commerce include:

- Implementing aspects of the OECD Guidelines for Consumer Protection in the Context of Electronic Commerce;
- Promoting the use of privacy-enhancing technologies and user education and awareness about online privacy issues;
- Studying the effects of e-commerce on cross-border trade in financial services, on contract law and on electronic delivery of insurance products;
- Studying access to high-bandwidth information and communication technologies at affordable costs in rural as well as in urban areas;
- Researching the needs for and constraints to, capacity development for trade faced by developing countries; and
- Disseminating its work on e-commerce to member and non-member countries through other international organizations.

iii. WIPO (*World Intellectual Property Organization*)

WIPO has been the international leader on digital copyright and trademark issues involving domain names. The World Intellectual Property Organization (WIPO) is an international organization that promotes and protects original works in the realms of art, science and technology. Headquartered in Switzerland, WIPO is one of the 16 specialized agencies of the United Nations. It administers 23 international treaties dealing with different aspects of intellectual property protection (both industrial protection and copyright) and has more than 170 Member States. Although WIPO was formed in 1970, its roots go back as far as the 1883 Paris Convention for the Protection of Industrial Property. In 1974, WIPO became a specialized agency of the United Nations with the mandate to administer intellectual property matters recognized by the Member States of the United Nations.

WIPO's Task in E-Commerce

WIPO has created a Digital Agenda to respond to the confluence of the Internet, digital technologies and the intellectual property system. Through international discussions and negotiations, WIPO is formulating new ways in which intellectual works can be disseminated, while at the same time ensuring the rights of their creators remain protected.

The Digital Agenda also aims to:

- Integrate developing countries into the Internet environment through such tools as the use of WIPO net and the electronic delivery of information and services;
- Rethink how intellectual property law works in Internet transactions and examine emerging new norms in this respect;
- Facilitate the creation of effective online systems to resolve disputes; and
- Coordinate and ensure the development of efficient and consistent responses to common concerns across national and multi-sectoral boundaries.

iv. ICANN (Internet Corporation for Assigned Names and Numbers)

ICANN has implemented the Uniform Domain Name Dispute Resolution Policy, which has addressed thousands of domain name disputes. The ICANN is a technical coordination body for the Internet. Created in October 1998 by a broad coalition of the Internet's business, technical, academic and user communities, ICANN has assumed responsibility for a set of technical functions previously performed under United States Government contract by other groups.

As a non-profit, private-sector corporation, ICANN is dedicated: to preserving the operational stability of the Internet; to promoting competition; to achieving broad representation of global Internet communities; and to developing policy through private-sector, bottom-up, consensus-based means. ICANN welcomes the participation of any interested Internet user, business or organization. The Board of ICANN

is currently composed of nineteen directors: nine at-large directors, nine selected by ICANN's three supporting organizations and the president/CEO (ex officio). Five of the current at-large directors were selected by an Internet users' vote.

Tasks of ICANN

ICANN coordinates the assignment of the following identifiers that must be globally unique for the Internet to function:

- Internet domain names
- IP address numbers
- Protocol parameter and port numbers.

In addition, ICANN coordinates the stable operation of the Internet's root server system.

ICANN's Involvement With E-Commerce

Future ICANN work is likely to address several key issues including institutional reform, the participation of Internet users in the policy-making process, the establishment of new top-level domains and amendments to ICANN's domain name dispute resolution process.

iv. APEC (Asia Pacific Economic Cooperation)

APEC (Asia Pacific Economic Cooperation) has worked on digital divide concerns and small and medium-sized enterprise (SME) e-commerce adoption. The Asia-Pacific Economic Cooperation (APEC) was established in 1989 in response to the growing interdependence of Asia-Pacific economies. It began as an informal ministerial-level dialogue group with 12 members and has grown to include 21 member economies comprising some 2.5 billion people, a combined gross domestic product of over USD 18 trillion in 1999 and over 47 per cent of world trade. Its goal is to advance economic dynamism and sense of community within the Asia-Pacific region.

APEC operates by consensus. The APEC chair rotates annually among members and hosts an annual ministerial meeting of foreign and economic ministers. At each year's ministerial meeting, members define and fund the work programs for APEC's various committees,

subcommittees, working groups and forums. APEC also has a Business Advisory Council composed of up to three senior business people from each member economy to provide advice on APEC action plans and specific business/private sector priorities.

Tasks of APEC: APEC's goal is to achieve "free and open trade and investment in the Asia-Pacific by 2010 for developed member economies and 2020 for developing ones." In Osaka in 1995, APEC leaders established the three pillars of APEC activities: trade and investment liberalization, business facilitation and economic and technical cooperation. In 2000, APEC's objectives included:

- Managing globalization through economic and technical cooperation and through participating in international forums;
- An Action Agenda for the New Economy, focusing on an e-Commerce Readiness Assessment, paperless trading and capacity building for both people and institutions;
- Ensuring individuals from rural and urban communities alike have access to the Internet by 2010, including a pledge to triple the number of people with such access by 2005; and
- Strengthening the multilateral trading system through a new WTO round.

APEC's involvement with e-commerce: APEC's E-Commerce Steering Group is currently working on a range of issues, including:

- A Digital Divide Blueprint for Action to address issues of the digital divide and reliable, affordable access to the information infrastructure;
- Paperless trading;
- A review of the 2000 APEC Action Plan to Support the Use of Electronic Commerce by SMEs;
- Development of APEC voluntary online consumer protection principles;
- Development of policy regarding the creation of an environment conducive to e-learning; and

- Reviewing and updating the 1998 APEC Blueprint for Action on Electronic Commerce.

vi. The Hague Conference on Private International Law

The Hague Conference on Private International Law has been the worldwide leader on Internet jurisdiction issues. The Hague Conference is an intergovernmental organization that works to unify private international law rules. The first session of The Hague Conference was held in 1893; after seven more sessions, a statute came into force in 1955 making the Conference a permanent organization.

The Conference, which has 59 Member States, holds plenary sessions every four years to discuss and adopt draft conventions and recommendations and make decisions on the working agenda of the Conference. Non-Member States invited to participate on an equal footing with Member States can vote at plenary sessions. The Conference is organized by a secretariat (the Permanent Bureau) which has its seat at The Hague and whose officials must be of different nationalities. The Bureau organizes the plenary sessions and maintains contacts with Member States, international organizations and users of the conventions.

Tasks of Hague Conference

The principal role of the Conference is to negotiate and draft multilateral treaties (conventions) in the different fields of private international law (e.g. international judicial and administrative cooperation; conflict of laws for contracts, torts, maintenance obligations, status and protection of children, relations between spouses, wills and estates or trusts; jurisdiction and enforcement of foreign judgments).

Currently, its areas of concern include:

- Conflict of jurisdictions;
- Applicable law and international judicial and administrative cooperation regarding civil liability for environmental damage;
- Problems of private international law raised by electronic interchange; and
- Maintenance (support) obligations.

Hague Conference's Involvement With E-Commerce

In 1999, the Conference held a round-table discussion (in conjunction with the University of Geneva) with experts in various fields on issues arising from e-commerce and Internet transactions. A series of recommendations were adopted in such areas as online contracts, business-to-business and business-to-consumer transactions and online dispute resolution.

In June 2001 the Conference held its Nineteenth Session to work towards a new Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters and to decide on its future work program. Delegates based their discussions on both a Preliminary Draft Convention drawn up in October 1999 and on the results of formal and informal meetings of experts on e-commerce and intellectual property.

vii. *WTO's Role in E-Commerce Law*

At the 1998 ministerial meeting, WTO members agreed to study trade issues arising from global electronic commerce, focusing on three questions:

- How do existing WTO agreements impact e-commerce?
- Are there any weaknesses or omissions in the law which needs to be remedied?
- Are there any new issues not now covered by WTO system on which members want to negotiate new disciplines?

Since then, issues related to e-commerce have been examined by WTO councils in the areas of services, goods, intellectual property and trade and development. A seminar on "Government Facilitation of E-commerce for Development" was held in June 2000, at which speakers from developing and developed countries, international organizations and the private sector addressed issues related to e-commerce and development. Each of WTO bodies working on e-commerce issues has produced progress reports for the General Council.

Parties Addressing E-Commerce Law at the National Level

E-commerce law frameworks at the national level vary by country. In some countries, such as Japan, India, Malaysia, South Africa and Columbia, most of the e-commerce law and policy initiatives come from the national government. The United States and Canada use a dual approach whereby both the federal and state/provincial governments play a role, while in the European Union, directives applicable in all Member States are often the most important source of legal guidance.

I. United States of America

Agencies and Organizations of United States in the forefront of e-commerce law and policy development are dealt below.

The United States has been a leader in developing e-commerce law policy since the Internet's inception. Agencies and organizations leading the way include:

- The Department of Commerce, which continues to play an oversight role over the Internet's infrastructure including the domain name system.
- The Federal Trade Commission, which has played the role of privacy and consumer protection enforcer.
- The Department of Justice, which administers United States competition law policy;
- The State Department, which leads the United States delegation at the Hague Conference negotiations;
- The Federal Communications Commission, which regulates communications infrastructure;
- The American Bar Association, which has developed policy documents on jurisdiction, privacy and e-commerce law; and
- The National Conference of Commissioners on Uniform State Law, which has drafted the Uniform Electronic Transactions Act, the United States version of the UNCITRAL Model Law on Electronic Commerce.

ii. Canada

Agencies that play a significant role in Canadian Internet and e-commerce law and policy include:

- Industry Canada (privacy, electronic commerce, electronic signatures, copyright)
- Justice (jurisdiction, cyber-crime)
- Canadian Heritage (copyright)
- Competition Bureau (consumer protection, marketplace regulation)
- Canadian Internet Registration Authority (dot-ca domain names)
- Canadian Copyright Board (copyright)
- Canadian Radio-television and Telecommunications Commission (broadcast, Internet regulation)
- Uniform Law Conference of Canada (e-commerce, jurisdiction).

iii. Australia

Although Australia has enacted e-commerce, privacy and online gambling legislation, it is perhaps best known for its online content regulation. The Australia Broadcasting Authority has been granted the power to order offensive content removed from Australian-based websites and to request that Australian Internet service providers take steps to make such foreign-based content inaccessible to Australian users. Despite dire predictions about the likely effect of such legislation, few sites have been removed from the web and the number of complaints has been relatively limited.

iv. Singapore

While dozens of countries have enacted e-commerce legislation, Singapore stands as one of the very first to establish an e-commerce legal framework. The country enacted the Electronic Transactions Act of 1998 in June of that year. Moreover, the first digitally signed international government document between Singapore, Canada and the State of Pennsylvania was signed in April 1998.

v. *Colombia*

Colombia approved a law on electronic commerce, digital signatures and certification authorities (Proyecto de Ley Sobre Comercio Electrónico, Firmas Digitales y Autoridades de Certificación) in August 1999. The law is based on the UNCITRAL Model Law on Electronic Commerce. Further regulations concerning requirements for certificate authorities (discussed further below) have also been adopted.

Important NGOs in the E-Commerce Law and Policy Development Process

On certain issues, such as jurisdictional rules and consumer protection, NGOs play a critical role in the development of e-commerce law and policy as they are often accorded a place at the negotiating and drafting table. At other times, the role of the NGO is more reactive, responding to new proposals and lobbying on behalf of business or consumer interests.

i. CBDe – Global Business Dialogue on E-Commerce

Established in January 1999, the Global Business Dialogue on E-commerce counts dozens of the world's largest companies as its members including Disney, Vivendi Universal, BCE, AOL Time Warner, NEC, NTT, Hitachi, Toshiba, Alcatel, Deutsche Telekom, Daimler Chrysler and Nokia. GBDe focuses on providing governments with the business perspective on e-commerce law and policy development. The organization has identified eight areas of concern: consumer confidence, convergence, cyber-security, digital bridges, e-government, intellectual property rights, taxation and trade.

ii. Internet Law and Policy Forum (ILPE)

Internet Law and Policy Forum Founded in 1995, the Internet Law and Policy Forum is an international non-profit organization of major, Internet-oriented companies, including Verisign, Microsoft, BCE, Fujitsu and Deutsche Telekom, dedicated to promoting the global growth of electronic commerce and communications by contributing to solutions of the particular legal issues which arise from the cross-border nature of the

Internet and electronic networks. ILPF provides information, calling upon the legal, business and technical expertise of its member companies and other companies, from governments and intergovernmental organizations and from the practice of law around the world.

ILPF addresses issues of concern through working groups consisting of representatives from member organizations. It currently has four such working groups:

- Working Group on Jurisdiction
- Working Group on Electronic Authentication (a combination of the original Working Groups on Certificate Authorities and on Digital Signatures)
- Working Group on Content Regulation and Intermediary Liability
- Working Group on Self-Regulation.

iii. Consumers International

Founded in 1960, Consumers International supports, links and represents consumer groups and agencies all over the world. It has a membership of more than 260 organizations in almost 120 countries. It strives to promote a fairer society through defending the rights of all consumers, including the poor, marginalized and disadvantaged. Consumers International identified e-commerce as an issue of concern in 1998, calling on governments to establish global protections for consumers who are engaged in e-commerce. Since that time, the organization has played a leading role in crafting e-commerce consumer protection policy and in working to establish effective and fair dispute resolution processes.

iv. Electronic Privacy Information Centre (EPIC)

EPIC is a public interest research centre in Washington, D.C., established in 1994 to focus public attention on emerging civil liberties issues and to protect privacy, the First Amendment of the United States Constitution and constitutional values. EPIC acts predominantly on cases of interest to the United States. It has appeared on some of the Internet and e-commerce's leading-edge cases including the Scarfo case on key stroke monitoring, the Microsoft antitrust case and the case challenging

the constitutionality of the Children's Online Protection Act. EPIC has also played an important role in global awareness campaigns involving privacy issues.

v. International Chamber of Commerce (ICC)

The International Chamber of Commerce is a world business organization that speaks on behalf of enterprises from all sectors in every part of the world. ICC promotes an open international trade and investment system and the market economy. It often works with its member companies to develop global business codes of conduct. It also provides essential services, foremost among them the ICC International Court of Arbitration, a leading arbitral institution. Within a year of the creation of the United Nations, ICC was granted consultative status at the highest level with the United Nations and its specialized agencies. ICC is involved in e-commerce law issues on several fronts. Given its leading role in dispute resolution, ICC has shown a keen interest in developing dispute resolution for both B2C and B2B E-Commerce. It has adapted for e-commerce its leading international trade rules, such as the Incoterms and the Uniform Rules for Documentary Credits (UCP 500). The organization has also become involved in jurisdictional negotiations, privacy and electronic contracting.

Regulatory Framework of Cross Border Transactions

Cross-border business transactions are complex. No transaction can be carried out without a normative structure to provide a framework for the actors to operate within. Obligations, rights, warranties, covenants, and so on have to be specified and allocated. Even economists agree that the rule of law is essential for the conduct of business. States, however, jealously guard their legal systems and resist incursions in their jurisdictions by others. No matter the level of hyper-legality" states adopt, they will always be incapable of providing all the necessary support structures for cross-border business.

Insufficiency of National Legal System

National legal systems fail to work efficiently in many circumstances and many transactions are actually coordinated by non-legal structures.

Still, in a national context actors usually have the possibility to resort to the state legal system in an endgame situation. This is completely different in the international context, where the development of a global legal system is unlikely at the present moment. The efforts of the nation states to create unified law are obvious, but the number of conventions that have been actually ratified by a sufficient number of nations in order to come into force remains small.

Nevertheless, it would be a mistake to give up the legal approach too early. Many companies have suffered negative experiences with cross-border litigation. There is a tendency among traders to consider the effectiveness of the legal system to be lower than it actually is. If international actors cooperate with lawyers to realize a transaction or to solve a conflict, the stabilization of expectations can occur only at the level of the role of the lawyer and not at the level of the legal system.

Shapiro assumes that a global commercial law can come into existence by the creation of a relatively uniform set of contract provisions. Parties may also resort to arbitral tribunals or national courts to resolve their disputes. This approach is also supported by the enormous success of international law firms, which create complex contracts that work as a system of private government largely freestanding of any national jurisdiction.

Laws Applicable to Cross border Transactions Business

1. Private International Law

The use of domestic choice of law rules to resolve issues of conflicts of laws and recognition and enforcement of foreign judgments. It is a domestic law field referring to a domestic court applying domestic rules to resolve choice of what laws between 2+ nations.

- i. **Choice of law rules is different from substantive law rules**
 - a. Examples: UCC 1-105 and Restatement Secs. 6 & 188 as choice-of-law rules and UCC 2-207 as substantive law rules. (UCC-Uniform Commercial Code of UN)
- ii. **Choice of law rules is different in different countries.**

- a. In the US, choice-of-law rules are usually specified in statute governing a particular transaction. E.g., UCC 1-105 for sales transactions.
- b. If no statutes, then case law or Restatements on Conflicts of Law. The Factors that a domestic court weighs are on p. 24

2. *Harmonization of Private International Law*

To harmonize private international law rules, the Hague Convention on Private International Law was convened by the Netherlands government in 1893. It became a permanent intergovernmental organization in 1955 under a statute adopted by a treaty.

- a. Has convention on choice of laws for many subject areas. E.g., the Convention on the Law Applicable to International Sale of Goods
- b. Substantive rules of law that applies to a particular transaction:
 - i. National laws as chosen by private international law rules
 - ii. Private international law rules are important only if national laws differ

3. *Supranational Laws*

Supranational laws could replace national laws, making choice of law rules inconsequential.

- i. Public international law- international Treaties e.g. CISG.
 - a. Once public international law is entered into, it is part of the domestic law of a country.
 - b. In the US, Treaties are federal law. International laws will prevail if they conflict with state laws.
- ii. Regional Supranational law e.g. EU
- iii. Uniform Code e.g. Inco-terms by ICC
 - a. Promulgated by private and nongovernmental bodies
 - b. Have no force of law unless incorporated by contract These supranational laws are sometimes called the New Lex Mercatoria ("New Law Merchant"). Before there were nation-states, IBT

in Europe was governed by Lex Mercatoria, a special body of common Law applicable to business transactions among European merchants. The “New Lex Mercatoria ” makes the law governing IBT truly international.

- c. Legal institutions and forums that create and interpret the law

4. UNCITRAL—*United Nations Commission on International Trade Law*

Established in 1966; composed of 60 UN member states. Membership represents various geographic regions as well as the principal legal and economic systems. Created multilateral conventions or treaties on international commerce that have the force of law such as the CISG (Convention on Contracts for the International Sales of Goods) and the “Hamburg Rules” (Convention on the Carriage of Goods by Sea), etc. These Conventions are formally adopted by the UN, and then open for countries to sign and ratify. The UNCITRAL is subject to UN pressure, and sensitive to issues to developing nations.

5. UNIDROIT—*The International Institute for the Unification of Private Law*

Established in 1926 as an organ of the League of Nations: It remained as an independent body after the League of Nations ’ demise. Has some overlapping goals with UNCITRAL. Principal drafters of UNIDROIT treaties are Western European nations; many developing countries are reluctant to adopt them. Has shifted to non-binding instruments like the Principles of International Commercial Contracts, the world’s restatement of contract law

6. ICC—*International Chamber of Commerce*

A private nonprofit organization; composed of national chambers of commerce, trade and business associations, and companies from about 130 countries. ICC represents interests of private business and industry. ICC runs a court of arbitration ICC creates uniform rules and standards for international business by promulgating nonbinding rules that can be adopted by contract. These include: a. Inco-terms and b. UCP (Uniform Customs and Practice for Documentary Credits).

Regulatory Framework of On-Line Financial Transfers and Legal Safeguards

First let us see, the meaning of On-line or electronic financial transfers. On-line financial transfer is a financial payment or fund relocating or shifting.

A **payment** is the transfer of money from one party (such as a person or company) to another. A payment is usually made in exchange for the provision of goods or services or any value received or both, or to fulfill a legal obligation. In law, the **payer** is the party making a payment while the **payee** is the party receiving the payment. There are no arbitrary limits on the form a payment can take and thus in complex transactions between businesses, payments may take the form of stock or other more complicated arrangements. So barter, currency, cheque, draft, pay-order, debit or credit card, account-to-account transfer, swap of mutual dues, etc are forms of payment. In every payment there is fund transfer.

