Appointment of additional directors [Section 48C]

[Repealed by the Insurance (Amendment) Act, 1968(62 of 1968).]

Restriction on dividends and bonuses [Section 49]

(1) No insurer, who carries on the business of life insurance or any other class or subclass of insurance business to which Sec. 13 applies, shall, for the purpose of declaring or paying any dividend to shareholders or any bonus to policy-holders or of making any payment in services of any debentures, utilize directly or indirectly any portion of the life insurance fund or of the fund of such other class or sub-class of insurance business, as the case may be, except a surplus shown in the valuation balance-sheet in such form as may be specified by the regulations made by the Authority submitted to the Authority as part of the abstract referred to in Section 15 as a result of an actuarial valuation assets and liabilities of the insurer; nor shall he increase such surplus by contributions out of any reserve fund or otherwise unless such contributions have been brought in as revenue account applicable to that class or sub-class of insurance business on or before the date of the valuation aforesaid, except when the reserve fund is made up solely of transfers from similar surpluses disclosed by valuations in respect of which returns have been submitted to the Authority under Section 15 of this Act:

Provided that payments made out of any such surplus in service of any debentures shall not exceed fifty per cent. of such surplus including any payment by way of interest on the debentures, and interest paid on the debentures shall not exceed ten per cent of any such surplus except where the interest paid on the debentures is offset against the interest credited to the fund or funds concerned in deciding the interest basis adopted in the valuation disclosing the aforesaid surplus:

Provided further that the share of any such surplus allocated to or reserved for the shareholders (including any amount for the payment of dividends guaranteed to them, whether by way of first charge or otherwise) shall not exceed such sums as may be specified by the Authority and such share shall in no case exceed ten percent of such surplus in case of participating policies and in other cases the whole thereof.

(2) For the purposes of sub-section (1) the actual amount of income-tax deducted at source during the period following the date as at which the last preceding valuation was made and preceding the date as at which the valuation in question is made may be added to such surplus after deducting an estimated amount for income-tax on such surplus, such addition and deduction being shown in an abstract of the report of the actuary referred to in sub-section (1) of section 13.

Notice of options available to the assured on the lapsing of a policy [Section 50]

An insurer shall, before the expiry of three months from the date on which the premiums in respect of a policy of life insurance were payable but not paid, give notice to the policy-holder informing him of the options available to him unless these are set forth in the policy.

Supply of copies of proposals and medical reports [Section 51]

Every insurer shall, on application by a policy-holder and on payment of a fee not exceeding one rupee, supply to the policy-holder certified copies of the questions put to him and his answers thereto contained in his proposal for insurance and in the medical report supplied in connection therewith.

Prohibition of business on dividing principle [Section 52]

No insurer shall commence any business upon the dividing principle, that is to say, on the principle that the benefit secured by a policy is not fixed but depends either wholly or partly on the result of a distribution of certain sums amongst policies becoming claims within certain time-limits, or on the principle that the premiums payable by a policyholder depend wholly or partly on the number of policies becoming claims within certain time-limits:

Provided that nothing in this section shall be deemed to prevent an insurer from allocating bonuses to holders of policies of life insurance as a result of a periodical actuarial valuation either as reversionary additions to the sums insured or as immediate cash bonuses or otherwise.

When Administrator for management of insurance business may be appointed [Section 52A]

(1) If at any time the Authority has reason to believe that an insurer carrying on life insurance business is acting in a manner likely to be prejudicial to the interests of holders of life insurance policies, it may, after giving such opportunity to the insurer to be heard appoint an Administrator to manage the affairs of the insurer under the direction and control of the Authority.

(2) The Administrator shall receive such remuneration as the Authority may direct and the Authority may at any time cancel the appointment and appoint some other person as Administrator.

Powers and duties of the Administrator [Section 52B]

(1) The Administrator shall conduct the management of the business of the insurer with the greatest economy compatible with efficiency and shall, as soon as may be possible, file with the Authority a report stating which of the following courses is in the circumstances most advantageous to the general interests of the holders of life insurance policies, namely:-

  (a) the transfer of the business of the insurer to some other insurer:

  (b) the carrying on of its business by the insurer (whether with the policies of the business continued for the original sum insured with the addition of bonuses that attach to the policies or for reduced amounts);

  (c) the winding up of the insurer; and

  (d) such other course as he deems advisable.

(2) On the filing of the report with the Authority, the Authority may take such action as he thinks fit for promoting the interests of the holders of life insurance policies in general.

(3) Any order passed by the Authority under sub-section (2), shall be binding on all persons concerned, and shall have effect notwithstanding anything in the memorandum or articles of association of the insurer, or a company.

Powers of Administrator respecting property liable to attachment under Section 106 [Section 52BB]

(1) If the Administrator is satisfied that any person has rendered himself liable to be proceeded against under Section 106, he may, pending the institution of proceedings against such person under that section, by order in writing, prohibit him or any other person from transferring or otherwise disposing of any property which, in the opinion of the Administrator, would be liable to attachment in proceedings under that section.

(2) Any person aggrieved by an order made by the Administrator under sub-section (1) may, within fourteen days from the date on which the order is served on him, appeal against such order to the Securities Appellate Tribunal, and the Securities Appellate Tribunal may pass such order thereon as it thinks fit.

(3) An order made by the Administrator under sub-section (1) shall, subject to any order made by the Securities Appellate Tribunal on appeal, be in force for a period of three months from the date of the order unless, before the expiry of the said period, an application is made under sub-section (1) of Sec. 106 to the Court competent to exercise jurisdiction under that sub-section, and when such an application is made, the order shall, subject to any order made by that Court, continue in force as if it were an order of attachment made by that Court in proceedings under that section.

(4) An order made by the Administrator under this section shall,—

(a) in the case of an order affecting a corporation or firm, be served in the manner provided for the service of summons in rule 2 of Order XXIX or rule 3 of Order XXX, as the case may be, in the First Schedule to the Code of Civil Procedure, 1908 (5 of 1908), and

(b) in the case of an order affecting a person not being a corporation or firm, be served on such person -

(i) personally, by delivering or tendering to him the order, or

(ii) by post, or

(iii) where the person cannot be found, by leaving a copy of the order with some adult male member of his family or by affixing such copy to some conspicuous part of the premises in which he is known to have last resided or carried on business or personally worked for gain.

and every such order shall also be published in the official Gazette.

(5) If any question arises whether a person was duly served with an order under sub-section (4), the publication of the order in the official Gazette shall be conclusive proof that the order was so served, and a failure to comply with the provisions of Clause (a) or Clause (b) of sub-section (4) shall not affect the validity of the order.

(6) Notwithstanding anything contained In this sections any property in respect of which an order has been made by the Administrator may, with the previous permission of the Administrator and subject to such terms and conditions as he may impose, be transferred or otherwise disposed of.

(7) Notwithstanding anything contained in any other law for the time being in force, the transfer or other disposition of any property in contravention of any order made by the Administrator under this section or of any terms and conditions imposed by him shall be void.

(8) For the purpose of enabling him to form an opinion as to whether any property would be liable to attachment in proceedings under Sec. 106 or for the purpose of enabling him to institute proceedings under that section, the Administrator may require any person to furnish information on such points or matters as, in the opinion of the Administrator, may be relevant for the purpose, and any person so required shall be deemed to be legally bound to furnish such information within the meaning of Sec. 176 of the Indian Penal Code (45 of 1860).

(9) The Administrator shall have all the powers of a civil court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit in respect of the following matters, namely:

(a) summoning and enforcing the attendance of witnesses and examining them on oath;

(b) requiring the production of documents; and

(c) receiving evidence on affidavits,

and any proceeding before the Administrator under this section shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code (45 of 1860).

