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Ensouth

The E-magazine brought to you by

N South

Advocates

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1. Managing Partner's Message

In the last edition of Ensouth, we predicted that tough times may shake out the weak, the dubious and the incompetent. As it turned out, the tough times were more tough talk than tough walk. As we enter the New Year, we find that our absolute revenues are not impacted though our work mix has changed. How many Indian service providers have arrived at the same fortuitous junction?

Consequently, the subjects of comment this time are more topical than current. First in **Who cares about shareholders value**, we examine the compulsions that drive promoters to return better value to their shareholders. Next in **Limitless lambs for lions**, we examine how the entertainment industry prefers to persecute its own consumers rather than adapt its business model to respond to changing technology. Finally, with deliberate intent to sound an optimistic note as we step into the New Year, we look at the radical changes that are transforming our judiciary in **Winds of Change**.

Happy new year!

Ranjeev Dubey

2. Comment-1

(This column appeared in the June 5th, 2009 issue of Business World)

Who cares about Shareholders value

(A truth about listed company ROE)

Ranjeev C Dubey

On one of those eminently forgettable dull days when not an economic leaf had stirred, the main story carried by *Economic Times* read "Less is more for promoter owned companies". With that headline, the paper found it counter intuitive that company performance improved as promoter holding dropped. That certainly sat me up because I thought that at one level, this was completely obvious! Pondering the point, I also thought that given the way our law is structured, promoter shareholding has a long way to drop before the promoter needs to worry about shareholder returns.

Why do I say so? Look at it philosophically (which in India means politically!). Who works most for the common good: the leader who must please a lot of people or the leader who need not please anyone? Is there such a thing as a benevolent despot? When a promoter decides that he must choose to maximize shareholder value for all, he is really making a choice between working for the greatest common good versus working mainly to his own self serving agenda. Who is more likely to make that choice: the promoter who needs to keep his shareholders happy or the one who does not? Is it then not self evident that a highly dominant promoter shareholder need not bother with shareholder returns?

But that bit of logic leaves open a fundamental question: when is a promoter shareholder "not dominant"? I suppose the answer is obvious: a promoter is not dominant only to the extent that he needs to worry about what the shareholder can do to him. That depends on what shareholders sovereignty really means in Indian law.

So what is shareholders sovereignty? What rights do shareholders actually have in a company? I will be blunt: it's not a lot, looks considerably better on paper than it does in practice and consists of four main things: (a) approving accounts, (b) appointing the same or new Directors from time to time, (c) allowing the company to push the envelope on stuff the law places limits on (like borrowing or selling a lot of assets), and (d) changing the company's constitution (like the Articles).

Let me tell you, even this stuff is a bit of an illusion. Take accounts as an example. Shareholders are by law required to meet once a year to approve accounts. Three weeks before the meeting, they get handed accounts and

they can approve them or not. They cannot visit the company and ask to look into the account books. Well you may ask, 'what are they approving if they can't look at the source material'? You are right: their approval is just so much procedure.

I could defend the way things are. Imagine a situation where every shareholder of Reliance decides he wants to appoint an accountant to inspect all its books of accounts. There would be more hyper ventilating accountants ready to plunge into the accounts than employees to serve them *samosas* and cold half milk tea for lunch. You can be sure that whether or not there are problems with the account books, these nosey accountants will contrive issues to justify their briefs.

The law decides we fix this one by giving the shareholders the right to appoint the Company auditors: the theory being that shareholders appoint the accountants, the accountants prepares the accounts which the shareholders can trust because they appointed them and the shareholders approve these accounts. Nice theory. The problem is shareholders can't approve the appointment of auditors if the directors don't propose a name. Can the shareholders supply their own name? You can't get two Indians to agree whether overtaking slower traffic should occur from the right or the left: you want thousands of shareholders to agree on an accountant?

The real problem is that if shareholders decide to gang up and not approve whatever the directors are asking, the best you get is a stand-off. Pulling down a prime minister is not the same thing as appointing another in his place. Walking into Iraq and destroying a regime without a very good idea of what is going to replace it isn't so smart either!