Payment Methods/Technologies in On-line financial Transfer:

There are two types of payment methods, namely exchanging and provisioning. Exchanging is to change coin, currency or bank notes in terms of the price. Provisioning is to transfer money from one account to another. In this method, a third party must be involved. **Debit card, credit card money transfers and recurring cash or ACH (Automated Clearing House) disbursements are all electronic payments methods.** Electronic payments technologies are magnetic stripe card, smartcards, contactless card and mobile handset. Mobile handset based payments are called mobile payments.

Parties involved in On-line Finance Transfer: Payments may be classified by the number of parties involved to consummate a transaction. For example, a credit card transaction in India or the USA requires a minimum of four parties (the purchaser, the seller, the issuing bank and the acquiring bank). A cash payment requires a minimum of three parties (the seller, the purchaser, and the issuer of the currency). A barter payment requires a minimum of two parties (the purchaser and the seller).

Payment Providers: The infrastructure and electronic clearing methods are formed by the payment provider. Global credit card payment

providers are Visa and MasterCard. Maestro and cirrus are international debit card payment providers.

Electronic Funds Transfer (EFT) Methods

EFT method is the electronic exchange, transfer of money from one account to another, either within a single financial institution or across multiple institutions, through computer-based systems. The term **Electronic funds transfer** covers a number of different concepts.

Wire Transfer: wire transfer is transfer of finance via an international banking network. **Wire transfer** or **credit transfer** is an electronic fund transfer method from one person or institution (entity) to another. A wire transfer can be made from one bank account to another bank account or through a transfer of cash at a cash office, such as Western union.

The Western Union Company is a financial services and communications company based in the United States. Western Union has several divisions, with products such as person-to-person money transfer, money orders, business payments and commercial services. Wire transfer systems are intended to provide more individualized transactions than bulk payment systems such as **Check21 and ACH**.

The **Check Clearing for the 21st Century Act** (or **Check 21 Act**) allows the recipient of the original paper check to create a digital version of the original check, a process known as cheque truncation, into an electronic format called a, 'substitute cheque' thereby eliminating the need for further handling of the physical document. Check 21 is not subject to ACH rules, therefore transactions are not subject to NACHA (The Electronic Payment Association) rules, regulations, fees and fines.

The process of removing the paper check from its processing flow is called cheque truncation. Paper checks continue to transition to electronic images, with almost 70% of all institutions receiving images as of January 2013. In truncation, both sides of the paper check are scanned to produce a digital image. If a paper document is still needed, these images are inserted into specially formatted documents containing a photo-reduced copy of the original checks called a 'substitute cheque'.

Once a check is truncated, businesses and banks can work with either the digital image or a print reproduction of it. Images can be exchanged between member banks, credit unions, servicers, CHs, and the Central bank.

Not all banks have the ability to receive image files, so there are companies who offer the service. At the item processing center, the checks are sorted by machine according to the routing/transit number as presented by the magnetic ink character recognition (MICR) line, and scanned to produce a digital image. A batch file is generated and sent to the Federal Reserve Bank or presentment point for settlement or image replacement. If a substitute check is needed, the transmitting bank is responsible for the cost of generating and transporting it from the presentment point to the Federal Reserve Bank or other corresponding bank.

NACHA manages the development, administration, and governance of the **ACH** Network, the backbone for the electronic movement of money and data. The ACH Network provides a safe, secure, and reliable network for direct account-to-account consumer, business, and government payments. Annually, it facilitates billions of Direct Deposit via ACH and Direct Payment via ACH transactions. Used by all types of financial institutions, the ACH Network is governed by the fair and equitable *NACHA Operating Rules*, which guide risk management and create payment certainty for all participants. As a not-for-profit association, NACHA represents more than 10,000 financial institutions via 17 regional payments associations and direct membership. Through its industry councils and forums, NACHA brings together payments system stakeholders to foster dialogue and innovation to strengthen the ACH Network.

It is important that activities that affect the ACH Network be conducted with the highest levels of integrity, professionalism, and fairness. This Code of Conduct has been adopted to further such integrity in the best interest of a mutually beneficial network. This Code of Conduct identifies the standards of behavior expected of members of NACHA and its various programs, and non-member organizations engaged in NACHA's activities and/or providing services to NACHA.

An organization and its representatives are in good standing under this Code if they:

- a. Adhere to the spirit as well as the letter of all applicable regulations and laws, including antitrust, banking, privacy, and other relevant laws;
- b. Avoid even the appearance of any criminal offense or professional misconduct;
- c. Conduct business in a manner that does not adversely affect the ACH Network;
- d. Conduct all activities in a professional manner, thereby bringing credit to the payments profession;
- e. Remain current with all financial obligations to NACHA;
- f. Comply with all applicable NACHA policies and procedures; and
- g. Work together to promote the efficiency, reliability, and security of the ACH Network.

NACHA reserves the right to disassociate itself from any organization that, in NACHA's opinion, fails to abide by these principles or otherwise brings discredit to NACHA and/or the payments profession.

Card Transfer Payment Method

Typically, a payment card is electronically linked to an account or accounts belonging to the cardholder. These accounts may be deposit accounts or loan or credit accounts. There are a number of payment cards including:

- i. Credit card: A feature of a credit card is that the issuer of the card creates a line of credit for the cardholder which the cardholder can draw on (i.e., borrow) for payment to a merchant in making a purchase or as a cash advance to the cardholder. Most credit cards are issued by or through local banks or credit unions, but some credit card companies offer cards directly to the public. Credit cards are popular in third world nations. A credit card is different from a charge card where a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers to 'revolve' their balance, at the cost of having interest charged.

- ii. **Debit card:** A feature of a debit card (also known as a bank card or check card or electronic cheque) is that when a cardholder makes a purchase funds are withdrawn directly from either the bank account or from the remaining balance on the card. In some cases, the cards are designed exclusively for use on the Internet, and so there is no physical card. In the U.S. debit cards are the fastest growing payment technology. In 2001, debit cards accounted for 9 percent of all purchase transactions, and this is expected to double to 18.82 percent in 2011. The use of debit cards has become widespread in many countries and has overtaken use of cheques, and in some instances cash transactions by volume. Like credit cards, debit cards are used widely for telephone and Internet purchases, and unlike credit cards the funds are transferred from the bearer's bank account instead of having the bearer to pay back on a later date. Debit cards can also allow for instant withdrawal of cash, acting as the ATM card, and as a cheque guarantee card. Merchants can also offer "cashback"/"cashout" facilities to customers, where a customer can withdraw cash along with their purchase.
- iii. **ATM card:** An ATM card (known under a number of names like Any Time Money, Automated Teller Machine, etc) is a card issued by a financial institution that can be used in an Automated Teller Machine (ATM) for transactions such as: deposits, cash withdrawals, obtaining account information, and other types of transactions, often through interbank networks. Debit or credit cards may also act as ATM cards.
- iv. **Charge card:** A charge card is similar to a credit card, except that the cardholder is required to pay the full balance of the statement amount, which is usually monthly. It is a means of obtaining a very short term loan for a purchase. The period of the loan is the period between the purchase and the statement date plus the period that the cardholder has to pay the account, a potential period of usually up to 55 days. Since there is no loan, there is no official interest. A partial payment (or no payment) may result in a severe late fee (as much as 5% of the balance) and the possible restriction of future transactions and a potential cancellation of the card.
- v. **Stored-value card:** A stored-value card refers to monetary value on a card not in an externally recorded account and differs from

prepaid cards where money is on deposit with the issuer similar to a debit card. One major difference between stored value cards and prepaid debit cards is that prepaid debit cards are usually issued in the name of individual account holders, while stored value cards are usually anonymous. The term stored value card means the funds and or data are physically (materially, with mass) stored on the card. With prepaid cards the data is maintained on computers affiliated with the card issuer. The value associated with the card can be accessed using a magnetic stripe embedded in the card, on which the card number is encoded; using radio-frequency identification (RFID)); or by entering a code number, printed on the card, into a telephone or other numeric keypad..

- vi. **Fleet card:** A fleet card is used as a payment card most commonly for gasoline, diesel and other fuels at gas stations. Fleet cards can also be used to pay for vehicle maintenance and expenses at the discretion of the fleet owner or manager. The use of a fleet card also eliminates the need for cash carrying, thus increasing the level of security felt by fleet drivers. The elimination of cash also makes it easier to prevent fraudulent transactions from occurring at a fleet owner or manager's expense. Fleet cards are unique due to the convenient and comprehensive reporting that accompanies their use. Fleet cards enable fleet owners/managers to receive real time reports and set purchase controls with their cards helping them to stay informed of all business related expenses.
- vii. **Electronic purse or money:** Electronic money is money that is exchanged electronically. This involves the use of computer networks, the internet and digital stored value systems. Bank deposits, Electronic fund Transfer, direct deposit, payment processors, digital currencies such as bitcoin are all examples of electronic money.
- viii. **Magnetic stripe card:** A magnetic stripe card is a type of card capable of storing data by modifying the magnetism of tiny iron-based magnetic particles on a band of magnetic material on the card. The magnetic stripe, sometimes called a *magstripe*, is read by physical contact and swiping past a reading head. Magnetic stripe cards are commonly used in credit cards, identity cards, and transportation tickets. They may also contain an RFID tag, a

transponder device and/or a microchip mostly used for business premises access control or electronic payment. A number of ISO standards, define the physical properties of the card, including size, flexibility, location of the magstripe, magnetic characteristics, and data formats. They also provide the standards for financial cards, including the allocation of card number ranges to different card issuing institutions.

- ix. Smart card: A smart card, chip card, or integrated circuit card (ICC), is any pocket-sized card with embedded integrated circuits which can process data. This implies that it can receive input which is processed — by way of the ICC applications — and delivered as an output. There are two broad categories of ICCs. Memory cards contain only non-volatile memory storage components, and perhaps some specific security logic. Microprocessor cards contain volatile memory and microprocessor components. Using smart cards is also a form of strong security authentication for single sign-on within large companies and organizations.
- x. Proximity card: Proximity card is a generic name for contactless integrated circuit devices used for security access or payment systems. It can refer to the older 125 kHz devices or the newer 13.56 MHz contactless RFID cards, most commonly known as contactless cards. Modern proximity cards are covered by the ISO Standard ISO/IEC 14443 (proximity card) standard. Proximity cards are powered by resonant energy transfer and have a range of 0-3 inches in most instances. The user will usually be able to leave the card inside a wallet or purse. The price of the cards is also low, usually US\$2–\$5, allowing them to be used in applications such as identification cards, keycards, payment cards and public transit fare cards.
- xi. Re-programmable magnetic stripe card: Re-programmable/dynamic magnetic stripe cards are standard sized transaction cards that include a battery, a processor, and a means (inductive coupling or otherwise) of sending a variable signal to a magnetic stripe reader. Re-programmable stripe cards are often more secure than standard magnetic stripe cards and can transmit information for multiple cardholder accounts

Electronic bill Payment in On-line Banking: Electronic bill payment may be delivered by EFT or paper check: Electronic bill payment is a now common feature of online banking allowing a depositor to send money from his demand account to a creditor or vendor such as a public utility or a chain store to be credited against a specific account. The payment is optimally executed electronically in real-time, though some financial institutions or payment services will wait until the next business day to send out the payment. The bank can usually also generate and mail a paper cheque or pay order to a creditor who is not set up to receive electronic payments.

Most large banks also offer various convenience features with their electronic bill payment systems, such as the ability to schedule payments in advance to be made on a specified date, the ability to manage payments from any computer with a web browser over internet, and various options for searching one's recent payment history: when did I last pay Company X? To whom did I make my most recent payment? In many cases one can also integrate the electronic payment data with accounting or personal finance software.

Electronic Benefit Transfer (EBT): Electronic Benefit Transfer is an electronic system that allows state welfare departments to issue benefits (like LPG/ Kerosene subsidy) via a magnetically encoded payment card, used in the United States and the United Kingdom. Common benefits provided (in the United States) via EBT are typically of two general categories: food and cash benefits. Food benefits are federally authorized benefits that can be used only to purchase food and non-alcoholic beverages.

An e-commerce payment system: E-commerce payment system facilitates the acceptance of electronic payment for online transactions. Also known as a sample of Electronic Data Interchange (EDI), e-commerce payment systems have become increasingly popular due to the widespread use of the internet-based shopping and banking.

Over the years, credit cards have become one of the most common forms of payment for e-commerce transactions. In North America almost 90% of online B2C transactions were made with this payment type. Increased security measures include use of the Card Verification Number

which detects fraud by comparing the verification number printed on the signature strip on the back of the card with the information on file with the cardholder's issuing bank. Also online merchants have to comply with stringent rules stipulated by the credit and debit card issuers this means that merchants must have security protocol and procedures in place to ensure transactions are more secure. This can also include having a certificate from an authorized certification authority who provides PKI- (Public – Key Infrastructure) for securing credit and debit card transactions.

Despite widespread use in North America, there are still a large number of countries such as China, India and Pakistan that have some problems to overcome in regard to credit card security. In the meantime, the use of smartcards has become extremely popular. A Smart-card is similar to a credit card; however it contains an embedded 8-bit microprocessor and uses electronic cash which transfers from the consumers' card to the sellers' device. A popular smartcard initiative is the VISA Smartcard. Using the VISA Smartcard you can transfer electronic cash to your card from your bank account, and you can then use your card at various retailers and on the internet.

There are companies that enable financial transactions to transpire over the internet, such as PayPal and Citadel EFT. Many of the cyber-mediaries permit consumers to establish an account quickly, and to transfer funds into their on-line accounts from a traditional bank account (typically via ACH transactions), and *vice versa*, after verification of the consumer's identity and authority to access such bank accounts. Also, the larger intermediaries further allow transactions to and from credit card accounts, although such credit card transactions are usually assessed a fee (either to the recipient or the sender) to recoup the transaction fees charged to the cyber-mediary. The speed and simplicity with which cyber-mediary accounts can be established and used have contributed to their widespread use, although the risk of abuse, theft and other problems—with disgruntled users frequently accusing the cyber-mediaries themselves of wrongful behavior—is associated with them.

PayPal: PayPal is a global e-commerce business allowing payments and money transfers to be made through the Internet. Online money transfers serve as electronic alternatives to paying with traditional paper methods, such as cheques and money orders. PayPal is an acquirer,

performing payment processing for online vendors, auction sites, and other commercial users, for which it charges a fee. It may also charge a fee for receiving money, proportional to the amount received. The fees depend on the currency used, the payment option used, the country of the sender, the country of the recipient, the amount sent and the recipient's account type. In addition, eBay purchases made by credit card through PayPal may incur extra fees if the buyer and seller use different currencies.

On October 3, 2002, PayPal became a wholly owned subsidiary of eBay. The company also has significant operations in United States; India, Ireland, Germany and in Israel. From July 2007, PayPal has operated across the EU as a Luxembourg-based bank. On March 17, 2010, PayPal entered into an agreement with China UnionPay (CUP), China's bankcard association, to allow Chinese consumers to use PayPal to shop online. PayPal is planning to expand its workforce in Asia to 2,000 by the end of the year 2010.

Electronic fund Transfer at Point of Sale (EFTPOS): EFTPOS is an electronic payment system involving electronic funds transfers based on the use of payment of cash, such as debit/credit cards, at terminals located at points of sale, popular in Australia and New Zealand, though the EFTPOS technology originated in the USA.

An **interbank network**: An Interbank network is also known as an **ATM consortium** or **ATM network**. It is a computer network that connects the ATMs of different banks and permits these ATMs to interact with the ATM cards of non-native banks.

While interbank networks provide capabilities for all ATM cards within the same network to use other banks' ATMs that belong to the same network, the services vary. For instance, when a person uses their ATM card at an ATM that does not belong to their bank, the basic services, such as balance inquiries and withdrawals, are usually available. However, special services, such as the purchase of mobile phone airtime, may not be accessible to ATM cardholders of banks other than the ATM cardholders of the acquirer (the bank that owns the ATM). Furthermore, banks may charge a fee to users of cards that do not come from their own bank (in addition to any fees imposed by the bank of the card the person is using). Interbank networks are convenient because people can access the ATMs of

other banks who are members of the network when their own bank's ATM is unavailable. Such is especially convenient for travelers traveling abroad, where multinational interbank networks, like Plus or Cirrus, are usually available. Interbank networks also, through different means, permit the use of ATM cards at a point of sale through the use of a special EFTPOS terminal where ATM cards are treated as debit cards.

Real time gross settlement system (RTGS): RTGS is a funds transfer systems where transfer of money or securities takes place from one bank to another on a “real time” and on “gross” basis. Settlement in “real time” means payment transaction is not subjected to any waiting period. The transactions are settled as soon as they are processed. “Gross settlement” means the transaction is settled on one to one basis without bunching or netting with any other transaction. Once processed, payments are final and irrevocable.

An efficient national payment system reduced the cost of exchanging goods and services, and indispensable to the functioning of the interbank, money, and capital markets. A weak payment system may severely drag on the stability and developmental capacity of a national economy; its failures can result in inefficient use of financial resources, inequitable risk-sharing among agents, actual losses for participants, and loss of confidence in the financial system and in the very use of money. Technical efficiency of the payment system is important for development of an economy.

RTGS systems in Europe covering multiple countries: TARGET resp. TARGET2 (Trans-European Automated Real-time Gross Settlement Express Transfer System) in 26 countries of the European Union. TARGET2 is the Real Time Gross Settlement system for the Euro currency, and is offered by the Eurosystem, which comprises the European Central Bank and the National Central Banks of those countries that have adopted the Euro currency. The Eurosystem and the European System of Central Banks will co-exist as long as there are EU Member States outside the Euro area. TARGET2 is used for the settlement of central bank operations, large-value Euro interbank transfers as well as other euro payments. TARGET 2 provides real-time financial transfers, debt settlement at central banks which is immediate and irreversible.

Society for Worldwide Interbank Financial Telecommunication (SWIFT): SWIFT is a cooperative society under Belgian law and it is owned by its member financial institutions. It has offices around the world. SWIFT provides a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardized and reliable environment. SWIFT also markets software and services to financial institutions, much of it for use on the SWIFTNet Network, and ISO 9362 bank identifier codes (BICs) are popularly known as “SWIFT codes”.

The majority of international interbank messages use the SWIFT network. As of September 2010, SWIFT linked more than 9,000 financial institutions in 209 countries and territories, who were exchanging an average of over 15 million messages per day (compared to an average of 2.4 million daily messages in 1995). SWIFT transports financial messages in a highly secure way, but does not hold accounts for its members and does not perform any form of clearing or settlement.

SWIFT does not facilitate funds transfer; rather, it sends payment orders, which must be settled by correspondent accounts that the institutions have with each other. Each financial institution, to exchange banking transactions, must have a banking relationship by either being a bank or affiliating itself with one (or more) so as to enjoy those particular business features.

International Business Taxation and Tax Laws Regarding Electronic Commerce and Cross Border Transactions

The Committee of Fiscal Affairs of the OECD has been actively working on taxation issues relating to e-commerce. The committee has developed the taxation framework conditions setting forth the governing principles in relation to e-commerce. The key conclusion was that the taxation principles that guide Governments in relation to conventional commerce, should also guide them in relation to e-commerce. It was postulated that this would be possible only by adapting and adopting the existing principles to a-commerce situations.

For adapting and adopting the existing principles, the following key areas in the context of international tax were identified:

- (i) The extent to which a website or a server can constitute a permanent establishment and how income may be attributed to it; and
- (ii) The manner in which payments for digitised products are to be characterized.

Permanent Establishment in E-Commerce Situations

We now discuss different situations which arise in an e-commerce environment and consider whether these situations would constitute a permanent establishment.

Situation A – Existence of a website on host country while: A website may be defined as a set of web documents belonging to a particular Organization, It consists of data and programs in digitised form which is stored on a server of the internet service provider. On the other hand, a permanent establishment, as the name itself suggests, is a fixed place of some permanence from where a business is carried on. Therefore, the existence of a website, by itself, would not constitute a permanent establishment.

Situation B –Server on host country soil: A server is a system which carries out activities initiated by an end-user's computer. The question whether a server can be considered whether a server can be considered as a permanent establishment is more complicated. It is possible that the enterprise that operates the server may be different from the enterprise that carries on business through the website. The use of a particular internet service provider (ISP) does not give website owner the right of control over the server's operation. The server's location is not at that enterprise's disposal. The server could easily be removed to other locations.