(10) Save as provided in this section or in Section 106, and notwithstanding anything contained in any other law for the time being in force,—

(a) no suit or other legal proceeding shall lie in any Court to set aside or modify any order of the Administrator made under this section, and

(b) no Court shall pass any decree, grant any injunction or make any other order which shall have the effect of nullifying or affecting in any way any such order.

Cancellation of contracts and agreements [Section 52C]

The Administrator may, at any time during the continuance of his appointment with respect to an insurer and after giving an opportunity to the persons concerned to be heard, cancel or vary (either unconditionally or subject to such conditions as he thinks fit to impose) any contract or agreement (other than a policy) between the insurer and any other person which the Administrator is satisfied is prejudicial to the interest of holders of life insurance policies.

Termination of appointment of Administrator [Section 52D]

If at any time, it appears to the Authority that the purpose of the order appointing the Administrator has been fulfilled or that, for any reason, it is undesirable that the order of appointment should remain in force, the Authority may cancel the order and thereupon the Administrator shall be divested of the management of the insurance business which shall, unless otherwise directed by the Authority, again vest in the person in whom it was vested immediately prior to the appointment of the Administrator or any other person appointed by the insurer in this behalf.

Finality of decision appointing Administrator [Section 52E]

Any order or decision of the Authority made in pursuance of Section 52-A or Section 52-D shad be final and shall not be called in question in any Court.

Penalty for withholding documents of property from Administrator [Section 52F]

If any director or officer of the insurer or any other person fails to deliver to the Administrator any books of account, registers, or any other documents in his custody relating to the business of the insurer the management of which has vested in the Administrator, or retains any property of such insurer, he shall be liable to penalty of rupees ten thousand each day during which such failure continues or rupees ten lakh, whichever is less.

Protection of action taken under Sections 52-A to 52-D [Section 52G]

(1) No suit, prosecution or other legal proceeding shall lie against an Administrator for anything which is in good faith done or intended to be done in pursuance of Section 52-A, Section 52-B, Section 52-BB or Section 52-C.

(2) No suit or other legal proceeding shall lie against the Authority for any damage caused- or likely to be caused by anything which is in good faith done or intended to be done under Section 52-A, Section 52-B, or Section 52-D.

Winding up by the Court [Section 53]

(1) The Court may order the winding up in accordance with the Companies Act, 2013, of any insurance company and the provisions of that Act shall, subject to the provisions of this Act apply accordingly.

Explanation.— For the purpose of sections 53 to 61A, "Tribunal" means the National Company Law Tribunal constituted under sub-section (*1*) of section 408 of the Companies Act, 2013.

(2) In additional to the grounds on which such an order may be based, the Court may order the winding up of an insurance company

(a) if with the sanction of the Court previously obtained a petition in this behalf is presented by shareholders not less in number than one-tenth of the whole body of shareholders and holding not less than one tenth of the whole share capital or by not less than fifty policy-holders holding policies of life insurance that have been in force for not less than three years and are of the total value of not less than fifty thousand rupees; or

(b) if the Authority, who is hereby authorised to do so, applies in this behalf to the Court on any of the following grounds, namely

(i) **Omitted**;

(ii) that the company having failed to comply with any requirement of this Act has continued such failure Nor having contravened any provision of this Act has continued such contravention for a period of three months after notice of such failure Nor contravention has been conveyed to the company by the Authority.

(iii) that it appears from Many returns or statements furnished under the provisions of this Act or from the results of any investigation made there under that the company is, or is deemed to be, insolvent, or

(iv) that the continuance of the company is prejudicial to the interest if the policy-holders or to the public interest generally

Unpaid-up share capital [Section 53A]

Notwithstanding anything contained in any other law, in ascertaining for any purpose of this Act the solvency or otherwise of an insurer no account shall be taken of any assets of the insurer consisting of unpaid-up share capital.

Voluntary winding up [Section 54]

Notwithstanding anything contained in the Companies Act, 2013, an insurance company shall not be wound up voluntarily except for the purpose of effecting an amalgamation or a re-construction of the company, or on the ground that by reason of its liabilities it cannot continue its business.

Valuation of liabilities [Section 55]

(1) In the winding up of an insurance company or in the insolvency of any other insurer the value of the assets and the liabilities of the insurer shall be ascertained in such manner and upon such basis as the liquidator or receiver in insolvency thinks fit, subject, so far as applicable, to the rule contained in the Seventh Schedule and to any directions which may be given by the Court.

(2) For the purposes of any reduction by the Court of the amount of the contracts of any insurance company the value of the assets and liabilities of the company and all claims in respect of policies issued by it shall be ascertained in such manner and upon such basis as the Court thinks proper having regard to the rule aforesaid.

(3) The rule in the Seventh Schedule shall be of the same force and may be repealed, altered or amended as if it were a rule made in pursuance of the Companies Act, 2013 and rules may be made under that section for the purpose of carrying into effect the provisions of this Act with respect to the winding up of insurance companies.

Application of surplus assets of life insurance fund in liquidation or insolvency [Section 56]

(1) In the winding up of an insurance company and in the insolvency of any other insurer the value of the assets and the liabilities of the insurer in respect of life insurance business shall be ascertained separately from the value of any other assets or any other liabilities of the insurer and no such assets shall be applied to the discharge of any liabilities other than those in respect of life insurance business except in so far as those assets exceed the liabilities in respect of life-insurance business.

(2) In the winding up of an insurance company carrying on the business of life insurance or in the insolvency of any other insurer carrying on such business where any proportion of the profits of the insurer was before the commencement of the winding up or insolvency allocated to policy-holders, if, when the assets and liabilities of the insurer have been ascertained, there is found to be a surplus of assets over liabilities (hereinafter referred to as a prima facie surplus) there shall be added to the liabilities of the insurer in respect of the life-insurance business an amount equal to such proportion of the prima facie surplus as is equivalent to such proportion of the profits allocated to shareholders and policy-holders as was allocated to policy-holders during the ten years immediately preceding the commencement of the winding up and the assets of

the insurer shall be deemed to exceed his liabilities only in so far as those assets exceed those liabilities after such addition:

Provided that-

(a) if in any case there has been no such allocation or if it appears to the Court that by reason of special circumstances it would be inequitable that the amount to be added to the liabilities of the insurer in respect of the life insurance business should be an amount equal to such proportion as aforesaid, the amount to be so added shall be such amount as the Court may direct, and

(b) for the purpose of the application of this sub-section to any case where before the commencement of the winding up or insolvency a proportion of such profits as aforesaid of a branch only of the life insurance business in question has been allocated to policy-holders, the value of the assets and liabilities of the insurer in respect of that branch shall be separately ascertained in like manner as the value of his assets and liabilities in respect to the life insurance business was ascertained, and the surplus so found, if any, of assets over liabilities shall, for the purpose of determining the amount to be added to :the liabilities of the insurer in respect of the life insurance business be deemed to be the prima facie surplus..

Winding up of secondary companies [Section 57]

(l) Where the insurance business or any part of the insurance business of an insurance company has been transferred to another insurance company under an arrangement in pursuance of which the first mentioned company (in this section referred to as the secondary company) or the creditors thereof has or have claims against the company to which such transfer was made (in this section referred to as the principal company) then, if the principal company is being wound up by or under the supervision of the Court, the Court shall (subject as hereinafter mentioned) order the secondary company to be wound up in conjunction with the principal company and may, by the same or any subsequent order appoint the same person to be liquidator for the two companies and make provision for such other matters as may seem to the Court necessary with a view to the companies being wound up as if they were one company.

(2) The commencement of the winding up of the principal company shall, save as otherwise ordered by the Court, be the commencement of the winding up of the secondary company.