This same principle also applies to the appointment of directors. Shareholders do have the power to appoint directors but they can only dispose what existing directors will propose. If the shareholders don't appoint a recommended director, that's one director less on the board. If shareholders are in a sulk, the board can keep running with fewer directors. Just so the cup of shareholders misery is complete, the law also allows existing directors to appoint 'additional directors'. These directors need to have shareholder approval at the next shareholder meeting but it doesn't really matter. If they don't get shareholder approval, the board is still free to appoint new additional directors all over again after the shareholders meeting.

Painful as the reality may be, to be a shareholder is nothing: you are nobody and the law says so. In fact, if 10 per cent of the shareholders can't get together, you are not even entitled to go to the Company Law Board and complain that the company is making a mess of itself.

In fairness, I can defend this law too. If every small shareholder could complain to CLB, I would simply buy 10 shares, dig up some dirt on my competitor and sue him to death. Yes I know: everyone mouths platitudes

about how they work for shareholders and how they are responsible only to their shareholders, etc, etc, etc but the truth is the law doesn't ask Promoters to care very much about shareholders. If promoters have 51 per cent of the Company, they need not pay any attention to their shareholders. Even if they own considerably less than 51 per cent, unless there is another dominant group of shareholders who can overthrow them, they need not pay any attention to their shareholders. So far, India has shown no appetite for hostile takeovers (though why is another story) so you could say there is no animal less relevant to the Company than the small shareholder.

But then if what I say is true, who do companies show good shareholder returns at all? The answer I am afraid has nothing to do with the greatest good of the current shareholders. An existing shareholder is locked in: a low return company offers poor dividends and low share prices on exit. In the old days when the stockmarket was dead, that was exactly the attitude Promoters took. What changed? Dhirubhai Ambani amongst others: the stockmarket woke up and public shareholders became an attractive source of company funding. Promoters started to think about investors they were going to make into shareholders and to do that, they needed high shareholder returns. Two in the bush is way more important than the one in hand, so to speak!

This is really the crux of it. Promoters are not here to make you rich. They are here to make themselves rich. However, if their business plans need them to collect more money from the public in the foreseeable future, they will provide good returns to existing investors just so they can get new ones to invest in their company. So contrary to the headline report *Economic Times* provided us, it is not companies with lower promoter holding that deliver better returns: it is companies that intend to reduce their promoter holding that deliver high returns!

3. Comment-2

(This column appeared in the October 30th, 2009 issue of Business World)

Limitless lambs for lions

(Music companies continue to follow outdated business models to keep a steady stream of revenues.)

Ranjeev C Dubey

One can make a fetish out of being counter-intuitive but I am completely convinced that many companies will do almost anything to promote business models that will proliferate litigation endlessly. A still-to-graduate young lawyer hired by a London law firm told the newspapers the other day that Intellectual Property Rights law was the best beginning she could expect to her career. Given that 95 per cent of IPR law is clerical stuff about making and maintaining registrations, where is all this romance with IPR coming from?

The paperboy brought me the answer the next day in a lengthy piece on

Pirate Bay. In a Eureka moment, I had the answer: IPR law is becoming popular because technology has changed the nature of the terrain on which we play but entertainment companies continue to pursue outmoded business models from the analogue era hoping to hang their revenue streams on litigation pegs. It's simple really: don't change with the times, try to kill progress. I can give you two different examples to support this fact.

First, let's look at the music industry. Let's agree that artists don't make money, record companies do. All talk of protecting the value in artistic creativity is rubbish. Forget for the moment the environmental hazard that CDs and DVDs will present to future generations. The truth of the matter is that if I like one song out of one album by an artist, I have to buy the whole disc. I cannot go out and buy that song. To add insult to injury, I also have to buy that song with its ten brothers in a completely outmoded uncompressed format which hogs acres of optical disc space and fills up rack after rack of valuable urban space in my den. As opposed to this, if someone would let me download the song, I would save den space and avoid buying ten songs I don't like. Throughout the 1990s, recording companies won't take this simple innovative step. When they did change this inflexible all-ten-songs-or-nothing model under pressure from online pirates, they charged an arm and a leg for a song: basically the same per song cost as one would pay if delivered on a CD. In the bargain, these internet sellers continued to operate in blissful innocence of the fundamental fact that the 'song' part of the music delivery supply chain was a fraction of the total package. I know that much of the cost consists of plastic, paper, printing, dealer margin, distribution costs and retail shelf visibility premiums. If I am simply buying a song, why am I paying for all the costs that would have been incurred if the song had been sold as part of a CD?