In such a situation, the server's location cannot be considered to be the place of business.

On the other hand, if the enterprise itself owns or leases and operates the server, and the computer equipment is fixed, and business is carried on through the server, it could be construed to be a permanent establishment. Therefore what is essential to be considered in this issue, is not merely whether a server exists or host country soil. but also what the

value as well as extent of its operations are. As the permanent establishment concept deals not only with permanence and a geographical link with the host soil, but also with the actual carrying on of the business, the values and extent of the operations carried out by the server becomes important. We now consider separately the above points.

Nature of Operation

The nature of operations could have a very wide range. The range could profess from being a mere provider of information, to being a forwarding address to acting as a warehouse for digitised goods, to contributing directly to productivity and value creation, thereby realising profits. In a situation where the server acts as a mere provider of information it cannot be considered to be a permanent establishment. At the other end, where it contributes to productivity, the server will become a permanent establishment for distinctions which falls in between these two entrances, it would be necessary to go to the next step of examining the extent of operations.

Extent of Operations

In the extent of operations, as well, there could be a wide range of activities. Server would be simply located on host country soil with skeletal support services, or it could be a server with multiple services,,or it could be a server which carries on the complete set of operations. In the last situation, there would clearly be a permanent establishment.

Situation C - Server functioning as an agent: It is Possible that a server on host country soil could be construed to be a dependent agent of the foreign enterprise. Such a situation will apply in the case of 'Smart' servers. 'Smart' servers are programmed to not only provide information but also to take and process orders from persons who make a 'hit' 'n the website. Such a server has the Power to contract on behalf of the foreign enterprise and habitually exercises this power, It is possible to argue that since such a server is a dependent agent of the foreign enterprise. it may be considered to be a permanent establishment. However, a contrary a logical view would be that the website together with the server that hosts it can only constitute the medium through which orders are placed. The time acceptance of the order is not done by the machine itself but by the

person or corporation which inserted. into the machine a program capable of performing these tasks. Therefore, the website and the server would not constitute a permanent establishment.

According to the principles of international taxation, business income cannot be taxed on Host State soil, unless there is a permanent establishment in the Host State. If there is such a permanent establishment, then the only income which the Host State is entitled to tax is the income attributable to the permanent establishment. Such attributable income is determined by imagining the permanent establishment to be an entity independent of the foreign enterprise, and dealing with the foreign enterprise at arm's length price. The issue therefore translates to one for determining the transfer price between the foreign enterprise and permanent establishment, and rewriting the transaction between the two, at arm's length.

Determination of the Nature of Income

The manner of taxation in income arising from e-commerce transactions, as it also the case in conventional commercial transactions depends on the characterization of the income. The characterization of income is relevant because different types of income are taxed differently. Once this is identified, the existing rules may be adopted and adapted to the e-commerce transactions.

In conventional commerce, when all rights in a property are transferred it would amount to a sale giving rise therefore to business income. On the other hand, when only limited rights in a property are transferred, the transferor retaining substantial rights therein, the income therefrom would be classified either as a royalty in the case of intellectual properties, or a lease rent in the case of tangible properties. Thirdly, if the ultimate results of the transaction is the rendering of services, the income would have to be characterized either as fees for professional services.

Similarly, in an e-commerce situation, if licensing of a know-how is done, the payment for this would clearly be characterized as a royalty income in terms of most double taxation avoidance agreements and this would be so irrespective of whether this is done by physical transfer of information or by transfer of digitised information. If on the other hand,

practically all rights in a design are transferred, whether physically or through electronic transfer of digitised information, with no rights being retained by the transferor, under most double taxation avoidance agreements, the transaction would be considered to be one which is more in the nature of outright sale of the design rather than a licence thereof. The payment for this would then be characterized as a sale consideration rather than as a royalty.

The principles of adopting and adapting postulated by the OECD and the US treasury unable a proper determination of the character of income in most cases. However, the problem arises in the case of transactions involving software. This is discussed below:

Transactions involving Software

The process of adopting and adapting existing rules to e-commerce transactions becomes complicated in the case of transactions involving software. For instance, where a packaged product like Windows 98 is sold, we normally refer to it as buying a product. Moreover, this sale in reality, not a sale but an agreement or a licence to use the software. The product comes in a transparent shrink wrap packaging through which the licence agreement can be read.

When the buyer tears open the packaging, this act is tantamount to his signing the agreement or licence. By doing so, the buyer (licensee) accepts the terms of the licence, then he agrees to use the software only at that one work station, to not make copies except for archival purposes, to not alter the contents, etc. other than a licence. When it comes to taxation of such transactions the characterisation of the income would become extremely relevant. If for instance the transactions were to be treated as a sale transaction, and the title is transferred outside the buyer's country, the transaction would not be subject to host country taxation in the buyer's State; this is because there would be no permanent establishment of the 'seller' of the software in the buyer's State, and therefore no subjection to Host

The OECD documents on e-commerce in a somewhat more restricted manner as commercial transactions between individuals and Organizations. E-commerce is based on the processing or transmission of

digitized data units, sound, and visual images, which are carried out over open networks (like internet) or over a closed network with a gateway to open networks. This more specific definition would therefore exclude electronic data interchange (EDI), carried out over closed networks, if such EDIs are being used by themselves, without access to an open network (e.g. credit cards used over a closed network, connecting specified merchants with a card Organization).

Whatever be the definition, this method of carrying on a business is widely different from the traditional practice of business. Where traditional business have rested squarely on the physical presence and delivery of goods, doing business via the internet, as is the case in e-commerce transactions, physical presence of goods is not required at all. Consequently, geographical boundaries between nations hold no significance. Secondly, in such type of transactions, physical delivery of goods is not necessary. Where the goods and services are available in digital form, e.g. computer software, music, magazines, drawings etc. physical transactions are replaced by transfer of bytes. Thirdly, e-commerce transactions can be completed almost instantaneously across the world and irrespective of the time of the day.

Issues and Problems in Taxing E-Commerce Transactions

Due to absence of national boundaries, physical presence of goods and non-requirement of physical delivery, taxation of e-commerce transactions raises several issues. There have to be understood in the light of international taxation. International taxation arises from cross border transactions for the reason that the author of the transactions arises in one country (called the Home State) and the sites of the transactions is in the other country (Host State).

Income arises out of such transaction is eligible to tax in both countries by virtue of 'personal attachment' to the transfer (in the Home State) and again by virtue of 'economic attachment' to the income itself (in the host State). Thus, this gives rise to double taxation of the same income. This problem is generally solved by a Double Taxation Avoidance Agreement (DTAA) between the two countries concerned. The problematic issues arising in respect of e-commerce transactions are as follows:

How to Determine 'Economic Attachment'

In order to determine economic attachment, the situs (place) of the transactions should be clearly determined. In a traditional commerce transaction, the situs of the transaction is clearly known, because of the physical presence and the physical delivery. Therefore the Source Rule as laid down in section 9 of the (Indian) Income-tax Act, 1961 can be clearly applied to effect Host State taxation. Section 9 provides that income is deemed to accrue or arise in Indian taxable territory if there is a business connection. In E-commerce situations, with transactions being completed in cyberspace, it is often not clear as to the place where the transaction is effected, giving rise thereby to difficulties in implementing Source Rule taxation.

How to determine existence of a permanent establishment: Under most bilateral double tax treaties, a country will seek to tax corporate business profits if they can be applied to a 'permanent establishment' in that country. The basic requirement is, therefore, that there must be a place of business and it must have some permanence.

The major taxation problem of e-commerce is that no establishment is necessary across the border to carry on business. With regard to tangible property, the source can be traced, as the delivery has to cross the other territory through the customs or postal barrier. The destination also will be known from the shipping address. Where the seller may be located in a tax-heaven country and there is no treaty for avoidance of taxation, it will be difficult to enforce tax laws on the non-resident business. In such cases, the natural option should be to tax the resident as the agent, especially where the non-resident cannot be reached.

The difficulty is not so much in taxing those who are assessed and who maintain accounts but in taxing others who do business and there is no record of their transactions, like the persons liable to pay the 'use tax' in US. With the development of WAP (Wireless Application Protocol) which integrates mobile telephony with the Internet, e-commerce will be taken over by M-commerce (Mobile Commerce). This makes the place of origin of business invisible thus adding complication to the existing scenario and is a real challenge to domestic jurisprudence.

Further, how such income is to be attributed to the permanent establishment is also a significant matter. This is relevant to determine whether income from sales can be made on host country soil. For instance, if a particular income is classified as royalties or fees for technical services, or dividends or interests, then irrespective of the existence of a permanent establishment, the income will be liable to host country taxation under section 115A of the Income-tax Act. On the other hand, if the income is classified as income from sales, then unless there is a permanent establishment, there can be no taxation in the host country. And if there is a permanent establishment, how much income is to be taxable will be determined by how much of the income is to be attributed to the permanent establishment.

Legal Difficulty

Till now all cross-border commercial transactions have to cross the customs barrier or the postal barrier. All trade and commerce are operated in a physical world and in terms of tangible goods. Hence, there is a check on these transactions, though smuggling remains outside the scope of any control. Even in the present situation, the tax authorities are unable to fully grapple with the problem of myriad ways of tax evasion. In e-commerce transactions, the contracting parties are in two different states and, therefore, the question would arise as to which state law would be applied.

Nature of Contract

A contract need not necessarily be in writing unless, the statute requires it to be so. It can be oral. This will create problems relating to the law that will be applicable in case of disputes. In a contract, generally the parties are free to choose the law applicable to the contract and the same can be expressed or implied in the terms of the contract. In some cases, the principal place of business is relevant in deciding the law applicable. In some other case, the place where the buyer normally resides decides the law to be applied. Where there is a clause for retention of title until the buyer performs some act, then the matter of which *lex situs* will govern the validity clause is open to question. In answering this, the Rome Convention says that if the contract accords with the rules of anyone of the States, its validity cannot be questioned. This would be the

most satisfactory solution and can be followed. All these problems arise mostly regarding transactions relating to movables and those relating to immovable properties are less difficult. There are many areas where the present domestic laws including international laws would be inadequate to deal with the emerging new field of e-commerce.

Taxable Jurisdiction

The taxable jurisdiction of any country covers its national boundary. Besides this the territorial jurisdiction includes territorial sea and airspace above as per the territorial waters, continental shelf, exclusive economic zone and other Maritime Zones Act, 1976. Each one extends to specified nautical miles from the base line. The following are the limits indicated therein:

- (i) Territorial Water -12 nautical miles from the nearest point of appropriate base line.
- (ii) Contiguous Zone - 24 nautical miles beyond and adjacent to the territorial waters from the base line.
- (iii) Continental Shelf-200 nautical miles from the base line.
- (iv) Exclusive Economic Zone is an area beyond and adjacent to the territorial waters extending to 200 nautical miles from the base line.

But electronic commerce takes place through satellite and the server can be in any part of the globe. It can in all probability be in a tax-haven country. Another condition for taxing the income arising or accruing beyond the taxable territories in the physical residence of the taxpayer for 182 days or more. This becomes meaningless with the Internet access. The information highway provides numerous visits to another jurisdiction outside the control of border mechanism.

How business is transacted through e-commerce.

Multilateral and Bi-Lateral Treaties and Sharing of Tax Revenues

Many countries have agreed with other countries in treaties to mitigate the effects of double taxation (Double Tax Avoidance Agreement).

Tax treaties may cover income tax, inheritance taxes, value added tax, or other taxes. Besides bilateral treaties, also multilateral countries are in place.

Countries of the European Union (EU) have also entered into a multilateral agreement with respect to value added taxes under auspices of the EU, while a joint treaty of the Council of Europe and the OECD exists open to all nations. Tax treaties tend to reduce taxes of one treaty country for residents of the other treaty country in order to reduce double taxation of the same income. The provisions and goals vary highly; very few tax treaties are alike.

Most Treaties

- Define which taxes are covered and who is a resident and eligible for benefits,
- Reduce the amounts of tax withheld from interest, dividends, and royalties paid by a resident of one country to residents of the other country,
- Limit tax of one country on business income of a resident of the other country to that income from a permanent establishment in the first country,
- Define circumstances in which income of individuals resident in one country will be taxed in the other country, including salary, self-employment, pension, and other income,
- Provide for exemption of certain types of organizations or individuals, and
- Provide procedural frameworks for enforcement and dispute resolution.

The stated goals for entering into a treaty often include reduction of double taxation, eliminating tax evasion, and encouraging cross-border trade efficiency. It is generally accepted that tax treaties improve certainty for taxpayers and tax authorities in their international dealings.

Several governments and organizations have proposed model treaties to use as starting points in their own negotiations. The OECD

model treaty is often used as such a starting point. The OECD members have from time to time agreed on various provisions of the model treaty, and the official commentary^[5] and member comments thereon serve as a guidance as to interpretation by each member country.

Tax residency: In general, the benefits of tax treaties are available only to persons who are residents of one of the treaty countries. In most cases, a resident of a country is any person that is subject to tax under the domestic laws of that country by reason of domicile, residence, place of incorporation, or similar criteria. Generally, individuals are considered resident under a tax treaty and subject to taxation where they maintain their primary place of abode. However, residence for treaty purposes extends well beyond the narrow scope of primary place of abode. For example, many countries also treat persons spending more than a fixed number of days in the country as residents. The United States includes citizens and green card holders, wherever living, as subject to taxation, and therefore as residents for tax treaty purposes. Because residence is defined so broadly, most treaties recognize that a person could meet the definition of residence in more than one jurisdiction (i.e., “dual residence”) and provide a “tie breaker” clause. Such clauses typically have a hierarchy of three to five tests for resolving multiple residency, typically including permanent abode as a major factor. Tax residency rarely impacts citizenship or permanent resident status, though certain residency statuses under a country’s immigration law may influence tax residency. Entities may be considered resident based on their country of seat of management, their country of organization, or other factors. The criteria are often specified in a treaty, which may enhance or override local law. It is possible under most treaties for an entity to be resident in both countries, particularly where a treaty is between two countries that use different standards for residence under their domestic law. Some treaties provide “tie breaker” rules for entity residency, some do not. Residency is irrelevant in the case of some entities and/or types of income, as members of the entity rather than the entity are subject to tax.

Permanent establishment: Most treaties provide that business profits (sometimes defined in the treaty) of a resident of one country are subject to tax in the other country only if the profits arise through a permanent establishment in the other country. Many treaties, however, address certain types of business profits (such as directors’ fees or income

from the activities of athletes and entertainers) separately. Such treaties also define what constitutes a permanent establishment (PE). Most but not all tax treaties follow the definition of PE in the OECD Model Treaty. Under the OECD definition, a PE is a fixed place of business through which the business of an enterprise is carried on. Certain locations are specifically enumerated as examples of PEs, including branches, offices, workshops, and others. Specific exceptions from the definition of PE are also provided, such as a site where only preliminary or ancillary activities (such as warehousing of inventory, purchasing of goods, or collection of information) are conducted. While in general tax treaties do not specify a period of time for which business activities must be conducted through a location before it gives rise to a PE, most OECD member countries do not find a PE in cases in which a place of business exists for less than six months, absent special circumstances.¹ Many treaties explicitly provide a longer threshold, commonly one year or more, for which a construction site must exist before it gives rise to a permanent establishment. In addition, some treaties, most commonly those in which at least one party is a developing country, contain provisions which deem a PE to exist if certain activities (such as services) are conducted for certain periods of time, even where a PE would not otherwise exist. Even where a resident of one country does not conduct its business activities in another country through a fixed place or business, a PE may still be found to exist in that other country where the business is carried out through a person in that other country that has the authority to conclude contracts on behalf of the resident of the first country. Thus, a resident of one country cannot avoid being treated as having a PE by acting through a dependent agent rather than conducting its business directly. However, carrying on business through an independent agent will generally not result in a PE.

Withholding taxes: Many tax systems provide for collection of tax from nonresidents by requiring payers of certain types of income to withhold tax from the payment and remit it to the government. Such income often includes interest, dividends, royalties, and payments for technical assistance. Most tax treaties reduce or eliminate the amount of tax required to be withheld with respect to residents of a treaty country.

Income from employment: Most treaties provide mechanisms eliminating taxation of residents of one country by the other country where the amount or duration of performance of services is minimal but

also taxing the income in the country performed where it is not minimal. Most treaties also provide special provisions for entertainers and athletes of one country having income in the other country, though such provisions vary highly. Also most treaties provide for limits to taxation of pension or other retirement income.

Tax exemptions: Most treaties eliminate from taxation income of certain diplomatic personnel. Most tax treaties also provide that certain entities exempt from tax in one country are also exempt from tax in the other. Entities typically exempt include charities, pension trusts, and government owned entities. Many treaties provide for other exemptions from taxation that one or both countries as considered relevant under their governmental or economic system.

Harmonization of tax rates: Tax treaties usually specify the same maximum rate of tax that may be imposed on some types of income. As an example, a treaty may provide that interest earned by a nonresident eligible for benefits under the treaty is taxed at no more than five percent (5%). However, local law in some cases may provide a lower rate of tax irrespective of the treaty. In such cases, the lower local law rate prevails.

Provisions unique to inheritance taxes: Generally, income taxes and inheritance taxes are addressed in separate treaties. Inheritance tax treaties often cover estate and gift taxes. Generally fiscal domicile under such treaties is defined by reference to domicile as opposed to tax residence. Such treaties specify what persons and property are subject to tax by each country upon transfer of the property by inheritance or gift. Some treaties specify which party bears the burden of such tax, but often such determination relies on local law (which may differ from country to country).

Most inheritance tax treaties permit each country to tax domiciliaries of the other country on real property situated in the taxing country, property forming a part of a trade or business in the taxing country, tangible movable property situated in the taxing country at the time of transfer (often excluding ships and aircraft operated internationally), and certain other items. Most treaties permit the estate or donor to claim certain deductions, exemptions, or credits in calculating the tax that might not otherwise be allowed to non-domiciliaries.

Double tax relief: Nearly all tax treaties provide a specific mechanism for eliminating it, but the risk of double taxation is still potentially present. This mechanism usually requires that each country grant a credit for the taxes of the other country to reduce the taxes of a resident of the country. The treaty may or may not provide mechanisms for limiting this credit, and may or may not limit the application of local law mechanisms to do the same.

India has comprehensive Double Taxation Avoidance Agreements (DTAA) with 88 (signed 88 DTAA's out of which 85 have entered into force) countries. This means that there are agreed rates of tax and jurisdiction on specified types of income arising in a country to a tax resident of another country. Under the Income Tax Act 1961 of India, there are two provisions, Section 90 and Section 91, which provide specific relief to taxpayers to save them from double taxation. Section 90 is for taxpayers who have paid the tax to a country with which India has signed DTAA, while Section 91 provides relief to tax payers who have paid tax to a country with which India has not signed a DTAA. Thus, India gives relief to both kinds of taxpayers.

A large number of foreign institutional investors who trade on the Indian stock markets operate from Mauritius and the second being Singapore. According to the tax treaty between India and Mauritius, capital gains arising from the sale of shares are taxable in the country of residence of the shareholder and not in the country of residence of the company whose shares have been sold. Therefore, a company resident in Mauritius selling shares of an Indian company will not pay tax in India. Since there is no capital gains tax in Mauritius, the gain will escape tax altogether. The Indian and Cypriot tax treaty is the only other such Indian treaty to provide for the same beneficial treatment of capital gains.

Mutual enforcement: Taxpayers may relocate themselves and their assets to avoid paying taxes. Some treaties thus require each treaty country to assist the other in collection of taxes and other enforcement of their tax rules.¹ Most tax treaties include, at a minimum, a requirement that the countries exchange of information needed to foster enforcement.

Tax information exchange agreement: The purpose of this agreement is to promote international co-operation in tax matters through

exchange of information. It was developed by the OECD Global Forum Working Group on Effective Exchange of Information. The working group consisted of representatives from OECD Member countries as well as delegates from other nations. The agreement grew out of the work undertaken by the OECD to address harmful tax practices. The lack of effective exchange of information is one of the key criteria in determining harmful tax practices. The mandate of the working group was to develop a legal instrument that could be used to establish effective exchange of information. The agreement represents the standard of effective exchange of information for the purposes of the OECD's initiative on harmful tax practices. This agreement, which was released in April 2002, is not a binding instrument but contains two models for bilateral agreements. A number of bilateral agreements have been based on this agreement.