(3) In adjusting the rights and liabilities of the members of the several companies among themselves the Court shall have regard to the constitution of the companies and to the arrangements entered into between the companies in the same manner as the Court has regard to the rights and liabilities of different classes of contributories in the case of the winding-up of a single company or as near thereto as circumstances admit.

(4) Where any company alleged to be secondary is not in process of being wound up at the same time as the principal company to which it is alleged to be secondary, the Court shall not direct the secondary company to be wound up, unless, after hearing all objections (if any) that may be urged by or on behalf of the company against its being wound up, the Court is of opinion that the company is secondary to the principal company and that the winding up of the company in conjunction with the principal company is just and equitable.

(5) An application may be made in relation to the winding up of any secondary company in conjunction with the principal company by any creditor of, or person interested in, the principal or secondary company.

(6) Where a company stands in the relation of a principal company to one insurance company and in the relation of a secondary company to some other insurance company or where there are several insurance companies standing in the relation of secondary companies to one principal company, the court may deal with any number of such companies together or in separate groups as it thinks most expedient upon the principles laid down in this section.

Schemes for partial winding-up of insurance companies [Section 58]

(1) If at any time it appears expedient that the affairs of an insurance company in respect of any class of business comprised in the undertaking of the Company should be wound up but that any other class of business comprised in the undertaking should continue to be carried on by the company or be transferred to another insurer, a scheme for such purposes may be prepared and submitted for confirmation of the Court in accordance with the provisions of this Act.

(2) Any scheme prepared under this section shall provide for the allocation and distribution of the assets and liabilities of the company between any classes of business affected (including the allocation of any surplus assets which may arise on the proposed winding-up) for any future rights of every class of policy-holders in respect of their policies and for the manner of winding-up any of the affairs of the company which are proposed to be wound up and may contain provisions for altering the memorandum of the company with respect to its objects and such further provisions as may be expedient for giving effect to the scheme.

(3) The provisions of this Act relating to the valuation of liabilities of insurers in liquidation and insolvency and to the application of surplus assets of the life insurance fund in liquidation or insolvency shall apply to the winding up of any part of the affairs of a company in accordance with the scheme under this section in like manner as they apply in the winding up of an insurance company, and any scheme under this section may apply with the necessary modifications any of the provisions of the Companies Act, 2013, relating to the winding up of companies.

(4) An order of the Tribunal confirming a scheme under this section whereby the memorandum of a company is altered with respect to its objects shall as respects the alteration have effect as if it were an order confirmed under section 4 of the Companies Act, 2013, and the provisions of sections 7 and 17 of that Act shall apply accordingly.

Notice of policy values [Section 60]

In the winding up of an insurance company for the purposes of a cash distribution of the assets and in the insolvency of any other insurer the liquidator or assignee, as the case may be, in the case of all persons appearing by the books of the company or other insurer to be entitled to or interested in the policies granted by the company or other insurer shall ascertain the value of the liability of the company or other insurer to each such person and shall give notice of such value to those persons in such manner as the Court may direct and any person to whom notice is so given shall be bound by the value so ascertained unless he gives notice of his intention to dispute such value in such manner and within such time as may be specified by a rule or order of the Court.

Power of Court to reduce contracts of insurance [Section 61]

(1) where an insurance company is in liquidation or any other insurer is insolvent, the Court may make an order reducing the amount of the insurance contracts of the company or other insurer upon such terms and subject to such conditions as the Court thinks Just.

(2) Where a company carrying on the business of life insurance has been proved to be insolvent, the Court may if it thinks fit in place of making a winding up order reduce the amount of the insurance contracts of the company upon such terms and subject to such conditions as the Court thinks fit.

(3) Application for an order under this section may be made either by the liquidator or by or on behalf of the company or by a policy-holder, or by the Authority and the Authority and any person whom the Court thinks likely to be affected shall be entitled to be heard on any such application.

Power of Central Government to impose reciprocal disabilities on non-Indian companies [Section 62]

Where by the law or practice of any country outside India in which an insurer carrying on insurance business in India is constituted, incorporated or domiciled, insurance companies incorporated in India are required as a condition of carrying on insurance business in that country to comply with any special requirement whether as to the keeping of deposits or assets in that country or otherwise which is not imposed upon insurers of that country under this Act, the Central Government shall, if satisfied of the existence of such special requirement, by notification in the official Gazette, direct that the same requirement or requirements, as similar thereto as may be, shall be imposed upon insurers of that country as a condition of carrying on the business of insurance in India.

Particulars to be filled by insurers established outside India [Section 63]

Every insurer, having his principal place of business or domicile outside Indian, who establishes a place of business within India or appoints a representative in India with the object of obtaining insurance business shall within three months from the establishment of such place of business or the appointment of such representative file with the Authority.

(a) a certified copy of the charter, statutes, deed of settlement or memorandum and articles or other instrument constituting or defining the constitution of the insurer, and, if the instrument is not written in the English language, a certified translation thereof.

(b) a list of the directors, if the insurer is a company,

(c) the name and address of some one or more persons resident in India authorised to accept on behalf of the insurer service of process and any notice required to be served on the insurer together with a copy of the power of attorney granted to him.

(d) the full address of the principal office of the insurer in India.

(e) a statement of the classes of insurance business to be carried on by the insurer, and

(f) a statement verified by an affidavit setting forth the special requirements, if any, of the nature specified in Section 62 imposed in the country of origin of the insurer on Indian nationals,

and, in the event of any alteration being made in the address of the principal office or in the classes of business to be carried on, or in any instrument here referred to, or in the name of any of the persons here referred to, or in the matters specified in Clause(f) above, the company shall forthwith furnish to the Authority particulars of such alteration.

Books to be kept by insurers established outside India [Section 64]

Every insurer having his principal place of business or domicile outside India shall keep at his principal office in India such books of account, registers and documents as will enable the accounts, statements and abstracts which he is required under this Act to furnish to the Authority in respect of the insurance business transacted by him, in India to be complied and if necessary, checked by the Authority and shall furnish to the Authority on or before the last day of January in every calendar year a certificate from an auditor to the effect that the said books of account, register and documents are being kept as required at the principal office of the insurer in India.

Councils of LIfe Insurance and General Insurance [Section 64C]

On and from the date of commencement of this Act,—

(a) the existing Life Insurance Council, a representative body of the insurers, who carry on the life insurance business in India; and

(b) the existing General Insurance Council, a representative body of insurers, who carry on general, health insurance business and re-insurance in India,

shall be deemed to have been constituted as the respective Councils under this Act.

Authorisation to represent in Councils [Section 64D]

It shall be lawful for any member of the Life Insurance Council or the General Insurance Council to authorise any of its officer to act as the representative of such member at any meeting of the Council concerned.

6.2 THE INSURANCE REGULATORY & DEVELOPMENT AUTHORITY ACT, 1999

Short title, extent and commencement [Section 1]

(1) This Act may be called THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT, 1999.

(2) It extends to the whole of India.

(3) 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.

Definitions [Section 2]

(1) In this Act, unless the context otherwise requires,--,

(a) "appointed day" means the date on which the Authority is established under sub-section (1) of section 3;

(b) "Authority" means the Insurance Regulatory and Development Authority of India established under sub-section (1) of section 3;

(c) "Chairperson" means the Chairperson of the Authority;

(d) "Fund" means the Insurance Regulatory and Development Authority Fund constituted under sub-section (1) of section 16;

(e) "Interim Insurance Regulatory Authority" means the Insurance Regulatory Authority set up by the Central Government through Resolution No 17(2)1 94-Ins.-V, dated the 23rd January, 1996;

(f) "Intermediary" or "insurance intermediary" includes insurance brokers, re-insurance brokers, insurance consultants, corporate agents, third party administrator, surveyors and loss assessors and such other entities, as may be notified by the Authority from time to time;

(g) "member" means a whole--time or a part-time member of the Authority and includes the Chairperson;

(h) "notification" means a notification published in the Official Gazette;

(i) "prescribed" means prescribed by rules made under this Act; (0 "regulations" means the regulations made by the Authority.