There is too the problem of format. I may want something timeless in a lossless WMA or OGG format to a high resolution, but I may want a silly but uplifting dance song in a low resolution MP3 type format. This is my choice to make but the music companies didn't think so. So Shawn Fanning put together Napster and the game was on. Litigation shut down Napster but not the void in the market, thus paving the way for decentralized peer-to-peer programs which downloaded both music and big trouble. Viruses proliferated through P2P and those of us who weren't obsessive about free lunches started to look for reliable websites that could give us what we wanted.

It was inevitable that paid bootlegger would appear on the net, a very good example of which was AllofMP3.com. The business model was simple: subscribers deposited a sum of money via credit cards and then downloaded from a huge bank of music stretching from Mozart to Malkiat Singh. Subscribers could pick from a variety of formats and they could select resolution from as low as 128 kbps all the way up to 320. The site charged per megabit of download so if a subscriber wanted better quality, he paid more. Just so we don't overlook the completely obvious, this site was not free; everyone paid, but they paid for what they bought, to the quality that

they bought, in a format that was compatible with their world of digital music players in a way that made sense. This Moscow registered company met its nemesis in 2008 after prolonged litigation with a bunch of recording companies but no recording company has yet come along offering a similar service that is grounded in economic common sense. Is it moral to fund politicians to keep archaic laws, hire IPR lawyers to hound deprived customers and decapitate the music lover?

That takes us to a second example: movie downloads. As it was with music, so it is with video. Much of the action started with P2P programmes and while websites offering paid video content of dubious legality are now becoming popular, most users are still preoccupied with a variety of torrent client programs on the back of which, they are downloading both videos and viruses. Enter Pirate Bay, Mininova, Torrentz, Isohunt... Again, many of these downloaders are not cash short: it's just that the 'legal' market is not responding to them.

So what is it that I want movie distributors to do? First I want access. Half the movies I want are not available in India, sometimes not at all (I spend two years looking for a movie called *Quest For Fire* and eventually picked it up in Australia!). Second, half of the old movies I do get are not to a quality I want. A few are DVD, most are CD and both are frequently lousy captures from analogue sources: I can do better with a Rs 5000 Pinnacle capture card hooked to my 520MB RAM XP era laptop! Third, I have CDs, VCDs, DVDs and now Blue Rays spilling all over the house: I am sick and tired of being sick and tired of hearing about environmental sensitivity even while the entertainment industry is about an ever increasing mountain of electronic trash. Fourth, I want portability, which is part of the same issue. I don't want to carry around two suitcases of optical discs on vacation to stick into the DVD players most hotels seem to thoughtfully provide these days: I want to carry along a 500 gig USB hard disc with all the movies I could conceivably want to watch.

Now, to meet all these objectives, people like me need a MP4 file no larger than one Gig so that we can download it off our ADSL connections at home within a day. Believe you me: a file this size would play just fine on a 40-inch LCD TV and any more is self indulgence. Unfortunately, the movie distributors won't react to this demand, forcing people to hitch up to a Swedish server owned by Pirate Bay, track and bit torrent, download illegally and leave themselves wide open to prosecution and Trojans. What kind of sense does that make? We know we pay about Rs 100 for a movie on a VCD, less than Rs 500 for the same movie on a DVD. Who in his right mind will not pay a dollar or two to download an XVID file of acceptable quality?

You could say I don't quite get it. Many movie distributors have practically no sales in many Asian markets yet they will rather pay IPR lawyers to pursue protracted litigation than sell compressed video format files on the web. For so long as such corporate cussedness continues, the movie companies will not

respond to either the technology or the market, the IPR lawyers are going to have a ball, we will continue to generate plastic trash and you and I my friends are going to be criminals in order to get movies no one will legally sell us.

4. Comment-3

(This column appeared in the September 11th, 2009 issue of Business World)

Winds of Change

(A look at the evolving judicial system in India)

Ranjeev C Dubey

We Indians are very good at doing cynicism. We love to complain, contrive conspiracies and diminish each other, but most of all, we love to believe that everybody stinks, all on the assumption that there are things about India that could not possibly change. Yet, here we are in 2009, experiencing radical changes in the most conservative of all liberal institutions: the judiciary.