Dispute resolution: Nearly all tax treaties provide some mechanism under which taxpayers and the countries can resolve disputes arising under the treaty. Generally, the government agency responsible for conducting dispute resolution procedures under the treaty is referred to as the “competent authority” of the country. Competent authorities generally have the power to bind their government in specific cases. The treaty mechanism often calls for the competent authorities to attempt to agree in resolving disputes.

Limitations of benefits: Recent treaties of certain countries have contained an article intended to prevent “treaty shopping,” which is the inappropriate use of tax treaties by residents of third states. These limitations of benefits articles deny the benefits of the tax treaty to residents that do not meet additional tests. Limitation of Benefits articles vary widely from treaty to treaty, and are often quite complex. The treaties of some countries, such as the United Kingdom and Italy, focus on subjective purpose for a particular transaction, denying benefits where the transaction was entered into in order to obtain benefits under the treaty. Other countries, such as the United States, focus on the objective characteristics of the party seeking benefits. Generally, individuals and publicly traded companies and their subsidiaries are not adversely impacted by the provisions of a typical limitation of benefits provision in a U.S. tax treaty. With respect to other entities, the provisions tend to deny benefits where an entity seeking benefits is not sufficiently owned by residents of one of the treaty countries (or, in the case of treaties with members of a unified economic bloc such

as the European Union or NAFTA, by “equivalent beneficiaries” in the same group of countries). Even where entities are not owned by qualified residents, however, benefits are often available for income earned from the active conduct of a trade or business.

Priority of law: Treaties are considered the supreme law of many countries. In those countries, treaty provisions fully override conflicting domestic law provisions. For example, many EU countries could not enforce their group relief schemes under the EU directives. In some countries, treaties are considered of equal weight to domestic law. In those countries, a conflict between domestic law and the treaty must be resolved under the dispute resolution mechanisms of either domestic law or the treaty.

Self Assessment Questions

1. Explain the Regulatory Framework of Electronic Commerce
2. Discuss the Regulatory Framework of Cross Border Transactions in India
3. Present Regulatory Framework of On-line Financial Transfers and Legal safeguards
4. What is International Business Taxation? State Tax Laws Regarding Electronic Commerce and Cross Border Transactions
5. Describe the Multilateral and Bi-lateral treaties and Sharing of Tax revenues

UNIT - V

Indian Laws and Regulations

Learning Objectives

The Objectives of this Unit are to learn Salient Provisions of Selected Indian Laws and Regulations Governing International Transactions namely:

- Foreign Exchange Management Act (FEMA), 1999
- Taxation of Foreign Income in India;
- Foreign Investments by Indian Entities
- Setting up Offices and Branches Abroad by Indian Entities;
- Restrictions on Trade in Endangered Species and Other Commodities.

Foreign Exchange Management Act (FEMA)

The Foreign Exchange Management Act (1999) or in short 'FEMA' has been introduced as a replacement for earlier Foreign Exchange Regulation Act, 1973 known in short as FERA. FEMA became an act on the 1st day of June, 2000. FEMA was introduced because the FERA didn't fit in with post-liberalization policies. A significant change that the FEMA brought with it, was that it made all offenses regarding foreign exchange civil offenses, as opposed to criminal offenses as dictated by FERA.

The main objective behind the Foreign Exchange Management Act (1999) is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments. It was also formulated to promote the orderly development and maintenance of foreign exchange market in India. FEMA is applicable to all parts of India.

The act is also applicable to all branches, offices and agencies outside India owned or controlled by a person who is a resident of India. The FEMA head-office, also known as Enforcement Directorate is situated in New Delhi and is headed by a Director. The Directorate is further divided into 5 zonal offices in Delhi, Mumbai, Kolkata, Chennai and

Jalandhar and each office is headed by a Deputy Director. Each zone is further divided into 7 sub-zonal offices headed by the Assistant Directors and 5 field units headed by Chief Enforcement Officers.

Important Sections

Salient provisions in the Act relevant to the focus of the study are presented below.

S.1. Short Title, Extent, Application and Commencement

- i. This Act may be called the Foreign Exchange Management Act, 1999.
- ii. It extends to the whole of India.
- iii. It shall also apply to all branches, offices and agencies outside India owned or controlled by a person resident in India and also to any contravention there under committed outside India by any person to whom this Act applies.
- iv. It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint:

Provided that different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

S.2. Definitions

In this Act, unless the context otherwise requires,-

- (a) “Adjudicating Authority” means an officer authorized under subsection (1) of section 16;
- (b) “Appellate Tribunal” means the Appellate Tribunal for Foreign Exchange established under section 18;
- (c) “authorized person” means an authorized dealer, money changer, off-shore banking unit or any other person for the time being authorized under sub-section (1) of section 10 to deal in foreign exchange or foreign securities;

- (d) “Bench” means a Bench of the Appellate Tribunal;
- (e) “capital account transaction” means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in subsection (3) of section 6;
- (f) “Chairperson” means the Chairperson of the Appellate Tribunal;
- (g) “chartered accountant” shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949);
- (h) “currency” includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travelers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank;
- (i) “currency notes” means and includes cash in the form of coins and bank notes;
- (j) “current account transaction” means a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes,-
 - i. Payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business,
 - ii. Payments due as interest on loans and as net income from investments,
 - ii. Remittances for living expenses of parents, spouse and children residing abroad, and
 - iv. Expenses in connection with foreign travel, education and medical care of parents, spouse and children;
- (k) “Director of Enforcement” means the Director of Enforcement appointed under sub-section (1) of section 36;
- (l) “export”, with its grammatical variations and cognate expressions, means,-
 - i. The taking out of India to a place outside India any goods,

- ii. Provision of services from India to any person outside India;
- (m) “foreign currency” means any currency other than Indian currency;
- (n) “foreign exchange” means foreign currency and includes,-
 - i. Deposits, credits and balances payable in any foreign currency,
 - ii. Drafts, travelers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency,
 - iii. drafts, travelers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency;
- (o) “foreign security” means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency;
- (p) “import”, with its grammatical variations and cognate expressions, means bringing into India any goods or services;
- (q) “Indian currency” means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under section 28A of the Reserve Bank of India Act, 1934 (2 of 1934);
- (r) “legal practitioner” shall have the meaning assigned to it in clause (i) of sub-section (1) of section 2 of the Advocates Act, 1961 (25 of 1961);
- (s) “Member” means a Member of the Appellate Tribunal and includes the Chairperson thereof;
- (t) “notify” means to notify in the Official Gazette and the expression “notification” shall be construed accordingly;
- (u) “person” includes-
 - i. Individual,
 - ii. A Hindu undivided family,

- iii. A company,
- iv. A firm,
- v. An association of persons or a body of individuals, whether incorporated or not,
- vi. Every artificial juridical person, not falling within any of the preceding sub-clauses, and
- vii. Any agency, office or branch owned or controlled by such person;

“Person resident in India” means-

- i. A person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include;-
 - A. A person who has gone out of India or who stays outside India, in either case-
 - a. For or on taking up employment outside India, or
 - b. For carrying on outside India a business or vocation outside India, or
 - c. For any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;
 - B. i Person who has come to or stays in India, in either case, otherwise than-
 - a. For or on taking up employment in India, or
 - b. For carrying on in India a business or vocation India, or
 - c. For any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;
 - ii. Any person or body corporate registered or incorporated in India,
 - iii. An office, branch or agency in India owned or controlled by a person resident outside India,

- iv. An office, branch or agency outside India owned or controlled by a person resident in India;
- (w) “person resident outside India” means a person who is not resident in India;
- (x) “prescribed” means prescribed by rules made under this Act;
- (y) “repatriate to India” means bringing into India the realized foreign exchange and-
 - i. The selling of such foreign exchange to an authorized person in India in exchange for rupees; or
 - ii. The holding of realized amount in an account with an authorized person in India to the extent notified by the Reserve Bank, and includes use of the realized amount for discharge of a debt or liability denominated in foreign exchange and the expression “repatriation” shall be construed accordingly;
- (z) “Reserve Bank” means the Reserve Bank of India constituted under sub-section (1) of section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (za) “security” means shares, stocks, bonds and debentures, Government securities as defined in the Public Debt Act, 1944 (18 of 1944), savings certificates to which the Government Savings Certificates Act, 1959 (46 of 1959) applies, deposit receipts in respect of deposits of securities and units of the Unit Trust of India established under sub-section (1) of section 3 of the Unit Trust of India Act, 1963 (52 of 1963) or of any mutual fund and includes certificates of title to securities, but does not include bills of exchange or promissory notes other than Government promissory notes or any other instruments which may be notified by the Reserve Bank as security for the purposes of this Act;
- (zb) “service” means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, medical assistance, legal assistance, chit fund, real estate, transport, processing, supply of electrical or other energy, boarding or lodging or both, entertainment, amusement or the purveying of

news or other information, but does not include the rendering of any service free of charge or under a contract of personal service;

- (zc) “Special Director (Appeals)” means an officer appointed under section 18;
- (zd) “specify” means to specify by regulations made under this Act and the expression “specified” shall be construed accordingly;
- (ze) “transfer” includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien.

S.3. Dealing in Foreign Exchange, Etc.

Save as otherwise provided in this Act, rules or regulations made thereunder, or with the general or special permission of the Reserve Bank, no person shall-

- i. Deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;
- ii. Make any payment to or for the credit of any person resident outside India in any manner;
- iii. Receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner;

Explanation.- For the purpose of this clause, where any person in, or resident in, India receives any payment by order or on behalf of any person resident outside India through any other person (*including an authorized person*) without a corresponding inward remittance from any place outside India, then, such person shall be deemed to have received such payment otherwise than through an authorized person;

- b.*** Enter into any financial transaction in India as consideration for, or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

Explanation. - For the purpose of this clause, “financial transaction” means making any payment to, or for the credit of any person, or receiving

any payment for, by order or on behalf of any person, or drawing, issuing or negotiating any bill of exchange or promissory note, or transferring any security or acknowledging any debt.

S.4. Holding of Foreign Exchange, Etc.

Save as otherwise provided in this Act, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.

S.5. Current Account Transactions

Any person may sell or draw foreign exchange to or from an authorized person if such sale or drawal is a current account transaction:

Provided that the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed

S.6. Capital Account Transactions

- (1) Subject to the provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction.
- (2) The Reserve Bank may, in consultation with the Central Government, specify-
 1. Any class or classes of capital account transactions which are permissible;
 2. The limit up to which foreign exchange shall be admissible for such transactions:

Provided that the Reserve Bank shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

- (3) Without prejudice to the generality of the provisions of sub-section

(2), the Reserve Bank may, by regulations prohibit, restrict or regulate the following,-

- i. Transfer or issue of any foreign security by a person resident in India;
 - ii. Transfer or issue of any security by a person resident outside India;
 - iii. Transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
 - iv. Any borrowing or lending in foreign exchange in whatever form or by whatever name called;
 - v. Any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
 - vi. Deposits between persons resident in India and persons resident outside India;
 - vii. Export, import or holding of currency or currency notes;
 - viii. Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
 - ix. Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
 - x. Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred,-
 - (i) By a person resident in India and owed to a person resident outside India; or
 - (ii) By a person resident outside India.
- (4) A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

- (5) A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.
- (6) Without prejudice to the provisions of this section, the Reserve Bank may by regulation prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

S.7. Export of Goods and Services

- (1) Every exporter of goods shall:
 - i. Furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India;
 - ii. Furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter.
- (2) The Reserve Bank may, for the purpose of ensuring that the full export value of the goods or such reduced value of the goods as the Reserve Bank determines, having regard to the prevailing market conditions, is received without any delay, direct any exporter to comply with such requirements as it deems fit.
- (3) Every exporter of services shall furnish to the Reserve Bank or to such other authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services.

S.8. Realization and Repatriation of Foreign Exchange

Save as otherwise provided in this Act, where any amount of foreign exchange is due or has accrued to any person resident in India such person shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

S.9. Exemption from Realization and Repatriation in Certain Cases

The provisions of sections 4 and 8 shall not apply to the following, namely:-

- i. Possession of foreign currency or foreign coins by any person up to such limit as the Reserve Bank may specify;
- ii. Foreign currency account held or operated by such person or class of persons and the limit up to which the Reserve Bank may specify;
- iii. Foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;
- iv. Foreign exchange held by a person resident in India up to such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c), including any income arising there from;
- v. Foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means up to such limit as the Reserve Bank may specify; and
- vi. Such other receipts in foreign exchange as the Reserve Bank may specify.

S.10. Authorized Person

- (1) The Reserve Bank may, on an application made to it in this behalf, authorize any person to be known as authorized person to deal in foreign exchange or in foreign securities, as an authorized dealer, money changer or off-shore banking unit or in any other manner as it deems fit.

- (2) An authorization under this section shall be in writing and shall be subject to the conditions laid down therein.
- (3) An authorization granted under sub-section (1) may be revoked by the Reserve Bank at any time if the Reserve Bank is satisfied that-
 - ii. It is in public interest so to do; or
 - ii. The authorized person has failed to comply with the condition subject to which the authorization was granted or has contravened any of the provisions of the Act or any rule, regulation, notification, direction or order made thereunder:

Provided that no such authorization shall be revoked on any ground referred to in clause (b) unless the authorized person has been given a reasonable opportunity of making a representation in the matter.

- (4) An authorized person shall, in all his dealings in foreign exchange or foreign security comply with such general or special directions or orders as the Reserve Bank may, from time to time, think fit to give, and, except with the previous permission of the Reserve Bank, an authorized person shall not engage in any transaction involving any foreign exchange or foreign security which is not in conformity with the terms of his authorization under this section.
- (5) An authorized person shall, before under-taking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and to give such information as will reasonably satisfy him that the transaction will not involve, and is not designed for the purpose of any contravention or evasion of the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder, and where the said person refuses to comply with any such requirement or makes only unsatisfactory compliance therewith, the authorized person shall refuse in writing to undertake the transaction and shall, if he has reason to believe that any such contravention or evasion as aforesaid is contemplated by the person, report the matter to the Reserve Bank.
- (6) Any person, other than an authorized person, who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to authorized person under sub-section (5)

does not use it for such purpose or does not surrender it to authorized person within the specified period or uses the foreign exchange so acquired or purchased for any other purpose for which purchase or acquisition of foreign exchange is not permissible under the provisions of the Act or the rules or regulations or direction or order made thereunder shall be deemed to have committed contravention of the provisions of the Act for the purpose of this section.

S.11. Reserve Bank's Powers to Issue Directions to Authorized Person

- (1) The Reserve Bank may, for the purpose of securing compliance with the provisions of this Act and of any rules, regulations, notifications or directions made thereunder, give to the authorized persons any direction in regard to making of payment or the doing or desist from doing any act relating to foreign exchange or foreign security.
- (2) The Reserve Bank may, for the purpose of ensuring the compliance with the provisions of this Act or of any rule, regulation, notification, direction, or order made thereunder, direct any authorized person to furnish such information, in such manner, as it deems fit.
- (3) Where any authorized person contravenes any direction given by the Reserve Bank under this Act or fails to file any return as directed by the Reserve Bank, the Reserve Bank may, after giving reasonable opportunity of being heard, impose on the authorized person a penalty which may extend to ten thousand rupees and in the case of continuing contravention with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues

S.12. Power of Reserve Bank to Inspect Authorized Person

- (1) The Reserve Bank may, at any time, cause an inspection to be made, by any officer of the Reserve Bank specially authorized in writing by the Reserve Bank in this behalf, of the business of any authorized person as may appear to it to be necessary or expedient for the purpose of-
 - I. Verifying the correctness of any statement, information or particulars furnished to the Reserve Bank;

- II. Obtaining any information or particulars which such authorized person has failed to furnish on being called upon to do so;
 - III. Securing compliance with the provisions of this Act or of any rules, regulations, directions or orders made thereunder.
- (2) It shall be the duty of every authorized person, and where such person is a company or a firm, every director, partner or other officer of such company or firm, as the case may be, to produce to any officer making an inspection under sub-section (1), such books, accounts and other documents in his custody or power and to furnish any statement or information relating to the affairs of such person, company or firm as the said officer may require within such time and in such manner as the said officer may direct.

S.13. Penalties

- (1) If any person contravenes any provision of this Act, or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act, or contravenes any condition subject to which an authorization is issued by the Reserve Bank, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contravention where such amount is quantifiable, or up to two lakh rupees where the amount is not quantifiable, and where such contravention is a continuing one, further penalty which may extend to five thousand rupees for every day after the first day during which the contravention continues.
- (2) Any Adjudicating Authority adjudging any contravention under sub-section (1), may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government and further direct that the foreign exchange holdings, if any of the persons committing the contraventions or any part thereof, shall be brought back into India or shall be retained outside India in accordance with the directions made in this behalf.

Explanation.- For the purposes of this sub-section, “property” in respect of which contravention has taken place, shall include;-

- a. Deposits in a bank, where the said property is converted into such deposits;
- b. Indian currency, where the said property is converted into that currency; and
- c. Any other property which has resulted out of the conversion of that property

S.14. Enforcement of the Orders of Adjudicating Authority

- 1 Subject to the provisions of sub-section (2) of section 19, if any person fails to make full payment of the penalty imposed on him under section 13 within a period of ninety days from the date on which the notice for payment of such penalty is served on him, he shall be liable to civil imprisonment under this section.
- 2 No order for the arrest and detention in civil prison of a defaulter shall be made unless the Adjudicating Authority has issued and served a notice upon the defaulter calling upon him to appear before him on the date specified in the notice and to show cause why he should not be committed to the civil prison, and unless the Adjudicating Authority, for reasons in writing, is satisfied
 - a. That the defaulter, with the object or effect of obstructing the recovery of penalty, has after the issue of notice by the Adjudicating Authority, dishonestly transferred, concealed, or removed any part of his property, or
 - b. That the defaulter has, or has had since the issuing of notice by the Adjudicating Authority, the means to pay the arrears or some substantial part thereof and refuses or neglects or has refused or neglected to pay the same.
- 3 Notwithstanding anything contained in sub-section (1), a warrant for the arrest of the defaulter may be issued by the Adjudicating Authority if the Adjudicating Authority is satisfied, by affidavit or otherwise, that with the object or effect of delaying the execution of the certificate the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority.

- 4 Where appearance is not made pursuant to a notice issued and served under sub-section (1), the Adjudicating Authority may issue a warrant for the arrest of the defaulter.
- 5 A warrant of arrest issued by the Adjudicating Authority under sub-section (3) or sub-section (4) may also be executed by any other Adjudicating Authority within whose jurisdiction the defaulter may for the time being be found.
- 6 Every person arrested in pursuance of a warrant of arrest under this section shall be brought before the Adjudicating Authority issuing the warrant as soon as practicable and in any event within twenty-four hours of his arrest (*exclusive of the time required for the journey*):

Provided that, if the defaulter pays the amount entered in the warrant of arrest as due and the costs of the arrest to the officer arresting him such officer shall at once release him.

Explanation. - For the purpose of this sub-section, where the defaulter is a Hindu undivided family, the *karta* thereof shall be deemed to be the defaulter.

- 7 When a defaulter appears before the Adjudicating Authority pursuant to a notice to show cause or is brought before the Adjudicating Authority under this section, the Adjudicating Authority shall give the defaulter an opportunity showing cause why he should not be committed to the civil prison.
- 8 Pending the conclusion of the inquiry, the Adjudicating Authority may, in his discretion, order the defaulter to be detained in the custody of such officer as the Adjudicating Authority may think fit or release him on his furnishing the security to the satisfaction of the Adjudicating Authority for his appearance as and when required.
- 9 Upon the conclusion of the inquiry, the Adjudicating Authority may make an order for the detention of the defaulter in the civil prison and shall in that event cause him to be arrested if he is not already under arrest:

Provided that in order to give a defaulter an opportunity of satisfying the arrears, the Adjudicating Authority may, before making the order of detention, leave the defaulter in the custody of the officer arresting him or of any other officer for a specified period not exceeding fifteen days, or release him on his furnishing security to the satisfaction of the Adjudicating Authority for his appearance at the expiration of the specified period if the arrears are not satisfied.