(2) Words and expressions used and not defined in this Act but defined in the Insurance Act, 1938 (4 of 1938) or the Life Insurance Corporation Act, 1956 (31 of 1956) or the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972) shall have the meanings respectively assigned to them in those Acts.

REGULATORY AND DEVELOPMENT AUTHORITY

Establishment and incorporation of Authority [Section 3]

(1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purpose of this Act, an Authority to be called "the Insurance Regulatory and Development Authority of India."

(2) The Authority shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.

(3) The head office of the Authority shall be at such place as the Central Government may decide from time to time.

(4) The Authority may establish offices at other places in India.

Composition of Authority [Section 4]

The Authority shall consist of the following members, namely:-

(a) a Chairperson;

(b) not more than five whole-time members;

(c) not more than four part-time members,

to be appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration or any other discipline which would, in the opinion of the Central Government, be useful to the Authority:

Provided that the Central Government shall, while appointing the Chairperson and the whole-time members, ensure that at least one person each is a person having knowledge or experience in life insurance, general insurance or actuarial science, respectively.

Tenure of office of Chairperson and other members [Section 5]

(1) The Chairperson and every other whole-time member shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:

Provided that no person shall hold office as a Chairperson after he has attained the age of sixty-five years:

Provided further that no person shall hold office as a whole-time member after he has attained the age of sixty-two years.

(2) A part-time member shall hold office for a term not exceeding five years from the date on which he enters upon his office.

(3) Notwithstanding anything contained in sub-section (l) or sub-section (2), a member may-

(a) relinquish his office by giving in writing to the Central Government notice of not less than three months; or

(b) be removed from his office in accordance with the provisions of section 6.

Removal from office [Section 6]

(l) The Central Government may remove from office any member who-

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

(b) has become physically or mentally incapable of acting as a member; or

(c) has been convicted of any offence which, in the opinion of the Central Government, involves moral turpitude; or

(d) has acquired such financial or other interest as is likely to affect prejudicially his functions as a member; or

(e) has so abused his position as to render his continuation in office detrimental to the public interest.

(2) No such member shall be removed under clause (d) or clause (e) of sub-section (1) unless he has been given a reasonable opportunity of being heard in the matter.

Salary and allowances of Chairperson and members [Section 7]

(l) The salary and allowances payable to, and other terms and conditions of service of, the members other than part-time members shall be such as may be prescribed.

(2) The part-time members shall receive such allowances as may be prescribed.

(3) The salary, allowances and other conditions of service of a member shall not be varied to his disadvantage after appointment.

Bar on future employment of members [Section 8]

The Chairperson and the whole-time members shall not, for a period of two years from the date on which they cease to hold office as such, except with the previous approval of the Central Government, accept-

(a) any employment either under the Central Government or under any State Government; or

(c) any appointment in any company in the insurance sector.

Administrative powers of Chairperson [Section 9]

The Chairperson shall have the powers of general superintendence and direction in respect of all administrative matters of the Authority.

Meetings of Authority [Section 10]

(1) The Authority shall meet at such time and places and shall observe such rules and procedures in regard to transaction of business at its meetings (including quorum at such meetings) as may be determined by the regulations.

(2) The Chairperson, or if for any reason he is unable to attend a meeting of the Authority, any other member chosen by the members present from amongst themselves at the meeting, shall preside at the meeting.

(3) All questions which come up before any meeting of the Authority shall be decided by a majority of votes by the members present and voting, and in the event of an equality of votes, the Chairperson, or in his absence, the person presiding shall have a second or casting vote.

(4) The Authority may make regulations for the transaction of business at its meetings.

Vacancies, etc., not to invalidate proceedings of Authority [Section 11]

No act or proceeding of the Authority shall be invalid merely by reason of-

(a) any vacancy in, or any defect in the constitution of, the Authority; or

(b) any defect in the appointment of a person acting as a member of the Authority; or

(c) any irregularity in the procedure of the Authority not affecting the merits of the case.

Officers and employees of Authority [Section 12]

(1) The Authority may appoint officers and such other employees as it considers necessary for the efficient discharge of its functions under this Act.

(2) The terms and other conditions of service of officers and other employees of the Authority appointed under sub-section (1) shall be governed by regulations made under this Act.

Transfer of assets, liabilities, etc., of Interim Insurance Regulatory Authority [Section 13]

On the appointed day,-

(a) all the assets and liabilities of the Interim Insurance Regulation Authority shall stand transferred to, and vested in, the Authority.

Explanation. -The assets of the Interim Insurance Regulatory Authority shall be deemed to include all rights and powers, and all properties, whether movable or immovable, including, in particular, cash balances, deposits and all other interests and rights in, or arising out of, such properties as may be in the possession of the Interim Insurance Regulatory Authority and all books of account and other documents relating to the same; and liabilities shall be deemed to include all debts, liabilities and obligations of whatever kind;

(b) without prejudice to the provisions of clause (a), all debts, obligations and liabilities incurred, all contracts entered into and all matters and things engaged to be done by, with or for the Interim Insurance Regulatory Authority immediately before that day, for or in connection with the purpose of the said Regulatory Authority, shall be deemed to have been incurred, entered into or engaged to be done by, with or for, the Authority;

(c) all sums of money due to the Interim Insurance Regulatory Authority immediately before that day shall be deemed to be due to the Authority; and

(d) all suits and other legal proceedings instituted or which could have been instituted by or against the Interim Insurance Regulatory Authority immediately before that day may be continued or may be instituted by or against the Authority.

Duties, powers and functions of Authority [Section 14]

(1) Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and reinsurance business.

(2) Without prejudice to the generality of the provisions contained in sub -section (1), the powers and functions of the Authority shall include,-

(a) issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;

(b) protection of the interests of the policy-holders in matters concerning assigning of policy, nomination by policy-holders, insurable interest, settlement of insurance claim, surrender value of policy, and other terms and conditions of contracts of insurance;

(c) specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;

(d) specifying the code of conduct for surveyors and loss assessors;

(e) promoting efficiency in the conduct of insurance business;

(f) promoting and regulating professional organisations connected with the insurance and re-insurance business;

(g) levying fees and other charges for carrying out the purposes of this Act;

(h) calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;

(i) control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64-U of the Insurance Act, 1938 (4 of 1938);

(j) specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

(k) regulating investment of funds by insurance companies;

(l) regulating maintenance of margin of solvency;

(m) adjudication of disputes between insurers and intermediaries or insurance intermediaries;

(n) supervising the functioning of the Tariff Advisory Committee;

(o) specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f};

(p) specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

(q) exercising such other powers as may be prescribed.

Grants by Central Government [Section 15]

The Central Government may, after due appropriation made by the Parliament by law in this behalf, make to the Authority grants of such sums of money as the Government may think fit for being utilised for the purposes of this Act.

Constitution of Fund [Section 16]

(1) There shall be constituted a fund to be called "the Insurance Regulatory and Development Authority Fund" and there shall be credited thereto--

   (a) all Government grants, fees and charges received by the Authority;

   (b) all sums received by the Authority from such other source as may be decided upon by the Central Government;

(2) The Fund shall be applied for meeting-

   (a) the salaries, allowances and other remuneration of the members, officers and other employees of the Authority;

   (b) the other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

Accounts and audit [Section 17]

(1) The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of account in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.

(2) The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.

(3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Authority shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books of account, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.