First, there is this question of judicial accountability of which I had something to say way back in 2007 when the Justice Sabharwal controversy was at its height (See: "Contemptuous Quotes" Business World Dec 12th, 2007). The process culminated in a rising demand that judges disclose their assets. Even while the current Chief Justice opposed this demand, a crescendo of protest was heard from the higher judiciary who had no difficulty with making such disclosures. In the last few weeks, a momentum so irresistible has developed that whatever may happen, judges will disclose their assets. There remained though the question whether the general public would know what these assets were. Many judges were ambivalent on this subject but in his inimitable fashion, Delhi's Chief Justice has also ruled last week ruled that courts are covered under the Right to Information Act. The jinn is now terminally out of the bag in a fashion greater than many of us comprehend.

Second, there is the problem of judicial accountability because securing honesty amidst judges doesn't secure that they are efficient. This too is changing. Court records are being computerized at high speed down to those of the trial courts. I think it is a matter of time that we will be filing cases on-line and it is not beyond the realm of possibility that in the foreseeable future, we will do away with hard copies completely. In doing so, between accountability and best practice, the judiciary would have leapfrogged into another paradigm.

That brings us to the problem of modernizing Indian lawyers, which is far more complex. Lawyers have thus far been positioned as deliverers of an overarching justice hammering away at evil within the hallowed portals of the judicial system. It has not mattered that the system worked slowly if at all, the misdeeds of judges was beyond redress and the lawyers themselves were laws into themselves. The third change upon us now is that lawyers are starting to be seen as service providers. Notwithstanding the challenge that

will inevitably come, we will eventually pay service tax and that will terminally change the perception we have perpetuated of ourselves.

At the same time, and this is the fourth change, the ways in which we are permitted to organize ourselves has changed. Limited Liability Partnerships are now street legal, a form of business organization that is meaningless unless we recognize that we can incur liability, an idea that is itself meaningless unless we acknowledge that we render a service and therefore are capable of deficient service. No doubt, our reorganization into LLPs will also help bring in cross border service competition, a force of change that at the very least will free us of the halo that seems to hover hypocritically behind our swollen heads!

Finally, there is the question of permitting lawyers to advertise. Rule 36 of the Bar Council of India has already been amended: now, lawyers can put up websites disclosing their names, their names, telephone numbers, e-mail addresses, professional qualification and areas of specialization. I can't imagine there is a lot else a lawyer would want to crow about! Since this is a work in progress, a little critique of the issue may well be in order.

Let's examine Rule 36: *An advocate shall not solicit work or advertise...whether by circulars, advertisements, touts, personal communications, interviews not warranted by personal relations, furnishing or inspiring newspaper comments or producing his photographs to be published in connection with cases in which he has been engaged or concerned. His sign-board or name-plate should be of a reasonable size...* As the situation stands today, these rules are observed only in the breach.

Let me illustrate. Lots of lawyers are sending out e-mail circulars and newsletters describing recent legal developments, new case law, insider views of cases they have done, reviews and comment on legal developments, et al. Most every law firm I know who has achieved any success at all will cold call potential clients using their network to get an interview and what is more significant, lawyers don't begin to get taken seriously till they are interviewed on TV or appear in the print media. I struggle to speculate what a reasonable nameplate would look like but thousands of lawyers have a 800 x 600 dpi nameplate on the internet which reaches all of mankind! How do you measure large: in inches or in reach? Lawyers are taking out paid classified advertisements in yellow pages and lawyers are taking out \$ 3000 listings in "lawyers directories" overseas. Lawyers are paying dozens of journals in India and abroad (including a leading Indian national daily) to print articles under their names. We have a fait accompli here, so what if we called a spade a spade, all we would do is disclose what everybody knows.

Still there is some resistance to permitting lawyers to advertise. It is true that advertising will always favor those with deep pockets but life is always unfair. It is axiomatic that my sweeper's son doesn't have the same opportunities as

the Prime Minister's son. Sure, advertising can mislead but then cars can kill: both mandate a case for regulation, not banning.

At the end of the day, to ban print media advertising while approving electronic advertising is a bit like Alaskan law on hunting bears; you can't trap them, but you sure can shoot them! The reality of the matter is that once you allow a lawyer to put up a website, you allow him to advertise to the widest audience that exists in the world at the lowest per eyeball cost it's possible to incur to do so. With websites here, can print media ads be far behind? I think not. Welcome to the future.

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