- 10 When the Adjudicating Authority does not make an order of detention under sub-section (9), he shall, if the defaulter is under arrest, direct his release.
- 11 Every person detained in the civil prison in execution of the certificate may be so detained;-
 - a. Regarding the certificate is for a demand of an amount exceeding rupees one crore - up to three years, and
 - b. Any other case - up to six months:

Provided that he shall be released from such detention on the amount mentioned in the warrant for his detention being paid to the officer-in-charge of the civil prison.

- 12 A defaulter released from detention under this section shall not, merely by reason of his release, be discharged from his liability for the arrears but he shall not be liable to be arrested under the certificate in execution of which he was detained in the civil prison.
- 13 A detention order may be executed at any place in India in the manner provided for the execution of warrant of arrest under the Code of Criminal Procedure, 1973 (2 of 1974).

S.15. Power to Compound Contravention

- (1) Any contravention under section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and officers of the Reserve Bank as may be authorized in this behalf by the Central Government in such manner as may be prescribed.

- (2) Where a contravention has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall be initiated or continued, as the case may be, against the person committing such contravention under that section, in respect of the contravention so compounded.

S.16. Appointment of Adjudicating Authority

- (1) For the purpose of adjudication under section 13, the Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government as it may think fit, as the Adjudicating Authorities for holding an inquiry in the manner prescribed after giving the person alleged to have committed contravention under section 13, against whom a complaint has been made under sub-section (2) (*hereinafter in this section referred to as the said person*) a reasonable opportunity of being heard for the purpose of imposing any penalty:

Provided that where the Adjudicating Authority is of opinion that the said person is likely to abscond or is likely to evade in any manner, the payment of penalty, if levied, it may direct the said person to furnish a bond or guarantee for such amount and subject to such conditions as it may deem fit.

- (2) The Central Government shall, while appointing the Adjudicating Authorities under sub-section (1), also specify in the order published in the Official Gazette their respective jurisdiction.
- (3) No Adjudicating Authority shall hold an enquiry under sub-section (1) except upon a complaint in writing made by any officer authorized by a general or special order by the Central Government.
- (4) The said person may appear either in person or take the assistance of a legal practitioner or a chartered accountant of his choice for presenting his case before the Adjudicating Authority
- (5) Every Adjudicating Authority shall have the same powers of a civil court which are conferred on the Appellate Tribunal under sub-section (2) of section 28 and;-

- a. Proceedings before it shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code, 1860 (45 of 1860);
 - b. Shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974).
- (6) Every Adjudicating Authority shall deal with the complaint under sub-section (2) as expeditiously as possible and endeavor shall be made to dispose off the complaint finally within one year from the date of receipt of the complaint:

Provided that where the complaint cannot be disposed off within the said period, the Adjudicating Authority shall record periodically the reasons in writing for not disposing off the complaint within the said period.

S.17. Appeal to Special Director (Appeals)

- (1) The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities under this section and shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction.
- (2) Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement, may prefer an appeal to the Special Director (Appeals)
- (3) Every appeal under sub-section (1) shall be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved person and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

Provided that the Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.

- (4) On receipt of an appeal under sub-section (1), the Special Director (Appeals) may after giving the parties to the appeal an opportunity of being heard, pass such order thereon as he thinks fit confirming, modifying or setting aside the order appealed against.
- (5) The Special Director (Appeals) shall send a copy of every order made by him to the parties to appeal and to the concerned Adjudicating Authority.
- (6) The Special Director (Appeals) shall have the same powers of a civil court which are conferred on the Appellate Tribunal under subsection (2) of section 28 and;-
 - a. All proceedings before him shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code, 1860 (45 of 1860);
 - b. Shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974)

S.18. Establishment of Appellate Tribunal

The Central Government shall, by notification, establish an Appellate Tribunal to be known as the Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals) under this Act

S.19. Appeal to Appellate Tribunal

- (1) Save as provided in sub-section (2), the Central Government or any person aggrieved by an order made by an Adjudicating Authority other than those referred to sub-section (1) of section 17, or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal:

Provided that any person appealing against the order of the Adjudicating Authority or the Special Director (Appeals) levying any penalty, shall while filing the appeal, deposit the amount of such penalty with such authority as may be notified by the Central Government:

Provided further that where in any particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realization of penalty.

- (2) Every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government and it shall be in such form verified in such manner and be accompanied by such fee as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

- (3) On receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- (4) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority (or the Special Director (Appeals) as the case may be.
- (5) The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavor shall be made by it to dispose of the appeal finally within one hundred and eighty days from the date of receipt of the appeal:

Provided that where any appeal could not be disposed off within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing off the appeal within the said period.

- (6) The Appellate Tribunal may, for the purpose of examining the legality, propriety or correctness of any order made by the Adjudicating Authority under section 16 in relation to any proceeding, on its own motion or other-wise, call for the records of such proceedings and make such order in the case as it think fit.

S.20. Composition of Appellate Tribunal

- (1) The Appellate Tribunal shall consist of a Chairperson and such number of Members as the Central Government may deem fit.
- (2) Subject to the provisions of this Act,-
 - i. The jurisdiction of the Appellate Tribunal may be exercised by Benches thereof;
 - ii. A Bench may be constituted by the Chairperson with one or more Members as the Chairperson may deem fit;
 - iii. The Benches of the Appellate Tribunal shall ordinarily sit at New Delhi and at such other places as the Central Government may, in consultation with the Chairperson, notify;
 - iv. The Central Government shall notify the areas in relation to which each Bench of the Appellate Tribunal may exercise jurisdiction.
- (3) Notwithstanding anything contained in sub-section (2), the Chairperson may transfer a member from one Bench to another Bench.
- (4) If at any stage of the hearing of any case or matter it appears to the Chairperson or a Member that the case or matter is of such a nature that it ought to be heard by a Bench consisting of two Members, the case or matter may be transferred by the Chairperson or, as the case may be, referred to him for transfer, to such Bench as the Chairperson may deem fit.

(Sections 21 to 40 not presented here)

S.41. Power of Central Government to Give Directions

For the purposes of this Act, the Central Government may, from time to time, give to the Reserve Bank such general or special directions as it thinks fit and the Reserve Bank shall, in the discharge of its functions under this Act, comply with any such directions.

S.42. Contravention by Companies

- (1) Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention took place without his knowledge or that he exercised due diligence to prevent such contravention.

- (2) Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Explanation.- For the purposes of this section-

1. “Company” means any body corporate and includes a firm or other association of individuals; and
2. “Director”, in relation to a firm, means a partner in the firm.

S.46. Power to Make Rules

- (1) The Central Government may, by notification, make rules to carry out the provisions of this Act.
- (2) Without prejudice to the generality of the foregoing power, such rules may provide for,-

- i. The imposition of reasonable restrictions on current account transactions under section 5;
- ii. The manner in which the contravention may be compounded under sub-section (1) of section 15;
- iii. The manner of holding an inquiry by the Adjudicating Authorities under sub-section (1) of section 16;
- iv. The form of appeal and fee for filing such appeal under sections 17 and 19;
- v. The salary and allowances payable to and the other terms and conditions of service of the Chairperson and other Members of the Appellate Tribunal and the Special Director (Appeals) under section 23;
- vi. The salaries and allowances and other conditions of service of the officers and employees of the Appellate Tribunal and the Office of the Special Director (Appeals) under sub-section (3) of section 27;
- vii. The additional matters in respect of which the Appellate Tribunal and the Special Director (Appeals) may exercise the powers of a civil court under clause (i) of sub-section (2) of section 28;
- viii. The authority or person and the manner in which any documents may be authenticated under clause (ii) of section 39; and
- ix. Any other matter which is required to be, or may be prescribed.

S.47. Power to Make Regulations

- (1) Reserve Bank may, by notification, make regulations, to carry out the provisions of this Act and the rules made thereunder::
- (2) Without prejudice to the generality of the foregoing power, such regulations may provide for,-
 1. The permissible classes of capital account transactions, the limits of admissibility of foreign exchange for such transactions,

and the prohibition, restriction or regulation of certain capital account transactions under section 6;

2. The manner and the form in which the declaration is to be furnished under clause (a) of sub-section (1) of section 7;
3. The period within which and the manner of repatriation of foreign exchange under section 8;
4. The limit up to which any person may possess foreign currency or foreign coins under clause (a) of section 9;
5. The class of persons and the limit up to which foreign currency account may be held or operated under clause (b) of section 9;
6. The limit up to which foreign exchange acquired may be exempted under clause (d) of section 9;
7. The limit up to which foreign exchange acquired may be retained under clause (e) of section 9;
8. Any other matter which is required to be, or may be, specified.

S.48. Rules and Regulations to be Laid Before Parliament

Every rule and regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

Legal Provisions as to Tax on Foreign Income in India

Foreign income is the one which satisfies both the following conditions: (i.) **Income is not received (or not deemed to be received under section 7) in India, and (ii.) Income doesn't accrue (or doesn't deemed to be accrued under section 9) in India.**

If an income satisfies any one (that is, in effect it is either received in India or it accrues from India) or none the above conditions (that is, in effect it is both received in India and accrues from India) then it is an Indian income.

Foreign Income is not taxable in the hands of a non-resident in India. For Resident (in case of firm, association of persons, company and every other person) or Resident & Ordinarily Resident (in case of an individual or an HUF), foreign income is always taxable. For 'Resident but not Ordinarily Resident' foreign income is taxable only if it is business income and business is controlled wholly or partly in India or it is a professional income and profession is set up in India.

Residential Status: The concept of Residential Status of the 'assessee' is useful in determining the scope or chargeability of the income for the 'assessee', i.e., whether taxable or not.

- i. Residential Status of an Individual Person:** For an *individual* person, to be a Resident, any one of the following basic conditions must be satisfied:-
- Presence of at least 182 days in India during the previous year.
 - Presence of at least 60 days in India during the previous year and 365 days during 4 years immediately preceding the relevant previous year.

However, in case the individual is an Indian citizen who leaves India during the previous year for the purpose of employment (or as a member of a crew of an Indian ship) or in case the individual is a person of Indian origin who comes on a visit to India during the previous year, then only the first of the above basic condition is applicable. To determine whether the resident individual is *ordinarily resident* the following both additional conditions are to be satisfied:-

- Resident in India in at least 2 out of 10 years immediately preceding the relevant previous year.
- Presence of at least 730 days in India during 7 years immediately preceding the relevant previous year.

If the individual resident satisfies only one or none of the additional conditions, then he is **Not Ordinarily Resident**. (In case the person is not an individual or an HUF, then the residential status can only be either resident or non-resident)

ii. Residential Status of a Person other than an Individual

| Type of person | Control & management of affairs of the taxpayer is wholly in India | Control & management of affairs of the taxpayer is wholly outside India | Control & management of affairs of the taxpayer is partly in India partly outside India |
|---------------------------------------|--|---|---|
| Hindu Undivided Family (HUF) | Resident | Non-resident | Resident |
| Firm | Resident | Non-resident | Resident |
| Association of persons | Resident | Non-resident | Resident |
| Indian company | Resident | Resident | Resident |
| Foreign company | Resident | Non-resident | Non-resident |
| Any other person except an individual | Resident | Non-resident | Resident |

Note 1: After determining whether an HUF is resident or non-resident, the additional conditions (as laid down for an individual) should be checked for the *karta* to determine whether the HUF is ordinary or not-ordinary resident.

Note 2: An Indian company is the one which satisfies the conditions as laid down under section 2(26) of the Act.

Note 3: Foreign company is the one which satisfies the conditions as laid down under section 2(23A) of the Act.

Scope of Taxable Total Income

Indian income is always taxable in India notwithstanding residential status of the taxpayer. **Foreign income** is not taxable in the hands of a non-resident in India. For resident (in case of firm, association

of persons, company and every other person) or resident & ordinarily resident (in case of an individual or an HUF), foreign income is always taxable. For resident but not ordinarily resident foreign income is taxable only if it is business income and business is controlled wholly or partly in India or it is a professional income and profession is set up in India.

Indian Law as to Inward and Outward Foreign Investment

There are two situations, namely, Inflow of foreign investment into India and outflow of foreign investment. Both are dealt with here.

Law as to Foreign Investment Into India by Overseas Entities

Foreign Direct Investment (FDI)

1. Forms in which business can be conducted by a foreign company in India

A foreign company planning to set up business operations in India may:

- Incorporate a company under the Companies Act, 1956, as a Joint Venture or a Wholly Owned Subsidiary.
- Set up a Liaison Office / Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000.

2. Procedure for Receiving Foreign Direct Investment in an Indian

An Indian company may receive Foreign Direct Investment under the two routes as given under:

i. Automatic Route

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/ sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

ii. Government Route

FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from <http://www.dipp.gov.in>. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

The Indian company having received FDI either under the **Automatic route** or the **Government route** is required to comply with provisions of the FDI policy including reporting the FDI to the Reserve Bank, as stated in Q 4.

3. Instruments for receiving Foreign Direct Investment in an Indian company

Foreign investment is reckoned as FDI only if the investment is made in equity shares, fully and mandatorily convertible preference shares and fully and mandatorily convertible debentures with the pricing being decided upfront as a figure or based on the formula that is decided upfront. Any foreign investment into an instrument issued by an Indian company which:

- Gives an option to the investor to convert or not to convert it into equity or
- Does not involve upfront pricing of the instrument as a date would be reckoned as ECB and would have to comply with the ECB guidelines.

The FDI policy provides that the price/ conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations [the DCF method of valuation for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies].

4. Modes of Payment Allowed for Receiving Foreign Direct Investment in an Indian Company

An Indian company issuing shares /convertible debentures under FDI Scheme to a person resident outside India shall receive the amount of consideration required to be paid for such shares /convertible debentures by:

- (i) Inward remittance through normal banking channels.
- (ii) Debit to NRE / FCNR account of a person concerned maintained with an AD category I bank.
- (iii) Conversion of royalty / lump sum / technical knowhow fee due for payment or conversion of ECB, shall be treated as consideration for issue of shares.
- (iv) Conversion of import payables / pre incorporation expenses / share swap can be treated as consideration for issue of shares with the approval of FIPB.
- (v) Debit to non-interest bearing Escrow account in Indian Rupees in India which is opened with the approval from AD Category – I bank and is maintained with the AD Category I bank on behalf of residents and non-residents towards payment of share purchase consideration.

If the shares or convertible debentures are not issued within 180 days from the date of receipt of the inward remittance or date of debit to NRE / FCNR (B) / Escrow account, the amount shall be refunded. Further, Reserve Bank may on an application made to it and for sufficient reasons permit an Indian Company to refund / allot shares for the amount of consideration received towards issue of security if such amount is outstanding beyond the period of 180 days from the date of receipt.

5. Sectors where FDI is not allowed in India, both under the Automatic Route as well as under the Government Route

FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

- i) Atomic Energy
- ii) Lottery Business
- iii) Gambling and Betting
- iv) Business of Chit Fund
- v) Nidhi Company
- vi) Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations) (c.f. Notification No. FEMA 94/2003-RB dated June 18, 2003).
- vii) Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in Notification No. FEMA 136/2005-RB dated July 19, 2005).
- viii) Trading in Transferable Development Rights (TDRs).
- ix) Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

(Please also see the website of Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India at www.dipp.gov.in for details regarding sectors and investment limits therein allowed, under FDI)

6. Procedure to be followed after investment is made under the Automatic Route or with Government approval

A two-stage reporting procedure has to be followed:.

On Receipt of Share Application Money

Within 30 days of receipt of share application money/amount of consideration from the non-resident investor, the Indian company is required to report to the Foreign Exchange Department, Regional Office concerned of the Reserve Bank of India, under whose jurisdiction its Registered Office is located, the Advance Reporting Form, containing the following details:

Name and address of the foreign investor/s;

- Date of receipt of funds and the Rupee equivalent;
- Name and address of the authorised dealer through whom the funds have been received;
- Details of the Government approval, if any; and
- KYC report on the non-resident investor from the overseas bank remitting the amount of consideration.

The Indian company has to ensure that the shares are issued within 180 days from the date of inward remittance which otherwise would result in the contravention / violation of the FEMA regulations.

Upon Issue of Shares to Non-Resident Investors

Within 30 days from the date of issue of shares, a report in Form FC-GPR- PART A together with the following documents should be filed with the Foreign Exchange Department, Regional Office concerned of the Reserve Bank of India.

Certificate from the Company Secretary of the company accepting investment from persons resident outside India certifying that:

- The company has complied with the procedure for issue of shares as laid down under the FDI scheme as indicated in the Notification No. FEMA 20/2000-RB dated 3rd May 2000, as amended from time to time.
- The investment is within the sectoral cap / statutory ceiling permissible under the Automatic Route of the Reserve Bank and it fulfills all the conditions laid down for investments under the Automatic Route,

OR

- Shares have been issued in terms of SIA/FIPB approval No. ----- dated ----- (enclosing the FIPB approval copy)

- Certificate from Statutory Auditors/ SEBI registered Merchant Banker / Chartered Accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.

7. Guidelines for transfer of existing shares from non-residents to residents or residents to non-residents

The term 'transfer' is defined under FEMA as including "sale, purchase, acquisition, mortgage, pledge, gift, loan or any other form of transfer of right, possession or lien" {Section 2 (ze) of FEMA, 1999}.

The following share transfers are allowed without the prior approval of the Reserve Bank of India

A. Transfer of shares from a Non Resident to Resident under the FDI scheme where the pricing guidelines under FEMA, 1999 are not met provided that:

- i. The original and resultant investment are in line with the extant FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation, etc.;
- ii. The pricing for the transaction is compliant with the specific/ explicit, extant and relevant SEBI regulations / guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/ substantial acquisition / SEBI SAST, buy back); and
- iii. Chartered Accountants Certificate to the effect that compliance with the relevant SEBI regulations / guidelines as indicated above is attached to the form FC-TRS to be filed with the AD bank.

B. Transfer of shares from Resident to Non Resident:

- i) **Where the transfer of shares requires the prior approval of the FIPB as per the extant FDI policy provided that:**
 - a) The requisite approval of the FIPB has been obtained; and
 - b) The transfer of share adheres with the pricing guidelines

and documentation requirements as specified by the Reserve Bank of India from time to time.

- ii) **Where SEBI (SAST) guidelines are attracted** subject to the adherence with the pricing guidelines and documentation requirements as specified by Reserve Bank of India from time to time.
- iii) **Where the pricing guidelines under the Foreign Exchange Management Act (FEMA), 1999 are not met provided that:-**

The resultant FDI is in compliance with the extant FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation etc.;

b) The pricing for the transaction is compliant with the specific/explicit, extant and relevant SEBI regulations / guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/ substantial acquisition / SEBI SAST); and Chartered Accountants Certificate to the effect that compliance with the relevant SEBI regulations / guidelines as indicated above is attached to the form FC-TRS to be filed with the AD bank.

- iv) Where the investee company is in the financial sector provided that:
 - a) NOCs are obtained from the respective financial sector regulators/ regulators of the investee company as well as transferor and transferee entities and such NOCs are filed along with the form FC-TRS with the AD bank; and
 - b) The FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation etc., are complied with.

Where non-residents (including NRIs) make investment in an Indian company in compliance with the provisions of the Companies Act, 1956, by way of subscription to Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

Transfer of shares/ fully and mandatorily convertible debentures by way of Gift:

A person resident outside India can freely transfer shares/ fully and mandatorily convertible debentures by way of gift to a person resident in India as under:

- Any person resident outside India, (not being a NRI or an erstwhile OCB), can transfer by way of gift the shares/ fully and mandatorily convertible debentures to any person resident outside India;
- A NRI may transfer by way of gift, the shares/convertible debentures held by him to another NRI only,
- Any person resident outside India may transfer share/ fully and mandatorily convertible debentures to a person resident in India by way of gift.