(4) The accounts of the Authority as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Power of Central Government to issue directions [Section 18]

(1) Without prejudice to the foregoing provisions of this Act, the Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:

Provided that the Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

(2) The decision of the Central Government, whether a question is one of policy or not, shall be final.

Power of Central Government to supersede Authority [Section 19]

(1) if, at any time, the Central Government is of the opinion-

(a) that, on account of circumstances beyond the control of the Authority, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or

(b) that the Authority has persistently defaulted in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Authority or the administration of the Authority has suffered; or

(c) that circumstances exist which render it necessary in the public interest so to do, the Central Government may, by notification and for reasons to be specified therein, supersede the Authority for such period, not exceeding six months, as may be specified in the notification and appoint a person to be the Controller of Insurance under section 2-B of the Insurance Act, 1938 (4 of 1938), if not already done:

Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Authority to make representations against the proposed supersession and shall consider the representations, if any, of the Authority.

(2) Upon the publication of a notification under sub-section (1) superseding the Authority,---

(a) the Chairperson and other members shall, as from the date of supersession, vacate their offices as such;

(b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, until the Authority is reconstituted under sub-section (3), be exercised and discharged by the Controller of Insurance; and

(c) all properties owned or controlled by the Authority shall, until the Authority is reconstituted under sub-section (3), vest in the Central Government.

(3) On or before the expiration of the period of supersession specified in the notification issued under sub-section (1), the Central Government shall reconstitute the Authority by a fresh appointment of its Chairperson and other members and in such case any person who had vacated his office under clause (a) of sub-section (2) shall not be deemed disqualified for re-appointment.

(4) The Central Government cause a copy of the notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Furnishing of returns, etc., to Central Government [Section 20]

(1) The Authority shall furnish to the Central Government at such time and in such form and manner as may be prescribed, or as the Central Government may direct to furnish such returns, state-

ments and other particulars in regard to any proposed or existing programme for the promotion and development of the insurance industry as the Central Government may, from time to time, require.

(2) Without prejudice to the provisions of sub-section (1), the Authority shall, within nine months after the close of each financial year, submit to the Central Government a report giving a true and full account of its activities including the activities for promotion and development of the insurance business during the previous financial year.

(3) Copies of the reports received under sub-section (2) shall be laid, as soon as may be after they are received, before each House of Parliament.

Chairperson, members, officers and other employees of Authority to be public servants [Section 21]

The Chairperson, members, officers and other employees of the Authority shall be deemed, when acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

Protection of action taken in good faith [Section 22]

No suit, prosecution or other legal proceedings shall lie against the Central Government or any officer of the Central Government or any member, officer or other employee of the Authority for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder:

Provided that nothing in this Act shall exempt any person from any suit or other proceedings which might, apart from this Act, be brought against him.

Delegation of powers [Section 23]

(1) The Authority may, by general or special order in writing, delegate to the Chairperson or any other member or officer of the Authority subject to such conditions, if any, as may be specified in the order, such of its powers and functions under this Act as it may deem necessary.

(2) The Authority may, by a general or special order in writing, also form Committees of the members and delegate to them the powers and functions of the Authority as may be specified by the regulations.

Power to make rules [Section 24]

(1) The Central Government may, by notification, make rules for carrying out the provisions of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely: -

 (a) the salary and allowances payable to, and other terms and conditions of service of, the members other than part-time members under sub-section (1) of section 7;

 (b) the allowances to be paid to the part-time members under sub-section (2) of section 7;

 (c) such other powers that may be exercised by the Authority under clause (q) of sub-section (2) of section 14;

 (d) the form of annual statement of accounts to be maintained by the Authority under sub-section (1) of section 17;

 (e) the form and the manner in which and the time within which returns and statements and particulars are to be furnished to the Central Government under sub-section (I) of section 20;

(f) the matters under sub-section (5) of section 25 on which the Insurance Advisory Committee shall advise the Authority;

(g) any other matter which is required to be, or may be, prescribed, or in respect of which provision is to be or may be made by rules.

Establishment of Insurance Advisory Committee [Section 25]

(1) The Authority may, by notification, establish with effect from such date as it may specify in such notification, a Committee to be known as the Insurance Advisory Committee.

(2) The Insurance Advisory Committee shall consist of not more than twenty-five members excluding ex officio members to represent the interests of commerce, industry, transport, agriculture, consumer fora, surveyors, agents, intermediaries, organisations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector.

(3) The Chairperson and the members of the Authority shall be the ex officio Chairperson and ex officio members of the Insurance Advisory Committee.

(4) The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to the making of the regulations under section 26.

(5) Without prejudice to the provisions of sub-section (4), the Insurance Advisory Committee may advise the Authority on such other matters as may be A prescribed.

Power to make regulations [Section 26]

(1) The Authority may, in consultation with the Insurance Advisory Committee, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters, namely: -

(a) the time and places of meetings of the Authority and the procedure to be followed at such meetings including the quorum necessary for the transaction of business under sub-section (1) of section 10;

(b) the transaction of business at its meetings under sub -section (4) of section 10;

(c) the terms and other conditions of service of officers and other employees of the Authority under sub-section (2) of section 12;

(d) the powers and functions which may be delegated to Committees of the members under sub-section (2) of section 23; and

(e) any other matter which is required to be, or may be, specified by regulations or in respect of which provision is to be or may be made by regulations.

Rules and regulations to be laid before Parliament [Section 27]

Every rule and every 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.

Application of other laws not barred [Section 28]

The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

Power to remove difficulties [Section 29]

(1) If any difficulty arises in giving effect to the provisions of this Act, the Central Government may, by order published in the Official Gazette, make such provisions not inconsistent with the provisions of this Act as may appear to be necessary for removing the difficulty:

Provided that no order shall be made under this section after the expiry of two years from the appointed day.

(2) Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

Amendment of Act 4 of 1938 [Section 30]

The Insurance Act, 1938 shall be amended in the manner specified in the First Schedule to this Act.

Amendment of Act 31 of 1956 [Section 31]

The Life Insurance Corporation Act, 1956 shall be amended in the manner specified in the Second Schedule to this Act.

Amendment of Act 57 of 1972 [Section 32]

The General Insurance Business (Nationalisation) Act, 1972 shall be amended in the manner specified in the Third Schedule to this Act.

CONCEPT ON BASEL - I

OBJECTIVES

After going through this Chapter, the student would have some understanding of the following-

- The Basel Accord 1988 (Base I)
- Definition/Clarification of `Bank' for the purpose of Basel accord, Commercial banks and Universal banks
- Shift from a `Credit risk only' position which existed during 1988-1998
- Market risk - Recognition of the need for capital - Amendment of Basel I in 1996
- Commercial Banks & Securities firms - Universal Banks
- Segregation of Banking book & Trading book for holding Capital
- Banks to have independent Risk Management function and satisfy the `Regulator' regarding its risk management practices

INTRODUCTION

As on date the provisions of Basel Accord of 1988 has undergone a number of changes made year after year. Though Basel II accord has become operational some of the covenants of Basel I (1988) are still relevant. Under the 1988 accord, Banks and security firms have been given different treatment. In the ensuing paragraphs we will focus on these developments.

THE BASEL ACCORD (BASEL I)

In 1988, the Basel Committee published a set of minimal capital requirements for banks. These became law in G-10 countries in 1992, with Japanese banks being permitted an extended transition period. The requirements have come to be known as the 1988 Basel Accord.

What is a `Bank' for the purpose of Basel accord: To understand the scope of the 1988 accord, we need to clarify what we mean by `bank.' This is because, some jurisdictions distinguished between banks and securities firms, and the Basel accord (Basel I) applied only to the former.