8. Person resident in India transferring security by way of gift to a person resident outside India

A person resident in India who proposes to transfer security **by way of gift** to a person resident outside India [other than an erstwhile OCBs] shall make an application to the Central Office of the Foreign Exchange Department, Reserve Bank of India furnishing the following information, namely:

- Name and address of the transferor and the proposed transferee
- Relationship between the transferor and the proposed transferee
- Reasons for making the gift.
- In case of Government dated securities, treasury bills and bonds, a certificate issued by a Chartered Accountant on the market value of such securities. In case of units of domestic mutual funds and units of Money Market Mutual Funds, a certificate from the issuer on the Net Asset Value of such security.
- In case of shares/ fully and mandatorily convertible debentures, a certificate from a Chartered Account on the value of such securities according to the guidelines issued by the Securities & Exchange Board of India or the Discount Free Cash Flow Cash (DCF)

method with regard to listed companies and unlisted companies, respectively.

- Certificate from the Indian company concerned certifying that the proposed transfer of shares/convertible debentures, by way of gift, from resident to the non-resident shall not breach the applicable sectoral cap/ FDI limit in the company and that the proposed number of shares/convertible debentures to be held by the non-resident transferee shall not exceed 5 per cent of the paid up capital of the company.

The transfer of security by way of gift may be permitted by the Reserve bank provided:

- (i) The donee is eligible to hold such security under Schedules 1, 4 and 5 to Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time.
- (ii) The gift does not exceed 5 per cent of the paid up capital of the Indian company/ each series of debentures/ each mutual fund scheme
- (iii) The applicable sectoral cap/ foreign direct investment limit in the Indian company is not breached
- (iv) The donor and the donee are relatives as defined in section 6 of the Companies Act, 1956.
- (v) The value of security to be transferred by the donor together with any security transferred to any person residing outside India as gift in the financial year does not exceed the rupee equivalent of USD 50000.
- (vi) Such other conditions as considered necessary in public interest by the Reserve Bank.

9. Transfer of shares from resident to non-resident does not fall under the above categories

Transfer of Shares by Resident which requires Government approval

The following instances of transfer of shares from residents to non-residents by way of sale or otherwise requires Government approval:

- (i) Transfer of shares of companies engaged in sector falling under the Government Route.
- (ii) Transfer of shares resulting in foreign investments in the Indian company, breaching the sectoral cap applicable.

Prior permission of the Reserve Bank in certain cases for acquisition / transfer of security

- i) Transfer of shares or convertible debentures from residents to non-residents by way of sale requires prior approval of Reserve Bank in case where the non-resident acquirer proposes deferment of payment of the amount of consideration. Further, in case approval is granted for the transaction, the same should be reported in Form FC-TRS to the AD Category – I bank, within 60 days from the date of receipt of the full and final amount of consideration.
- (ii) A person resident in India, who intends to transfer any security, by way of gift to a person resident outside India, has to obtain prior approval from the Reserve Bank.

Any other case not covered by General Permission.

10. Reporting obligations in case of transfer of shares between resident and non-resident

The transaction should be reported by submission of form FC-TRS to the AD Category – I bank, within 60 days from the date of receipt/ remittance of the amount of consideration. The onus of submission of the form FC-TRS within the given timeframe would be on the resident in India, the transferor or transferee, as the case may be.

11. Method of payment and remittance/credit of sale proceeds in case of transfer of shares between resident and non-resident

The sale consideration in respect of the shares purchased by a person resident outside India shall be remitted to India through normal banking channels. In case the buyer is a Foreign Institutional Investor (FII), payment should be made by debit to its Special Non-Resident Rupee Account. In case the buyer is a NRI, the payment may be made by way of debit to his NRE/FCNR (B) accounts. However, if the shares are acquired

on non-repatriation basis by NRI, the consideration shall be remitted to India through normal banking channel or paid out of funds held in NRE/FCNR (B)/NRO accounts.

The sale proceeds of shares (net of taxes) sold by a person resident outside India) may be remitted outside India. In case of FII the sale proceeds may be credited to its special Non-Resident Rupee Account. In case of NRI, if the shares sold were held on repatriation basis, the sale proceeds (net of taxes) may be credited to his NRE/FCNR(B) accounts and if the shares sold were held on non repatriation basis, the sale proceeds may be credited to his NRO account subject to payment of taxes. The sale proceeds of shares (net of taxes) sold by an erstwhile OCB may be remitted outside India directly if the shares were held on repatriation basis and if the shares sold were held on non-repatriation basis, the sale proceeds may be credited to its NRO (Current) Account subject to payment of taxes, except in the case of erstwhile OCBs whose accounts have been blocked by Reserve Bank.

12. Repatriation of the Investments and Profits Earned in India

All foreign investments are freely repatriable (net of applicable taxes) except in cases where:

- i) The foreign investment is in a sector like Construction and Development Projects and Defence wherein the foreign investment is subject to a lock-in-period; and
- ii) NRIs choose to invest specifically under non-repatriable schemes.

Further, dividends (net of applicable taxes) declared on foreign investments can be remitted freely through an Authorised Dealer bank.

13. Guidelines on issue and valuation of shares in case of existing companies

- A. The price of shares issued to persons resident outside India under the FDI Scheme shall not be less than:
 - (i) The price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company is listed on any recognised stock exchange in India;
 - (ii) The fair valuation of shares done by a SEBI registered Category

- I Merchant Banker or a Chartered Accountant as per the discounted free cash flow method, where the shares of the company is not listed on any recognised stock exchange in India; and
 - (iii) The price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment.
- B. The price of shares transferred from resident to a non-resident and vice versa should be determined as under:
- i) Transfer of shares from a resident to a non-resident:
 - a) In case of listed shares, at a price which is not less than the price at which a preferential allotment of shares would be made under SEBI guidelines.
 - b) In case of unlisted shares at a price which is not less than the fair value as per the Discount Free Cash Flow (DCF) Method to be determined by a SEBI registered Category-I-Merchant Banker/Chartered Accountant.
 - ii) Transfer of shares from a non-resident to a resident - The price should not be more than the minimum price at which the transfer of shares would have been made from a resident to a non-resident.

In any case, the price per share arrived at as per the above method should be certified by a SEBI registered Category-I-Merchant Banker / Chartered Accountant.

14. Regulations pertaining to issue of ADRs/ GDRs by Indian companies

Indian companies can raise foreign currency resources abroad through the issue of ADRs/ GDRs, 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 thereunder from time to time.

A company can issue ADRs / GDRs, if it is eligible to issue shares to persons resident outside India under the FDI Scheme. However, an Indian listed company, which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) will not be eligible to issue ADRs/GDRs.

Unlisted companies, which have not yet accessed the ADR/GDR route for raising capital in the international market, would require prior or simultaneous listing in the domestic market, while seeking to issue such overseas instruments. Unlisted companies, which have already issued ADRs/GDRs in the international market, have to list in the domestic market on making profit or within three years of such issue of ADRs/GDRs, whichever is earlier.

After the issue of ADRs/GDRs, the company has to file a return in Form DR as indicated in the RBI Notification No. FEMA.20/ 2000-RB dated May 3, 2000, as amended from time to time. The company is also required to file a quarterly return in Form DR- Quarterly as indicated in the RBI Notification *ibid*.

There are no end-use restrictions on GDR/ADR issue proceeds, except for an express ban on investment in real estate and stock markets.

Erstwhile OCBs which are not eligible to invest in India and entities prohibited to buy, sell or deal in securities by SEBI will not be eligible to subscribe to ADRs / GDRs issued by Indian companies.

The pricing of ADR / GDR issues including sponsored ADRs / GDRs should be made at a price determined under the provisions of the Scheme of issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Government of India and directions issued by the Reserve Bank, from time to time.

15. Sponsored ADR & Two-way fungibility Scheme of ADR/ GDR

Ans. Sponsored ADR/GDR: An Indian company may sponsor an issue of ADR/ GDR with an overseas depository against shares held by

its shareholders at a price to be determined by the Lead Manager. The operative guidelines for the same have been issued vide A.P. (DIR Series) Circular No.52 dated November 23, 2002.

Two-way fungibility Scheme: Under the limited Two-way fungibility Scheme, a registered broker in India can purchase shares of an Indian company on behalf of a person resident outside India for the purpose of converting the shares so purchased into ADRs/ GDRs. The operative guidelines for the same have been issued vide A.P. (DIR Series) Circular No.21 dated February 13, 2002. The Scheme provides for purchase and re-conversion of only as many shares into ADRs/ GDRs which are equal to or less than the number of shares emerging on surrender of ADRs/ GDRs which have been actually sold in the market.

Thus, it is only a limited two-way fungibility wherein the headroom available for fresh purchase of shares from domestic market is restricted to the number of converted shares sold in the domestic market by non-resident investors. So long the ADRs/ GDRs are quoted at discount to the value of shares in domestic market, an investor will gain by converting the ADRs/ GDRs into underlying shares and selling them in the domestic market. In case of ADRs/ GDRs being quoted at premium, there will be demand for reverse fungibility, i.e. purchase of shares in domestic market for re-conversion into ADRs/ GDRs. The scheme is operationalised through the Custodians of securities and stock brokers under SEBI.

16. Indian companies issue Foreign Currency Convertible Bonds (FCCBs)

FCCBs can be issued by Indian companies in the overseas market in accordance with the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

The FCCB being a debt security, the issue needs to conform to the External Commercial Borrowing guidelines, issued by RBI vide Notification No. FEMA 3/2000-RB dated May 3, 2000, as amended from time to time.

17. Regulations for Foreign investor investment in Preference Shares

Foreign investment through preference shares is treated as foreign direct investment. However, the preference shares should be fully and mandatorily convertible into equity shares within a specified time to be reckoned as part of share capital under FDI. Investment in other forms of preference shares requires to comply with the ECB norms.

18. Issue debentures as part of FDI

Debentures which are fully and mandatorily convertible into equity within a specified time would be reckoned as part of share capital under the FDI Policy.

19. Shares against Lumpsum Fee, Royalty, ECB, Import of capital goods/ machineries / equipments (excluding second-hand machine) and Pre-operative/pre-incorporation expenses (including payments of rent

An Indian company eligible to issue shares under the FDI policy and subject to pricing guidelines as specified by the Reserve Bank from time to time, may issue shares to a person resident outside India:

- i. Being a provider of technology / technical know-how, against Royalty / Lumpsum fees due for payment;
- ii. Against External Commercial Borrowing (ECB) (other than import dues deemed as ECB or Trade Credit as per RBI Guidelines).
- iii. With prior approval from FIPB for against import of capital goods/ machineries / equipments and Pre-operative/pre-incorporation expenses subject to the compliance with the extant FEMA regulations and AP Dir Series 74 dated June 30,2011.

Provided, that the foreign equity in the company, after such conversion, is within the sectoral cap.

20. Other modes of issues of shares for which general permission is available under RBI Notification No. FEMA 20 dated May 3, 2000

- Issue of shares under ESOP by Indian companies to its employees or employees of its joint venture or wholly owned subsidiary abroad

who are resident outside India directly or through a Trust up to 5% of the paid up capital of the company.

- Issue and acquisition of shares by non-residents after merger or de-merger or amalgamation of Indian companies.
- Issue shares or preference shares or convertible debentures on rights basis by an Indian company to a person resident outside India.

21. Foreign investor investment in shares issued by an unlisted company in India

As per the regulations/guidelines issued by the Reserve Bank of India/Government of India, investment can be made in shares issued by an unlisted Indian company.

22. Foreigner setting up a partnership/ proprietorship concern in India

Only NRIs/PIOs are allowed to set up partnership/proprietorship concerns in India **on non-repatriation basis**.

23. Foreign investor investment in Rights shares issued by an Indian company at a discount

There are no restrictions under FEMA for investment in Rights shares issued at a discount by an Indian company, provided the rights shares so issued are being offered at the same price to residents and non-residents. The offer on right basis to the person's resident outside India shall be:

- (a) In the case of shares of a company listed on a recognized stock exchange in India, at a price as determined by the company; and
- (b) In the case of shares of a company not listed on a recognized stock exchange in India, at a price which is not less than the price at which the offer on right basis is made to resident shareholders.

2. Foreign Technology Collaboration Agreement

Payment in terms of foreign technology collaboration agreement' can be made by an Authorised Dealer (AD) bank

RBI has delegated the powers, to make payments for royalty, lumpsum fee for transfer of technology and payment for use of trademark/ brand name in terms of the foreign technology collaboration agreement entered by the Indian company with its foreign partners, to the AD banks subject to compliance with the provisions of Foreign Exchange Management (Current Account Transactions) Rules, 2000. Further, the requirement of registration of the agreement with the Regional Office of Reserve Bank of India has also been done away with

3. Foreign Portfolio Investment

Regulations regarding Portfolio Investments by SEBI registered Foreign Institutional Investors (FIIs)

Investment by SEBI registered FIIs is regulated under SEBI (FII) Regulations, 1995 and Regulation 5(2) of FEMA Notification No.20 dated May 3, 2000, as amended from time to time. FIIs include Asset Management Companies, Pension Funds, Mutual Funds, and Investment Trusts as Nominee Companies, Incorporated / Institutional Portfolio Managers or their Power of Attorney holders, University Funds, Endowment Foundations, Charitable Trusts and Charitable Societies.

SEBI acts as the nodal point in the registration of FIIs. The Reserve Bank of India has granted general permission to SEBI Registered FIIs to invest in India under the Portfolio Investment Scheme (PIS).

Investment by SEBI registered FIIs and its sub accounts cannot exceed 10 per cent of the paid up capital of the Indian company. However, in case of foreign corporates or High Networth Individuals (HNIs) registered as sub accounts of an FII, their investment shall be restricted to 5 per cent of the paid up capital of the Indian company. All FIIs and their sub-accounts taken together cannot acquire more than 24 per cent of the paid up capital of an Indian Company. An Indian company can raise the 24 per cent ceiling to the sectoral cap / statutory ceiling, as applicable, by

passing a resolution by its Board of Directors followed by passing a Special Resolution to that effect by their General Body. The Indian company has to intimate the raising of the FII limit to the Reserve Bank to enable the Bank to notify the same on its website for larger public dissemination.

SEBI registered FIIs/sub-accounts of FIIs can invest in primary issues of Non-Convertible Debentures (NCDs)/ bonds only if listing of such bonds / NCDs is committed to be done within 15 days of such investment. In case the NCDs/bonds issued to the SEBI registered FIIs / sub-accounts of FIIs are not listed within 15 days of issuance to the SEBI registered FIIs / sub-accounts of FIIs, for any reason, then the FII/sub-account of FII shall immediately dispose of these bonds/NCDs either by way of sale to a third party or to the issuer and the terms of offer to FIIs / sub-accounts should contain a clause that the issuer of such debt securities shall immediately redeem / buyback the said securities from the FIIs/sub-accounts of FIIs in such an eventuality.

Regulations regarding Portfolio Investments by NRIs/PIOs

Non- Resident Indian (NRIs) and Persons of Indian Origin (PIOs) can purchase or sell shares/ fully and mandatorily convertible debentures of Indian companies on the Stock Exchanges under the Portfolio Investment Scheme. For this purpose, the NRI/ PIO has to apply to a designated branch of a bank, which deals in Portfolio Investment. All sale/ purchase transactions are to be routed through the designated branch.

An NRI or a PIO can purchase shares up to 5 per cent of the paid up capital of an Indian company. All NRIs/PIOs taken together cannot purchase more than 10 per cent of the paid up value of the company. This limit can be increased by the Indian company to 24 per cent by passing a General Body resolution. The Indian company has to intimate the raising of the NR Limit to the Reserve Bank to enable the Bank to notify the same on its website for larger public dissemination.

The sale proceeds of the repatriable investments can be credited to the NRE/ NRO, etc. accounts of the NRI/ PIO, whereas the sale proceeds of non-repatriable investment can be credited only to NRO accounts.

The sale of shares will be subject to payment of applicable taxes.

4. Investment in Other Securities

Non-resident Indian (NRI) and SEBI registered Foreign Institutional Investor (FII) invest in Government Securities/ Treasury bills and Corporate debt

Under the FEMA Regulations, only NRIs and SEBI registered FIIs are permitted to purchase Government Securities/Treasury bills and Corporate debt. The details are as under:

- A. A Non-resident Indian can purchase without limit,
 - (1) On repatriation basis
 - i) Dated Government securities (other than bearer securities) or treasury bills or units of domestic mutual funds;
 - ii) Bonds issued by a public sector undertaking (PSU) in India; and
 - iii) Shares in Public Sector Enterprises being disinvested by the Government of India.
 - (2) On non-repatriation basis
 - i) Dated Government securities (other than bearer securities) or treasury bills or units of domestic mutual funds;
 - ii) Units of Money Market Mutual Funds in India; and
 - iii) National Plan/Savings Certificates.
- B. A SEBI registered FII may purchase, on repatriation basis, dated Government securities/ treasury bills, listed non-convertible debentures/ bonds issued by an Indian company and units of domestic mutual funds either directly from the issuer of such securities or through a registered stock broker on a recognised stock exchange in India.

Purchase of debt instruments including Upper Tier II instruments issued by banks in India and denominated in Indian Rupees by FIIs are subject to limits notified by SEBI and the Reserve Bank from time to time. The present limit for investment in Corporate Debt Instruments like non-

convertible debentures / bonds by FIIs is USD 45 billion, which constitutes of the:

Out of USD 45 billion, USD 25 billion is earmarked for investment in infrastructure corporate bonds and the remaining USD 20 billion is earmarked for investment in non-infrastructure corporate bonds. Out of the USD 25 billion earmarked for FIIs investment in infrastructure corporate bonds, a uniform lock-in period of one year and residual maturity of fifteen months has been prescribed for USD 22 billion investment by FIIs excluding the USD 3 billion limit earmarked for QFIs investment in mutual fund debt oriented schemes. The present limit of investment by SEBI registered FIIs in Government Securities is USD 20 billion which constitutes of:

- USD 10 billion will be without any conditions and the remaining USD 10 billion is with the condition that the residual maturity of the instrument at the time of first purchase by FIIs should be at least three years.

Sovereign Wealth Funds (SWFs), Multilateral agencies, endowment funds, insurance funds, pension funds and foreign Central Banks to be registered with SEBI are also allowed to invest in Government securities within this enhanced limit of USD 20 billion.

NRI and SEBI registered FII invest in Tier I and Tier II instruments issued by banks in India

SEBI registered FIIs and NRIs have been permitted to subscribe to the Perpetual Debt instruments (eligible for inclusion as Tier I capital) and Debt Capital instruments (eligible for inclusion as upper Tier II capital), issued by banks in India and denominated in Indian Rupees, subject to the following conditions:

- a. Investment by all FIIs in Rupee denominated Perpetual Debt instruments (Tier I) should not exceed an aggregate ceiling of 49 per cent of each issue and investment by individual FII should not exceed the limit of 10 per cent of each issue.
- b. Investments by all NRIs in Rupee denominated Perpetual Debt instruments (Tier I) should not exceed an aggregate ceiling of 24

per cent of each issue and investments by a single NRI should not exceed 5 percent of each issue.

- c. Investment by FIIs in Rupee denominated Debt Capital instruments (Tier II) shall be within the limits stipulated by SEBI for FII investment in corporate debt instruments.
- d. Investment by NRIs in Rupee denominated Debt Capital instruments (Tier II) shall be in accordance with the extant policy for investment by NRIs in other debt instruments.
- e. Investment by FIIs in Rupee denominated Upper Tier II Instruments raised in Indian Rupees will be within the limit prescribed by the SEBI for investment in corporate debt instruments.
- f. The details of the secondary market sales / purchases by FIIs and the NRIs in these instruments on the floor of the stock exchange are to be reported by the custodians and designated Authorised Dealer banks respectively, to the Reserve Bank through the soft copy of the Forms LEC (FII) and LEC (NRI).

NRI and SEBI registered FII invest in Indian Depository Receipts (IDRs)

NRI and SEBI registered FIIs have been permitted to invest, purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market, subject to the following conditions:

- (i) The purchase, hold and transfer of IDRs is in accordance with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 notified vide Notification No. FEMA 20 / 2000-RB dated May 3, 2000, as amended from time to time.

A limited two way fungibility for IDRs (similar to the limited two way fungibility facility available for ADRs/GDRs) subject to the following terms and conditions:

- i. The conversion of IDRs into underlying equity shares would be governed by the conditions mentioned in paras 6 and 7 of A.P. (DIR Series) Circular No. 5 dated July 22, 2009.