Commercial Banks and Universal Banks - Glass Steagal Act, USA (1933-1999)

Under its Glass-Steagal Act, the United States had quite some time back made a distinction between commercial banks and securities firms (investment banks or broker-dealers). Following World War II, Japan adopted a similar legal distinction. The United Kingdom also distinguished between banks and securities firms, although this was more a matter of custom than law. By comparison, Germany had a tradition of universal banking, which made no distinction between banks and securities firms. Under German law, securities firms were banks and a single regulatory authority oversaw banks. France and the Scandinavian countries had similar regimes. The USA revoked the Glass Steagal Act in 1999.

Exclusive Focus on Credit Risk During 1988-1998

The 1988 Basel Accord -Basel I- primarily addressed banking in the sense of deposit taking and lending (commercial banking under US law), so its focus was credit risk. Under this dispensation, bank assets were assigned `risk weights.' Generally, G-10 government debt was weighted 0 per cent, G-10 bank debt was weighted 20 per cent, and other debt was weighted 100 per cent. Following this the Government of India Securities were assigned zero risk weight. Having assigned and aggregated the risk, Banks were required to hold capital equal to 8 per cent of the risk weighted value of assets. Additional rules applied to contingent obligations, such as letters of credit or derivatives.

MARKET RISK - RECOGNITION OF THE NEED FOR CAPITAL - AMENDMENT OF BASEL I IN 1996

With banks increasingly taking market risks, in the early 1990s, the Basel Committee decided to update the 1988 accord to include bank capital requirements for market risk. This would have implications for non-bank securities firms. Any capital requirements the Basel Committee adopted for banks' market risk where to be incorporated into future updates of Europe's Capital Adequacy Directive (CAD) and thereby apply to Britain's non-bank securities firms. If the same framework were extended to non-bank securities firms outside Europe, then market risk capital requirements for banks, and, securities firms could be harmonized globally. In 1991, the Basel Committee entered discussions with the International Organization of Securities Commissions (TOSCO) to jointly develop such a framework. The two organizations formed a technical committee, and work commenced in January 1992.

COMMERCIAL BANKS & SECURITIES FIRMS - UNIVERSAL BANKS

Glass Steagal Act revocation in 1999 by USA: Historically, capital requirements for banks and securities firms had served different purposes.

1. Banks

Banks were primarily exposed to credit risk. They, often held illiquid portfolios of loans supported by deposits. Such loans could be liquidated rapidly only at 'fire sale' prices. This placed banks at risk of 'runs.' If depositors feared that a bank might fail, they would withdraw their deposits. Forced to liquidate its loan portfolio, the bank would succumb to staggering losses on those sales.

Though Deposit insurance and lender-of-last-resort provisions implemented eliminated the risk of bank runs, they introduced a new problem. Depositors no longer had an incentive to consider a bank's financial viability before depositing funds. Without such marketplace discipline, regulators were forced to intervene often at huge cost to the exchequer. One solution was to impose minimum capital requirements on banks. Because of the high cost of liquidating a bank, such requirements were generally based upon the value of a bank as a going concern.

Securities Firms

The primary objective behind stipulation of capital requirements for securities firms was to protect clients who might have funds or securities on deposit with a firm. Securities firms were primarily exposed to market risk. They held liquid portfolios of marketable securities supported by secured financing such as repos. A troubled firm's portfolio could be unwound quickly at market prices. For this reason, capital requirements were based upon the liquidation value of a firm.

Capital for Banks & Securities Firms

In a nutshell, banks entailed systemic risk. It was thought then that Securities firms did not. Regulators would strive to keep a troubled bank afloat but would gladly unwind a troubled securities firm. Banks needed long-term capital in the form of equity or long-term subordinated debt. Securities firms could operate with more transient capital, including short-term subordinated debt.

SEGREGATION OF BANKING BOOK & TRADING BOOK FOR HOLDING CAPITAL

In April 1993, the Basel Committee released a package of proposed amendments to the 1988 accord. This included a document proposing minimum capital requirements for banks' market risk.

- *Banks would be required to identify a trading book and hold capital for market risk under trading book and organization-wide foreign exchange exposures.*
- *Capital charges for the trading book would be based upon a crude value-at-risk (VaR) measure broadly consistent with a 10-day 95 per cent VaR metric. Similar to a VaR measure used by Europe's CAD, this partially recognized hedging effects but ignored diversification effects.*
- *Later VaR measure was changed modestly from the 1993 proposal, still reflecting a 10-day 95 per cent VaR metric. Market risk capital requirements were set equal to the greater of either the previous day's VaR, or the average VaR over the previous six days, multiplied by 3.*

BANKS TO HAVE INDEPENDENT RISK MANAGEMENT FUNCTION AND SATISFY THE REGULATOR REGARDING ITS RISK MANAGEMENT PRACTICES

The Basel Committee's new proposal was adopted in 1996 as an amendment to the 1988 accord. It is known as the 1996 amendment. It went into effect in 1998.

Let Us Sum Up

The Basel Committee published a set of minimal capital requirements for banks and distinguished between banks and securities firms. Bank assets were assigned `risk weights'. The primary purpose of capital requirements for securities firms was to protect clients who might have funds or securities on deposit with a firm.

Keywords

International Organization, of Securities Commissions (TOSCO), Basel 1, Glass Steagal Act, Security firm, credit risk, market risk, risk weights, capital adequacy directive(CAD), deposit insurance, lender of last resort, Repos, trading book, value at risk (VaR), risk management practices

Check Your Progress

1. *In the case of Value at Risk (VaR), the -*
   (a) *VaR at 95 per cent confidence level, implies a 5 per cent probability of incurring the loss*
   (b) *VaR at 95 per cent confidence level, implies a 95 per cent probability of incurring the loss*
   (c) *It is the part of investment which is at risk*
   (d) *None of the above*
   Ans. [a]
2. *`The Banking Book' includes assets and liabilities subjected to interest rate risk on their Maturities/ re-pricing.*
   (a) *True*
   (b) *False*
   Ans. [a]
3. *The Trading Book includes all the assets that are held with intention of trading that are marketable:*
   (a) *True*
   (b) *False Ans. [a]*
4. *`Run' in banking terms means*
   (a) *Banks running for deposits*
   (b) *If depositors feared a bank might fail, they would withdraw their deposits*
   (c) *Depositors running after banks for best price for their investment*
   (d) *None of the above*
   Ans. [b]
5. *Securi ty firms are primarily exposed to*
   (a) *credit risks*
   (b) *market risks*
   (c) both the above
   (d) None of the above
   Ans. [b]

CONCEPT ON BASEL - II

OBJECTIVES

The objectives of this unit are to familiarize the readers with:

- *Pillar I - Minimum Capital requirement for Credit risk, Market risk and Operational risk*
- *Pillar II - Supervisory review process - Capital adequacy assessment*
- *Pillar III - Market discipline [Transparency and Disclosure requirement by banks]*

INTRODUCTION

The Basel Committee replaced the 1988 accord (amended in 1996 and adopted in 1998) in April 2006. This has been dubbed Basel 11. It includes more sophisticated treatment of credit risk. Basel II also addressed `Operational risk', among other things.

BASEL I WAS BASED ON UNIFORM ASSESSMENT METHODOLOGY FOR CAPITAL ADEQUACY

Basel II is based on 3 pillars as mentioned below: Pillar - I Minimum Capital requirements

Pillar - II Supervisory Review Process

Pillar - III Market Discipline

PILLAR - I MINIMUM CAPITAL REQUIREMENTS

A bank will have to determine the proportion of its capital that it must keep in reserve based on this calculation:

$$\frac{\text{Total Capital (Unchanged)}}{\text{Credit Risk+Market Risk+Operational Risk}} = \text{The Bank's Capital Ratio nor} = 8\%$$

[9% for India]

Credit risk capital is for 'Banking book'.

Market risk Capital is for `Trading book'.

Operational risk - New rules introduced for Basel II

Market Risk Capital is for 'Trading book'.

Operational risk- New rules introduced for Basel II

PILLAR - II SUPERVISORY REVIEW PROCESS

Pillar II seeks to enhance the link between institution's [bank's] risk profile, its risk management and risk mitigation systems and its capital

Banks must ensure that they have a process in place to make sure that they hold adequate capital consistent with their risk profile and strategy.

The Internal Capital Adequacy Assessment Process [ICAAP] is the responsibility of the bank and they should own, develop and manage their risk management processes.

PILLAR - III MARKET DISCIPLINE [TRANSPARENCY & DISCLOSURES]

This sets out the `minimum disclosure requirements for external reporting. A bank is expected to be transparent. It should disclose various information relating to its financial aspects including its risks at periodical intervals.

COMPARISON BETWEEN BASEL I AND BASEL

Introduction: In the previous paragraphs we have given the highlights of Basel] and Basel fl. In this chapter we compare the two for better understanding.

Comparison between Basel I and Basel II

Basel - 1(1988 and amended in 1996) – Based on Methodology for Capital Adequacy Basel - 11 (to be in place by 2006 in G-10	Basel- II (to be in place by 2006 in G-10 countries and in India in 2008)- Basel II based on 3 pillars
1. Capital adequacy based on `Risk Weighted Assets	1. Capital adequacy based on 'Risk Weighted Assets)
2. Not risk sensitive. Prescriptive.	2. Risk sensitive.
3. All credit exposures carried risk weight of 100 per cent - except for some sovereign exposures and mortgages	3. Credit exposures carry risk weights based on credit qualityes.
4. Risk Capital = Credit exposure * Risk Weights * 8 per cent	4. Risk capital: Similar to Basel I. But efficient Banks can have lesser capital than others
Implications were • Every bank had to maintain same 8 per cent capital. Thus Banks with good quality assets had no incentives. As a result credit quality had to be lowered to increase returns • Low rated exposures were subsidized by high rated exposures • No provision for economic pricing by banks	Implications are • Banks with good quality assets have incentives because they can manage with lower capital • Better quality assets requires lesser capital • Risk pricing can be done by banks based on credit risk perception • Provision exists for economic pricing by banks

Let Us Sum Up

Basel II introduced in 2006 brought in a new concept - 'Operational risk'. Basel II also introduced the idea of 3 pillars for assessing and ensuring capital adequacy of banks.

Basel II was implemented from 2006 m G-10 countries. It was implemented in India in 2008.

Keywords

Pillars, Operational risk, minimum capital requirement, Transparency, Capital Ratio, Internal Capital Adequacy Assessment Process [ICAAP], Capital adequacy, Risk weighted assets, Risk capital.

Check Your Progress

1. Basel II is based on 3 pillars. The 3 pillars are
   (a) Minimum Capital requirements, Supervisory Review Process and Market Discipline
   (b) Transparency, minimum disclosures and financial aspects
   (c) Banks. Credit risk. Operational risk
   (d) None of the above
   Ans. [a]
2. The minimum capital adequacy ratio for India is
   (a) Higher than prescribed by Basel H
   (b) Same as for other countries
   (c) Lower than suggested by Basel II
   (d) None of the above
   Ans. [a]
3. 1CAAP is a Supervisory review process for Capital adequacy assessment. This process is to be periodically done by
   (a) The Central Bank of a country
   (b) The Bank itself which is required to ensure its own capital adequacy
   (c) The auditors
   Ans. [b]
4. Credit exposures carry risk weights based on credit quality as per
   (a) Basel I
   (b) Basel II
   Ans. [b]

Study Note - 7

LAWS RELATED TO POWER SECTOR

This Study Note includes

7.1 THE INDIAN ELECTRICITY ACT, 1910

ABSTRACT

The Indian Electricity Sector has gone through a lot of metamorphosis. The three major acts concerning the electricity sector were the Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998. With the changing times many of the acts had become passé and thus had to be reviewed. The Electricity Act 2003, enacted by the Parliament of India, received the President's assent on 26th May 2003 and came in to force on June 10, 2003. The main aim of the Act was to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalisation of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto. However even after many deliberations there are some major issues that were overlooked. They need to be addressed promptly so that the power sector can be truly the engine of growth for the Indian Economy. This paper will briefly try to point out the troublesome issues and will try to suggest remedial measures.

Introduction:

Electricity is one of the key inputs for the overall socio-economic development of the country. The basic responsibility of the power supply industry is to provide adequate electricity at economic cost, while ensuring reliability and quality of the supply. Despite significant progress in capacity addition since Independence, the demand for electricity continues to outstrip the supply with the result that energy and peaking shortages continue to plague the economy. With the increasing pace of economic development facilitated by the reforms initiated by the Government, the demand for power in both rural and urban areas is likely to increase rapidly in the coming years. The major task of the power sector will, therefore, be to ensure that the anticipated demand is met adequately and in a reliable and cost-effective manner.

The power sector is currently witnessing a critical phase. State Electricity Boards (SEBs) are responsible for providing electricity to the people. Most of the SEBs are cash strapped. They are not even able to earn a minimum Rate of Return (RoR) of 3% on their net fixed assets in servicing after providing for depreciation and interest charges in accordance with Section 59 of the Electricity (Supply) Act, 1948. The power sector in the country has accumulated a huge deficit, dues to Central Power Generating Companies because of the deteriorating financial performance. The structure of the electricity industry in independent India was laid down by the Electricity (Supply) Act, 1948 that created the State Electricity Boards (SEBs). In their initial years, the SEBs performed yeomen service in carrying electric power everywhere, but over the years they have become unsustainable, thanks to their mismanagement and politicisation coupled with the economic and technological developments of the past decade. It is high time that the electricity industry is denationalised, and restructured on commercial principles. Even though, the legal framework was amended in 1998 to facilitate private investment in generation and transmission, respectively, it enabled private entities to sell or transmit power only through long-term contracts with state-owned entities. Such contract-driven privatisation through state-owned monopolies can have little chance of enduring success. Similarly, the setting up of regulatory commissions under the 1998 Act, though a welcome move, only had a limited impact on the state-owned monopolies. It should surprise no one that these piecemeal changes in the name of reform have not been able to arrest the deterioration of this industry.

To overcome these teething problems that the sector faces, The Electricity Act, 2003 (referred to as The Act from here on) was introduced in the Indian parliament after a lot of political debate. The Act came into force (except for section 121) on June 10, 2003 is stated to be the 'distilled wisdom' of a series of commissioned international and national consultancy studies and seminars and conferences held at the all-India level during the last three years. It replaces the three existing legislations, namely, Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998. The objectives of the Act are to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalization of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies, constitution of Central Electricity Authority, Regulatory Commissions and establishment of Appellate Tribunal. It is acclaimed to be the roadmap for the electricity industry, which will help hasten the pace of economic reforms in the country. When the Bill on this subject was under consideration of the standing committee of parliament, a number of issues deserved closer examination. Several of these remain unattended. The Act, which is a halfway house, raises a number of new issues, which are likely to pose serious problems in the coming years.

The new Act seeks to free up distribution, the main stumbling block in the development of India's power sector. The Act brings together laws on generation, transmission, distribution, trading and use of electricity, liberalising generation, transmission and distribution and providing for penal action for theft of power or default on payment for power consumed. Captive plants have far greater freedom under the Act. Consumers are allowed to form bulk-purchasing groups and buy power directly from generating companies, traders or distribution companies. Non-government organisations, local bodies and user organisations too can distribute power in non-urban areas, purchasing power from the supplier of their choice. Open access has been permitted in transmission. Additional, limited open access has been provided for in the case of distribution as well, although the extent of actual competition in distribution will depend on the quality of state level regulation. The Act also seeks to set up an appellate tribunal to hear complaints against the central and state level regulatory commissions and to exercise general supervision and control over these bodies.