- ii. Fresh IDRs would continue to be issued in terms of the provisions of A.P. (DIR Series) Circular No. 5 dated July 22, 2009.
- iii. The re-issuance of IDRs would be allowed only to the extent of IDRs that have been redeemed /converted into underlying shares and sold.
- iv. There would be an overall cap of USD 5 billion for raising of capital by issuance of IDRs by eligible foreign companies in Indian markets. This cap would be akin to the caps imposed for FII investment in debt securities and would be monitored by SEBI.
- v. IDRs shall not be redeemable into underlying equity shares before the expiry of one year period from the date of issue of the IDRs.
- vi. At the time of redemption / conversion of IDRs into the underlying shares, the Indian holders (persons resident in India) of IDRs shall comply with the provisions of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 notified vide Notification No. FEMA 120 / RB-2004 dated July 7 2004, as amended from time to time.

The FEMA provisions shall not apply to the holding of the underlying shares, on redemption of IDRs by the FIIs including SEBI approved sub-accounts of the FIIs and NRIs. The issuance, redemption and fungibility of IDRs would also be subject to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended from time to time as well as other relevant guidelines issued in this regard by the Government, the SEBI and the RBI from time to time.

Person resident in India investment in the Indian Depository Receipts (IDRs) and procedure for redemption of IDRs held by persons resident in India

A person resident in India may purchase, hold and transfer IDRs of eligible companies resident outside India and issued in the Indian capital market. The FEMA Regulations shall not be applicable to persons resident in India as defined under section 2(v) of FEMA, 1999, for investing in IDRs and subsequent transfer arising out of a transaction on a recognized Stock Exchange in India. However, at the time of redemption / conversion of IDRs into underlying shares, the Indian holders (persons resident in

India) of IDRs shall comply with the provisions of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 notified vide Notification No. FEMA 120 / RB-2004 dated July 7 2004, as amended from time to time. The following guidelines shall be followed on redemption of IDRs by persons resident in India:

- i. Listed Indian companies may either sell or continue to hold the underlying shares subject to the terms and conditions as per Regulations 6B and 7 of Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time.
- ii. Indian Mutual Funds, registered with SEBI may either sell or continue to hold the underlying shares subject to the terms and conditions as per Regulation 6C of Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time.
- iii. Other persons resident in India including resident individuals are allowed to hold the underlying shares only for the purpose of sale within a period of 30 days from the date of conversion of the IDRs into underlying shares.

5. Regulations for Foreign Venture Capital Investment

A SEBI registered Foreign Venture Capital Investor has general permission from the Reserve Bank of India to invest in a Venture Capital Fund (VCF) or an Indian Venture Capital Undertaking (IVCU), in the manner and subject to the terms and conditions specified in Schedule 6 of RBI Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time. These investments by SEBI registered FVCI, would be subject to the SEBI regulation and sector specific caps of FDI.

FVCIs can purchase equity / equity linked instruments / debt / debt instruments, debentures of an IVCU or of a VCF through initial public offer or private placement in units of schemes / funds set up by a VCF. At the time of granting approval, the Reserve Bank permits the FVCI to open a Foreign Currency Account and/ or a Rupee Account with a designated branch of an AD Category – I bank.

FVCIs allowed to invest in the eligible securities (equity, equity linked instruments, debt, debt instruments, debentures of an IVCU

or VCF, units of schemes / funds set up by a VCF) by way of private arrangement / purchase from a third party also. FVCIs are also allowed to invest in securities on a recognized stock exchange.

The purchase / sale of shares, debentures and units can be at a price that is mutually acceptable to the buyer and the seller.

AD Category – I banks can offer forward cover to FVCIs to the extent of total inward remittance. In case the FVCI has made any remittance by liquidating some investments, original cost of the investments has to be deducted from the eligible cover to arrive at the actual cover that can be offered.

Overseas Direct Investment By Indian Entities

Guidelines Pertaining to Overseas Direct Investments

The guidelines have been notified by the Reserve Bank of India vide Notification No. FEMA 120/RB-2004 dated July 7, 2004, as amended from time to time, which can be accessed at the Reserve Bank's website <http://www.rbi.org.in/scripts/Fema.aspx>. A Master Circular titled 'Master Circular on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad', which is a compendium of all notifications/circulars incorporating the developments, is also available at the website <http://www.rbi.org.in>.

Clarifications Pertaining to the Guidelines on Overseas Investment

Please see answer to Q. 2 above. Any clarifications in respect of cases not covered by the instructions may be obtained, giving full details of the case, from the Central Office of the Reserve Bank at the following address:

The Chief General Manager Reserve Bank of India Foreign Exchange Department Overseas Investment Division Central Office Amar Building, 5th Floor Mumbai 400 001

General permissions available to persons (individual) resident in India for purchase / acquisition of securities abroad

General permission has been granted to persons (individual) resident in India for purchase / acquisition of securities as under:

- a. Out of funds held in the RFC account;
- b. As bonus shares on existing holding of foreign currency shares;
- c. When not permanently resident in India, from the foreign currency resources outside India.

General permission is also available to sell the shares so purchased or acquired. A resident Indian can remit up to USD 200,000/- per financial year under the Liberalized Remittance Scheme (LRS), for permitted current and capital account transactions including purchase of securities.

Direct Investment Outside India

Direct investment outside India means investments, either under the Automatic Route or the Approval Route, by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity, signifying a long-term interest in the overseas entity (setting up / acquiring a Joint Venture (JV) or a Wholly Owned Subsidiary (WOS). This is different from portfolio investment which is stated as answers to Qs 39, 40 and 44.

Acquiring an Existing Company Either Partially or Wholly

An eligible Indian entity is free to acquire either a partial stake (JV) or the entire stake (WOS) in an already existing entity overseas, provided the valuation is as per the laid down norms. Please also see Q No. 16.

Overseas Direct Investment be made in any activity

An Indian Party can make overseas direct investment in any bonafide activity (except those that are specifically prohibited as stated in answer to Q. 9). However, for undertaking activities in the financial services sector, certain additional conditions as specified in Regulation 7 of the Notification should be adhered to. Please refer answer to Q.25.

Persons Eligible to make Overseas Direct Investment under the Automatic Route

An Indian Party is eligible to make overseas direct investment under the Automatic Route. An Indian Party is a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act 1932 and any other entity in India as may be notified by the Reserve Bank. When more than one such company, body or entity makes investment in the foreign entity, such combination will also form an “Indian Party”.

Prohibited Activities for Overseas Direct Investment

Real estate as defined in Regulation 2(p) of the Notification and banking business are the prohibited sectors for overseas direct investment.

However, Indian banks operating in India can set up JVs/WOSs abroad provided they obtain clearance under the Banking Regulation Act, 1949, from the Department of Banking Operations and Development (DBOD), CO, RBI.

Items Covered Under the Term Real Estate Business

Real estate business means buying and selling of real estate or trading in Transferable Development Rights (TDRs) but does not include development of townships, construction of residential/commercial premises, roads or bridges.

Automatic Route

Under the Automatic Route, an Indian Party does not require any prior approval from the Reserve Bank for making overseas direct investments in a JV/WOS abroad. The Indian Party should approach an Authorized Dealer Category – I bank with an application in Form ODI and the prescribed enclosures / documents for effecting the remittances towards such investments. However, in case of investment in the financial services sector, prior approval is required from the regulatory authority concerned, both in India and abroad.

Limits and Requirements for Direct Investment to be made under the Automatic Route

The criteria for direct investment under the Automatic Route are as under:

- i. The Indian Party can invest up to 400% of its net worth (as per the last audited Balance Sheet) in JV / WOS for any bonafide activity permitted as per the law of the host country. The ceiling of 400% of net worth will not be applicable where the investment is made out of balances held in the EEFC account of the Indian party or out of funds raised through ADRs/GDRs;
- ii. The Indian Party is not on the Reserve Bank's exporters' caution list / list of defaulters to the banking system published/ circulated by the Credit Information Bureau of India Ltd. (CIBIL) /RBI or any other credit information company as approved by the Reserve Bank or under investigation by the Directorate of Enforcement or any investigative agency or regulatory authority; and
- iii. The Indian Party routes all the transactions relating to the investment in a JV/WOS through only one branch of an authorised dealer to be designated by the Indian Party.

Procedure to be followed by an Indian party to make direct investment in a JV/WOS under the Automatic Route

The Indian Party intending to make a direct investment under the automatic route is required to fill up form ODI duly supported by the documents listed therein, i.e., certified copy of the Board Resolution, Statutory Auditors certificate and Valuation report (in case of acquisition of an existing company) as per the valuation norms listed in answer to Q.16 and approach an Authorized Dealer (designated Authorized Dealer) for making the investment/remittance.

Form ODI

Form ODI is available as an Annex to the 'Master Circular on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad' dated July 1, 2011' available on the RBI website.

With effect from March 2, 2010, Authorized Dealers Category – I banks have to file Part I (Sections A to D), II and III of form ODI online in the Overseas Investment Application with the Reserve Bank for allotment of UIN, reporting of subsequent remittances, filing of APRs, etc. AD Category –I banks would continue to receive the ODI forms in physical form from the Indian Party.

‘Financial Commitment’

Financial commitment means the amount of direct investments outside India by an Indian Party -

- i. By way of contribution to equity shares of the JV / WOS abroad
- ii. As loans to its the JV / WOS abroad
- iii. 100% of the amount of corporate guarantee issued on behalf of its overseas JV/WOS and
- iv. 50% of the amount of performance guarantee issued on behalf of its overseas JV/WOS.
- v. Bank guarantee/standby letter of credit issued by a resident bank on behalf of an overseas JV / WOS of the Indian party, which is backed by a counter guarantee / collateral by the Indian party
- vi. Creation of charge (pledge / mortgage / hypothecation) on the movable / immovable property or other financial assets of the Indian party / its group companies

(**Note:** The amount and period of the guarantee should be specified upfront).

Valuation Norms

In case of partial / full acquisition of an existing foreign company where the investment is more than USD five million, share valuation of the company has to be done by a Category I Merchant Banker registered with the Securities and Exchange Board of India (SEBI) or an Investment Banker/ Merchant Banker outside India registered with the appropriate regulatory authority in the host country and in all other cases by a Chartered Accountant/ Certified Public Accountant.

However, in the case of investment by acquisition of shares where the consideration is to be paid fully or partly by issue of the Indian Party's shares (swap of shares), irrespective of the amount, the valuation will have to be done by a Category I Merchant Banker registered with SEBI or an Investment Banker/ Merchant Banker outside India registered with the appropriate regulatory authority in the host country.

In case of additional overseas direct investments by the Indian promoter to its WOS which is made at premium or discount, the concept of valuation as indicated above shall be applicable.

Free creation of a pledge/mortgage/hypothecation/charge on immovable/ moveable property or other financial assets of Indian party/ group companies in favour of a non- resident entity Prior permission of the Reserve Bank is required for creating such a charge on immovable/ moveable property or other financial assets of the Indian parent / group companies.

Country and Currency Restrictions on Overseas Investments

Investment in Pakistan is prohibited. Investments in Nepal can be only in Indian Rupees. Investments in Bhutan are allowed in Indian Rupees and in freely convertible currencies.

Concept of a 'Designated Authorised Dealer'

The Indian party is to route all transactions in respect of a particular overseas JV/WOS only through one branch of an Authorized Dealer. This branch would be the 'designated Authorised Dealer' in respect of that JV/WOS and all transactions and communications relating to the investment in that particular JV/WOS are to be reported only through this 'designated' branch of an Authorized Dealer. In case the JV/WOS is being set up abroad by two or more Indian promoters, then all Indian promoters collectively called the Indian party, would be required to route all transactions in respect of that JV/WOS only through one 'designated Authorised Dealer'. In case the Indian Party wants to switch over to another AD, an application by way of a letter may be made to the Reserve Bank after obtaining an NOC from the existing Authorized Dealer.

Prior registration with the Reserve Bank necessary for direct investments under the Automatic Route

No prior registration with the Reserve Bank is necessary for making direct investments under the automatic route. After the report of the first remittance / investment in Form ODI is received by the Reserve Bank, a Unique Identification Number (UIN) for that particular JV/WOS will be issued for the purpose of taking on record the overseas direct investment with the objective of maintaining a database for monitoring the outflows/inflows in respect of the overseas entities. Subsequent investments in the same project can be made only after allotment of the UIN.

Allotment of UIN by the Reserve Bank for direct investments under the automatic route constitute an approval from the Reserve Bank

No. The allotment of UIN does not constitute an approval from the Reserve Bank for the investment made/to be made in the JV/WOS. The issue of UIN only signifies taking on record of the investment for maintaining the database. The onus of complying with the provisions of FEMA regulations rests with the AD bank and / or the Indian party.

Further, with effect from June 01, 2012 an auto generated e-mail, giving the details of UIN allotted to the JV / WOS under the automatic route, shall be treated as confirmation of allotment of UIN, and no separate letter shall be issued by the Reserve Bank to the Indian party and AD Category - I bank confirming the allotment of UIN.

Approval Route

Proposals not covered by the conditions under the automatic route require the prior approval of the Reserve Bank for which a specific application in form ODI with the documents prescribed therein is required to be made through the Authorized Dealer Category – I banks. Some of the proposals which require prior approval are:

- i) Overseas Investments in the energy and natural resources sector exceeding 400% of the net worth of the Indian companies as on the date of the last audited balance sheet;

- ii) Investments in Overseas Unincorporated entities in the oil sector by resident corporates exceeding 400% of their net worth as on the date of the last audited balance sheet, provided the proposal has been approved by the competent authority and is duly supported by a certified copy of the Board Resolution approving such investment. However, Navaratna Public Sector Undertakings, ONGC Videsh Ltd and Oil India Ltd are allowed to invest in overseas unincorporated entities in oil sector (i.e. for exploration and drilling for oil and natural gas, etc.), which are duly approved by the Government of India, without any limits, under the automatic route;
- iii) Overseas Investments by proprietorship concerns and unregistered partnership firms satisfying certain eligibility criteria;
- iv) Investments by Registered Trusts / Societies (satisfying certain eligibility criteria) engaged in the manufacturing / educational / hospital sector in the same sector in a JV / WOS outside India;

Applications in Form ODI- Part I may be forwarded through the designated Authorized Dealer Category – I bank to:

The Chief General Manager Reserve Bank of India Foreign Exchange Department Overseas Investment Division Central Office Amar Building, 5th Floor Mumbai 400 001.

Permissible Sources for Funding Overseas Direct Investment

Funding for overseas direct investment can be made by one or more of the following sources:

1. Drawal of foreign exchange from an AD bank in India.
2. Swap of shares (refers to the acquisition of the shares of an overseas entity by way of exchange of the shares of the Indian entity).
3. Capitalization of exports and other dues and entitlements.
4. Proceeds of External Commercial Borrowings / Foreign Currency Convertible Bonds.
5. In exchange of ADRs / GDRs issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary

Shares (Through Depository Receipt Mechanism) Scheme, 1993 and the guidelines issued by Government of India in the matter.

6. Balances held in Exchange Earners Foreign Currency account of the Indian Party maintained with an Authorized Dealer.
7. Proceeds of foreign currency funds raised through ADR / GDR issues.

In respect of (6) and (7) above, the ceiling of 400 per cent of the net worth does not apply.

Indian Party utilizing the net worth of its Indian subsidiary / holding company for investing in a JV/WOS abroad

For the purpose of reckoning net worth of an Indian party, the net worth of its holding company (which holds at least 51% direct stake in the Indian Party) or its subsidiary company (in which the Indian party holds at least 51% direct stake) may be taken into account to the extent not availed of by the holding company or the subsidiary independently and has furnished a letter of disclaimer in favour of the Indian Party.

However, this facility is not available to partnership firms. Also the partnership firm's net worth cannot be taken into account by an incorporated entity.

Indian Party capitalizing the Proceeds of the Exports to its Overseas JV / WOS

An Indian Party is permitted to capitalize the payments due from the foreign entity towards exports, fees, royalties or any other dues from the foreign entity for supply of technical know-how, consultancy, managerial and other services within the ceilings applicable.

Capitalization of export proceeds remaining unrealized beyond the prescribed period of realization will require the prior approval of the Reserve Bank.

Indian software exporters are permitted to receive 25 % of the value of their exports to an overseas software start-up company in the

form of shares without entering into Joint venture Agreements, with the prior approval of the Reserve Bank.

Indian Party extending loan or guarantee to an overseas entity without any equity participation in that entity

- i) No. Loan and guarantee can be extended to an overseas entity only if there is already existing equity participation by way of direct investment, within the overall ceiling of 400% of the Indian party's net worth as on the date of the last audited balance sheet.

However, based on the business requirement of the Indian Party and legal requirement of the host country in which JV/WOS is located, proposals from the Indian party for undertaking financial commitment without equity contribution in JV / WOS may be considered by the Reserve Bank under the approval route

In case, however, the overseas entity is a first level step down operating subsidiary of the Indian party, guarantee may be issued by the Indian party on behalf of such step down operating subsidiary provided such guarantee is reckoned for the purpose of computing the financial commitment of the Indian party.

In case, the overseas entity is a second or subsequent level step down operating subsidiary of the Indian party, guarantee may be issued by the Indian party on behalf of such step down operating subsidiary with prior approval of the Reserve Bank provided such Indian party holds direct or indirect stake of not less 51% in the step down operating subsidiary and guarantee is reckoned for the purpose of computing the financial commitment of the Indian party.

- ii) Eligible Indian entities are allowed to invest in overseas unincorporated entities in oil sector (i.e. for exploration and drilling for oil and natural gas, etc.), which are duly approved by the Government of India, without any limits, under the automatic route.
- iii) Eligible Indian companies are allowed to participate in a consortium with other international operators to construct and maintain submarine cable systems on co-ownership basis under the automatic route.

Treatment of Compulsorily Convertible Preference Shares (CCPS) for the purpose of Overseas Direct Investment

With effect from March 28, 2012, Compulsorily Convertible Preference Shares (CCPS) are treated at par with equity shares and the Indian party is allowed to undertake financial commitment based on the exposure to JV by way of CCPS.

Requirement for direct investment in an overseas concern by way of share swap

Direct investment outside India in a JV/WOS by way of share swap arrangement can be made under the automatic route provided the valuation norms prescribed i.e. valuation of the shares is done by a Category I Merchant Banker registered with the SEBI or an Investment Banker outside India registered with the appropriate Regulatory Authority in the host country are satisfied, and the shares are duly issued / transferred in the name of the Indian investing company. Investors may also please note that all share swap transactions require the prior approval of the Foreign Investment Promotion Board (FIPB) for the inward leg of the investment.

Permitted activities that partnership firms can undertake through overseas direct investment route

Partnership firms registered under the Indian Partnership Act, 1932 can make overseas direct investments subject to the same terms and conditions as applicable to corporate entities.

Partners holding shares of the overseas concerns for and on behalf of the firm

Individual partners can hold shares for and on behalf of the firm in an overseas JV/WOS, where the entire funding for the investments has been done by the firm provided the host country regulations or operational requirements warrant such holding.

Restrictions for Setting up of a Second Generation Company

There are no restrictions on entities having JVs/WOSs abroad

setting up second generation operating companies (step-down subsidiaries) within the overall limits applicable for investments under the Automatic Route. However, companies wishing to set up step-down operating subsidiaries to undertake financial sector activities will have to comply with the additional requirements for direct investment in the financial services sector as indicated in Q 25 (a).

Indian Party having a JV/WOS through a Special Purpose Vehicle (SPV) under the Automatic Route

Direct investment through the medium of a SPV is permitted under the Automatic Route, for the sole purpose of investment in JV/WOS overseas.

Indian Party Directly Funding such Step- Down Subsidiaries

Where the JV/WOS has been established through a SPV, all funding to the operating subsidiary should be routed through the SPV only. However, in the case of guarantees to be given to the first level step down operating subsidiary of the SPV, these can be given directly by the Indian Party provided such exposures are within the permissible financial commitment of the Indian Party.

Shares of a JV/WOS abroad be pledged for the purpose of financial assistance

The shares of a JV/WOS can be pledged by an Indian Party as a security for availing fund based or non-fund based facility for itself or for the JV/WOS, from an authorised dealer/ public financial institution in India or from an overseas lender, provided the overseas lender is regulated and supervised as a bank and the total financial commitments of the Indian entity remain within the limit stipulated by the Reserve Bank for overseas investment from time to time.

Obligations of the Indian party, which has made direct investment outside India

An Indian Party will have to comply with the following: -

- i. Receive share certificates or any other documentary evidence of investment in the foreign entity as an evidence of investment and submit the same to the designated AD within 6 months;
- ii. Repatriate to India, all dues receivable from the foreign entity, like dividend, royalty, technical fees etc.;
- iii. Submit to the Reserve Bank through the designated Authorized Dealer, every year, an Annual Performance Report in Part III of Form ODI in respect of each JV or WOS outside India set up or acquired by the Indian party;
- iv. Report the details of the decisions taken by a JV/WOS regarding diversification of its activities /setting up of step down subsidiaries/ alteration in its share holding pattern within 30 days of the approval of those decisions by the competent authority concerned of such JV/WOS in terms of the local laws of the host country. These are also to be included in the relevant Annual Performance Report; and
- v. In case of disinvestment, sale proceeds of shares/securities shall be repatriated to India immediately on receipt thereof and in any case not later than 90 days from the date of sale of the shares /securities and documentary evidence to this effect shall be submitted to the Reserve Bank through the designated Authorised Dealer.

Mandatory furnishing Annual Performance Reports (APR) of the overseas JV/WOS based on its audited financial statements

Where the law of the host country does not mandatorily require auditing of the books of accounts of JV / WOS, the Annual Performance Report (APR) may be submitted by the Indian party based on the un-audited annual accounts of the JV / WOS provided:

- a. The Statutory Auditors of the Indian party certifies that ‘The un-audited annual accounts of the JV / WOS reflect the true and fair picture of the affairs of the JV / WOS’ and
- b. That the un-audited annual accounts of the JV / WOS has been adopted and ratified by the Board of the Indian party.

Resident individual in India acquiring/selling foreign securities without prior approval of the Reserve Bank

Resident individuals can acquire/sell foreign securities without prior approval in the following cases: -

- i. As a gift from a person resident outside India;
- ii. By way of ESOPs issued by a company incorporated outside India under Cashless Employees Stock Option Scheme which does not involve any remittance from India;
- iii. By way of ESOPs issued to an employee or a director of Indian office or branch of a foreign company or of a subsidiary in India of a foreign company or of an Indian company irrespective of the percentage of the direct or indirect equity stake in the Indian company;
- iv. As inheritance from a person whether resident in or outside India;
- v. By purchase of foreign securities out of funds held in the Resident Foreign Currency Account maintained in accordance with the Foreign Exchange Management (Foreign Currency Account) Regulations, 2000; and
- vi. By way of bonus/rights shares on the foreign securities already held by them.

Indian corporates investing overseas other than by way of direct investment

Listed Indian companies can invest up to 50 % of their net worth as on the date of the last audited Balance Sheet in overseas companies, listed on a recognized stock exchange, or in the rated debt securities issued by such companies.

Resident individual acquiring shares of a foreign company in his capacity as Director

Reserve Bank has given General Permission to a resident individual to acquire foreign securities to the extent of the minimum number of qualification shares required to be held for holding the post of Director. Accordingly, resident individuals are permitted to remit funds under

general permission for acquiring qualification shares for holding the post of a Director in the overseas company to the extent prescribed as per the law of the host country where the company is located and the limit of remittance for acquiring such qualification shares shall be within the overall ceiling prescribed for the resident individuals under the Liberalized Remittance Scheme (LRS) in force at the time of acquisition.

Resident individuals acquiring shares from a foreign entity in lieu of the professional services rendered by them or in lieu of Director's remuneration under General Permission

A. Resident individuals are allowed under General Permission to acquire shares of a foreign entity in part / full consideration of professional services rendered to the foreign company or in lieu of Director's remuneration.

The limit of acquiring such shares in terms of value shall be within the overall ceiling prescribed for the resident individuals under the Liberalized Remittance Scheme (LRS) in force at the time of acquisition.

Resident individual subscribing to the rights issue of shares held by him

A resident individual may acquire foreign securities by way of rights shares issued by a company incorporated outside India provided the existing shares were held in accordance with the provisions of FEMA.

Relaxations for individual employees/Directors of an Indian company engaged in the field of software for acquisition of shares in their JV/WOS abroad

General permission is available for the individual employees/Directors of an Indian promoter company engaged in the field of software for acquisition of shares of a JV/WOS abroad provided:

- i. The consideration for purchase does not exceed the ceiling as stipulated by RBI from time to time. the shares acquired by all the employees/directors do not exceed 5% of the paid-up capital of the Joint Venture or Wholly Owned Subsidiary outside India; and
- ii. After allotment of such shares, the percentage of shares held by

the Indian promoter company, together with shares allotted to its employees is not less than the percentage of shares held by the Indian promoter company prior to such allotment.

Resident employees of Indian companies in the knowledge based sectors including working directors may purchase foreign securities under the ADR/GDR linked stock option scheme provided that the consideration for purchase does not exceed the ceiling as stipulated by RBI from time to time.

Law as to Setting up Offices and Branches Abroad

- (i) **Submit Applications:** Firms/Companies in India desiring to open offices (trading/non-trading) or post representatives abroad including offices/representatives sought to be opened/posted abroad for promotion of their exports should submit applications to their bankers (authorised dealers) in form OBR along with the particulars of their turnover duly certified by their auditors and also a declaration to the effect that they have not approached/ would not approach any other authorised dealer for the facility being applied for. Authorised dealers may release exchange towards initial expenditure as also for recurring expenses of the office as under, provided the applicant fulfils the following conditions:

| Category | Initial Expenditure | Annual Recurring Expenditure |
|--|--|---|
| EEFC Account | No limit for remittances out of EEFC funds. | No limit for holders remittances out of EEFC funds. |
| Firms/companies not having EEFC accounts or not having sufficient funds EEFC accounts | Up to 2% of their average annual sales/ income turnover during last two years. | Up to 1% of their average annual sales/ income turnover during last two years |

Notes

- A. The above limits are applicable for all the overseas offices of the applicant taken together. In regard to category (b) above the

ceiling is inclusive of remittances, if any, allowed out of EEFC Account.

- B. In the case of newly established 100% EOUs or Units in EPZs and Hardware/Software Technology Parks, exchange may be released as per their estimated requirements for initial as well as recurring expenses on verification of suitable documentary evidence during the first two years of their operation. From third year onwards, exchange may be released as per item (a) or (b) above.
 - C. Remittances towards actual retainer fees may be allowed to be made to the overseas agents engaged for rendering services for promotion of exports by Indian firms/companies provided (a) the applicant does not have a non-trading/trading office or representative posted at that centre, (b) the eligibility criteria as stated in (i) above is satisfied and (c) the amount of retainer fee is within the ceiling fixed for recurring expenses of all the overseas offices taken together as stated above.
 - D. Firms/companies wishing to take Indian goods such as floor covering, furniture and other items for office use may approach Reserve Bank for grant of GR waiver in respect of such exports.
- (ii) **Obtaining Confirmation:** Remittance facilities on the above basis may be allowed initially for a period of two years only, after obtaining confirmation from the applicant that they have completed all legal and other formalities in India and abroad in connection with the opening of trading/non-trading office or for posting a representative abroad. While issuing approval the following terms and conditions should be advised to the applicant:
- a) The overseas office should **not** create any financial liabilities contingent or otherwise for the Head Office in India.
 - b) Exchange released by the authorised dealer should be strictly utilized for the purpose(s) for which it is released. The unused exchange may be repatriated to India under advice to the authorised dealer.
 - c) The details of bank account opened in the overseas countries should be promptly reported to authorised dealer.
 - d) The approval granted for the purpose should be made

valid for 6 months from the date thereof, within which time the applicant should open its overseas office or post representative abroad. In case the overseas office is not opened or the representative is not posted abroad within this period, an intimation in writing to that effect should be sent to the authorised dealer immediately after expiry of 6 months period. Fresh application for release of exchange should be submitted to the authorised dealer as and when the overseas office is desired to be opened.

- e) Profits, if any, earned by the overseas office/s should be repatriated to India.
- f) The following statements should be submitted by the applicant to the authorised dealer

Notes

- (A) A statement showing details of initial expenses incurred together with suitable documentary evidence, wherever possible, within three months from the date of release of exchange for that purpose
- (B) Annual account of trading/non-trading office abroad duly certified by statutory Auditors/Chartered Accountants
- (iii) **Report of Permission:** Authorised dealer should send a report of permission granted for opening of trading/non-trading office/posting of representative abroad in form ORA on a monthly basis to the Regional Office of Reserve Bank. The statement should be submitted to the concerned office of Reserve Bank within ten days from the close of month. Where remittances are made by utilizing funds held in EEFC accounts, authorised dealers may obtain from the applicants a statement in form ORR. Copies of **ORR** statements should be submitted to Reserve Bank by authorised dealers after adding their certification thereon along with the monthly statements in form ORA. The records relating to the remittance facilities should be kept in a systematic manner by authorised dealers so as to facilitate inspection. A 'nil' statement in form ORA may

be sent if no permission is granted during the month, for the above purpose.

- (iv) **Renewal of Remittance:** The renewal of remittance facility after two years may be granted, provided proper accounts of utilization of foreign exchange released are furnished to the authorised dealer.
- (v) **Justify the Need:** Applications from firms/companies who do not satisfy the conditions in (i) above are required to be made in form OBR to the concerned Regional Office under whose jurisdiction the Registered/Head Office of the applicant is situate. The applicant should justify the need for setting up the office. Reserve Bank will also consider applications for posting technical representatives abroad by manufacturer exporters of sophisticated machinery etc. to provide technical support, after sales service etc.

Note: Setting up of offices and posting of representatives abroad and meeting their expenses from out of foreign exchange retained abroad or from foreign exchange released by Reserve Bank for any other purpose or from out of proceeds of exports or any income earned abroad is prohibited.

- (vi) **‘No Remittance’ Basis:** Firms/companies having trading offices abroad operating on ‘no remittance’ basis or maintained out of funds in EEFC accounts need not apply for renewal of permission to continue the existing office abroad. However, annual statements as indicated in paragraph 9B.1(ii)(f) should be submitted to the authorised dealer.

Credit Facilities for Overseas Trading Offices of Indian Companies

Reserve Bank considers, on merits, request from Export Houses/ Trading Houses/Star Trading Houses/Super Star Trading Houses to avail of fund based/non-fund based facilities for their trading offices abroad from overseas banks. Application in such cases should be made to the Chief General Manager, Reserve Bank of India, Exchange Control Department (Export Division), Mumbai together with full particulars of the exchange facilities availed of for maintenance of the overseas office concerned, full

details of terms and conditions subject to which the facilities are being extended by the overseas bank and the need for availing of the credit facilities by the overseas trading office.

Temporary Site/Project Offices Abroad

Indian firms/companies executing contracts/projects abroad with the approval of the appropriate authority are permitted under a general permission granted by Reserve Bank to set up site/project offices abroad provided that such offices are maintained out of project receipts and remittances from India are not required. These offices are required to be closed down and surplus foreign exchange earnings repatriated to India after completion of the project (See paragraph D.1 of Memorandum PEM)

Opening of Overseas Branches by Indian Banks

Opening of branches abroad by Indian banks requires permission of Reserve Bank under Section 23 of the Banking Regulation Act, 1949. Indian banks wishing to open branches abroad should apply to the Chief General Manager, Department of Banking Operations and Development, Reserve Bank of India, Central Office and Mumbai. After the application has been approved by that Department, the bank should apply to the Chief General Manager, Exchange Control Department (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai for release of foreign exchange for initial remittance, if such remittance is necessary.

Note: Opening of representative offices abroad by Indian banks also requires permission of both the Department of Banking Operations and Development and the Exchange Control Department of Reserve Bank.

Maintenance of Overseas Offices Appointment/Posting of Correspondents/ Representatives by Newspapers/Periodicals/News Agencies

- i **Engage the Services of Correspondents/Representatives Abroad:** Indian newspapers/periodicals having a minimum daily/per issue circulation of 50,000 copies and Indian news agencies recognised by the concerned Administrative Ministry of Government of India may engage the services of correspondents/representatives abroad without the prior permission of Reserve Bank. Authorised dealers

may allow remittances in such cases as under:

- a The actual amount of exchange required towards monthly/ maintenance expenses (salary, allowances, house rent etc.) of the correspondent/ representative posted abroad as per the terms of their appointment. Other office expenses such as office rent, telephone/cable charges, postage, stationery etc. as also travel within the country of posting or visits to other countries to cover international events or specific assignments can be remitted on actual basis. Remittance can also be sent in advance on the basis of estimates furnished, subject to accounting. However, wherever 'collect telex' facility has been made available by the Director General, Overseas Communication Service, Mumbai to the correspondent/representative in respect of sending telex message from foreign countries to India on a regular basis, remittances of telex charges would not be admissible.
 - b All remittances to the correspondents/ representatives posted in one country abroad should be remitted through one branch of an authorised dealer to be designated by the company. There is, however, no objection to designating different branches of authorised dealers for making remittances to correspondents / representatives posted to different countries. Applications from Indian newspapers/periodicals which do not satisfy the above criteria and applications for posting of correspondent/ representative on temporary basis for covering international events or on specific assignments should be referred to Reserve Bank for prior approval.
- ii **Indian Newspapers/periodicals/news agencies companies desiring to appoint correspondent/s or representative/s abroad:** Indian Newspapers/periodicals/news agencies companies desiring to appoint correspondent/s or representative/s abroad and satisfying the conditions laid down in sub-paragraph (1) should advise by letter, the name/nationality/address of the correspondent/ representative, country of posting and terms of appointment together with a certified copy of the consent letter from the correspondent/ representative to the terms of appointment to the designated branch of authorised dealer through whom the remittances to the correspondent will be made by them, under intimation to the

concerned office of Reserve Bank within whose jurisdiction the company's Head/Registered Office is situate. A certificate from the Audit Bureau of Circulation or the Company's auditors, confirming the circulation figures (in the case of newspapers/periodicals) or a copy of the recognition of the concerned Administrative Ministry of Government of India (in the case of news agency) should also be sent to the designated branch along with the letter. Applications for remittances to be made to the correspondent/representative under the arrangement should be made by the Indian company direct to the authorised dealer concerned on form A2 separately in respect of each correspondent/representative. The newspaper/periodical/news agency should submit to the designated branch of authorised dealer, in duplicate, a half-yearly statement as on 30th September/31st March every year in form CNP duly certified by its auditors, giving item-wise details of expenditure incurred in foreign exchange by each correspondent/representative. The statement should be submitted to the designated branch within one month of the close of the half-year to which it pertains.

- iii On receipt of the application from the Indian newspaper/periodical/news agency on form A2, the designated branch of the authorised dealer may allow the remittance after ensuring that the amount of remittance is in conformity with conditions (a) AND (b) of subparagraph (i). The designated branch should keep a proper record (correspondent-wise) of remittances made and verify the same with the half-yearly statements in form CNP received from the company and also forward to Reserve Bank one copy of the statement after completing the certificate in Part C of the statement, within 15 days of the receipt from the newspaper/periodical/news agency.

Arrangements with Overseas News Services

Indian newspapers/news agencies may be required in the normal course of their business, to make arrangements for obtaining news features, pictures, photographs, colour pictures, cartoons, crossword puzzles, etc. from overseas news agencies, feature agencies, etc. on a regular basis against payment. Indian newspapers/news agencies wishing to enter into such arrangements should first approach Government of India (Ministry of Information and Broadcasting) for prior approval for the arrangements

indicating full details of the arrangements such as nature of the material to be supplied by the overseas news service, remuneration payable therefor, etc.

Applications for remittance should be made by Indian newspapers/news agencies to authorised dealers alongwith the letter of sanction in original from the Ministry of Information and Broadcasting and the relative invoice received from the overseas news agency, etc. Authorised dealers may allow the remittances strictly in accordance with the approval issued by the Govt. of India, Ministry of Information and Broadcasting. A photo copy of the Government's letter of approval and the relevant contract with the overseas company should be kept on record for verification by internal auditors/Reserve Bank.

Restrictions on Trade in Endangered Species and Other Commodities

Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES): CITES entered into force on 1975 and now has a membership of 152 countries. These countries act by banning commercial international trade in an agreed list of endangered species and by regulating and monitoring trade in others that might become endangered. India is a member of the CITES and prohibits Trade in Endangered Species of Wild Flora and Fauna.

The detailed list is provided below.

| HS code/ Exim Code | Item Description | Policy | Condition Relating to the policy |
|-------------------------------|--|---------------|---|
| 0106000120 | Wild animals as specified under Wild Life Protection Act, 1972 | Prohibited | Not permitted to be imported. |
| 0106000220 | Wild animals as specified under Wild Life Protection Act, 1972 | Prohibited | Not permitted to be imported. |
| 0106000320 | Bees and other insects as specified under Wild Life Protection Act, 1972 | Prohibited | Not permitted to be imported. |

| | | | |
|------------|---|------------|-------------------------------|
| 0106000920 | Wild animals as specified under Wild Life Protection Act, 1972 | Prohibited | Not permitted to be imported. |
| 0208900010 | Meat and edible meat of-fal, fresh, chilled or frozen of wild animals | Prohibited | Not permitted to be imported. |

Self Assessment Questions

1. Explain the salient features of Foreign Exchange Management Act (FEMA), 1999, as amended of in 2012.
2. Taxation of Foreign Income in India is a vexatious task but laws are clear. Discuss.
3. What are Foreign Investment inflow and outflow. State the Government/RBI guidelines on this aspect.
4. Explain the law relating to Setting up Offices and Branches Abroad by Indian Entities.
5. How do Restrictions on Trade in Endangered Species and Other Commodities contain such illegal issues?
6. What are the reasons for increasing direct investment outflow from India, of late?
7. Explain the role of RBI in maintaining exchange rate and forex reserves.

CASE STUDY

Kodak started selling photographic equipment on Japan 1889 and by the 1930s it had a dominant position in the Japanese market. But after world war II, U.S. occupation forces persuaded most U.S. companies including Kodak to leave Japan to give the war torn local industry a chance to recover. Kodak was effectively priced out of the market by tariff barriers; over the next 35 years Fuji gained a 70% share of the market while Kodak saw its share slip to a miserable 5%. During this period Kodak limited much of its activities in Japan to the sale of technology.

This situation persisted until the early 1980s when Fuji launched on aggressive export drive, attacking Kodak in the North American and European markets. Deciding that a good offense is the best defense, in 1984 and the next six years, Kodak outspent Fuji in Japan by a ratio of more than 3 to 1. It erected mammoth \$1 million near signs as land marks in many of Japan's big cities and also sponsored Sumo wrestling, Judo, and Tennis tournaments and even the Japanese team at the 1988 Seoul Olympics. Thus Kodak has put Fuji on the defensive, forcing it to divert resources from overseas to defend itself at home. By 1990, some of Fuji's best executives had been pulled back to Tokyo.

All this success, however, was apparently not enough for Kodak. In May 1995, Kodak filled a petition with the US trade office, that accused the Japanese government and Fuji of "Unfair trading practices". According to the petition, the Japanese government helped to create a 'profit sanctuary' for Fuji in Japan by systematically denying Kodak access to Japanese distribution channels for consumer film and paper. Kodak claims Fuji has effectively shut Kodak products out of four distributors that have a 70% share of the photo distribution market. Fuji has an equity position in two of the distributors as a reward for their loyalty to Fuji, and owns stakes in the banks that finance them. Kodak also claims that Fuji uses similar tactics to control 430 wholesale photo furnishing labs in Japan to which it is the exclusive supplier. Moreover, Kodak's petition claims that the Japanese government has actively encourage these practices.

But Fuji a similar counter arguments relating to Kodak in U.S. and states bluntly that Kodak's charges are a clear case of the pot calling the kettle black.

- (a) What was the critical catalyst that led Kodak to start taking the Japanese market seriously?
- (b) From the evidence given in the case do you think Kodak's charges of unfair trading practices against Fuji are valid? Support your answer.
- (c) What legal remedies available to Kodak as well as Fuji, under the above circumstances.

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