The present paper will identify the major features of the act and will point out the major shortcomings of the Act. The first section is the introduction. The Second section deals with power generation scenario, which will look at the major development in the electricity sector over the years. The third section looks at the salient features of the act. The fourth section will look at the regulation aspect and point out some of its shortcomings in the act. The fifth section is divided in two parts wherein the first section i.e. 5.1 will look at the Open Access. The second section i.e. 5.2 will look at the implications of the act for the electricity sector. The last section is the conclusion, which will summarise the paper and put forward some issues that need to be addressed.

THE ELECTRICITY ACT, 2003

An Act to consolidate the laws relating to generation, transmission, distribution, trading and use of electricity and generally for taking measures conducive to development of electricity industry, promoting competition therein, protecting interest of consumers and supply of electricity to all areas, rationalisation of electricity tariff, ensuring transparent policies regarding subsidies, promotion of efficient and environmentally benign policies constitution of Central Electricity Authority, Regulatory

Commissions and establishment of Appellate Tribunal and for matters connected therewith or incidental thereto.

Be it enacted by Parliament in the Fifty- fourth Year of the Republic of India as follows: -

Short title, extent and commencement [Section 1]

(1) This Act may be called the Electricity (Amendment) Act, 2007.

(2) It extends to the whole of India except the State of Jammu and Kashmir.

(3) 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.

Definitions [Section 2]

In this Act, unless the context otherwise requires,

(1) "Appellate Tribunal" means the Appellate Tribunal for Electricity established under section 110;

(2) "appointed date" means such date as the Central Government may, by notification, appoint;

(3) "area of supply" means the area within which a distribution licensee is authorised by his licence to supply electricity;

(4) "Appropriate Commission" means the Central Regulatory Commission referred to in sub-section (1) of section 76 or the State Regulatory Commission referred to in section 82 or the Joint Commission referred to in section 83, as the case may be ;

(5) "Appropriate Government" means, -

(a) the Central Government, -

(i) in respect of a generating company wholly or partly owned by it;

(ii) in relation to any inter-State generation, transmission, trading or supply of electricity and with respect to any mines, oil-fields, railways, national highways, airports, telegraphs, broadcasting stations and any works of defence, dockyard, nuclear power installations;

(iii) in respect of National Load Despatch Centre; and Regional Load Despatch Centre;

(iv) in relation to any works or electric installation belonging to it or under its control ;

(b) in any other case, the State Government, having jurisdiction under this Act;

(6) "Authority "means the Central Electricity Authority referred to in sub-section (1) of section 70;

(7) "Board" means, a State Electricity Board, constituted before the commencement of this Act, under sub-section (I) of section 5 of the 3 commencement of this Act, under sub-section (I) of section 5 of the Electricity (Supply) Act, 1948;

(8) "Captive generating plant" means a power plant set up by any person to generate electricity primarily for his own use and includes a power plant set up by any co-operative society or association of persons for generating electricity primarily for use of members of such cooperative society or association;

(9) "Central Commission" means the Central Electricity Regulatory Commission referred to in sub-section (1) of section 76;

(10) "Central Transmission Utility" means any Government company which the Central Government may notify under sub-section (1) of section 38;

(11) "Chairperson" means the Chairperson of the Authority or Appropriate Commission or the Appellate Tribunal as the case may be;

(12) "Cogeneration" means a process which simultaneously produces two or more forms of useful energy (including electricity);

(13) "company" means a company formed and registered under the Companies Act, 1956 and includes anybody corporate under a Central, State or Provincial Act;

(14) "Conservation" means any reduction in consumption of electricity as a result of increase in the efficiency in supply and use of electricity;

(15) "consumer" means any person who is supplied with electricity for his own use by a licensee or the Government or by any other person engaged in the business of supplying electricity to the public under this Act or any other law for the time being in force and includes any person whose premises are for the time being connected for the purpose of receiving electricity with the works of a licensee, the Government or such other person, as the case may be;

(16) "Dedicated Transmission Lines " means any electric supply line for point to point transmission which are required for the purpose of connecting electric lines or electric plants of a captive generating plant referred to in section 9 or generating station referred to in section 10 to any transmission lines or sub-stations or generating stations or the load centre, as the case may be;

(17) "Distribution licensee" means a licensee authorised to operate and maintain a distribution system for supplying electricity to the consumers in his area of supply;

(18) "distributing main" means the portion of any main with which a service line is, or is intended to be, immediately connected;

(19) "distribution system" means the system of wires and associated facilities between the delivery points on the transmission lines or the generating station connection and the point of connection to the installation of the consumers;

(20) "Electric line" means any line which is used for carrying electricity for any purpose and includes

(a) any support for any such line, that is to say, any structure, tower, pole or other thing in, on, by or from which any such line is, or may be, supported, carried or suspended; and

(b) any apparatus connected to any such line for the purpose of carrying electricity;

(21) "Electrical Inspector" means a person appointed as such by the Appropriate Government under sub-section (1) of section 162 and also includes Chief Electrical Inspector;

(22) "electrical plant" means any plant, equipment, apparatus or appliance or any part thereof used for, or connected with, the generation, transmission, distribution or supply of electricity but does not include-

(a) An electric line; or

(b) A meter used for ascertaining the quantity of electricity supplied to any premises; or

(c) An electrical equipment, apparatus or appliance under the control of a consumer;

(23) "Electricity" means electrical energy-

(a) Generated, transmitted, supplied or traded for any purpose; or

(b) Used for any purpose except the transmission of a message; 1 of 1956

(24) "Electricity Supply Code" means the Electricity Supply Code specified under section 50;

(25) "electricity system" means a system under the control of a generating company or licensee, as the case may be, having one or more -

(a) Generating stations; or

(b) Transmission lines; or

(c) Electric lines and sub-stations; and when used in the context of a State or the Union, the entire electricity system within the territories thereof;

(26) "Electricity trader" means a person who has been granted a licence to undertake trading in electricity under section 12;

(27) "franchisee means a persons authorised by a distribution licensee to distribute electricity on its behalf in a particular area within his area of supply;

(28) "generating company" means any company or body corporate or association or body of individuals, whether incorporated or not, or artificial juridical person, which owns or operates or maintains a generating station;

(29) "generate" means to produce electricity from a generating station for the purpose of giving supply to any premises or enabling a supply to be so given;

(30) "generating station" or " station" means any station for generating electricity, including any building and plant with step-up transformer, switch yard, switch-gear, cables or other appurtenant equipment, if any used for that purpose and the site thereof, a site intended to be used for a generating station, and any building used for housing the operating staff of a generating station, and where electricity is 5 operating staff of a generating station, and where electricity is generated by water-power, includes penstocks, head and tail works, main and regulating reservoirs, dams and other hydraulic works, but does not in any case include any sub-station;

(31) "Government company" shall have the meaning assigned to it in section 617 of the Companies Act, 1956;

(32) "grid" means the high voltage backbone system of inter-connected transmission lines, sub-stations and generating plants;

(33) "Grid Code" means the Grid Code specified by the Central Commission under clause (h) of sub-station (1) of section 79;

(34) "Grid Standards" means the Grid Standards specified under clause (d) of section 73 by the Authority;

(35) "high voltage line" means an electric line or cable of a nominal voltage as may be specified by the Authority from time to time;

(36) " inter-State transmission system" includes -

(i) any system for the conveyance of electricity by means of main transmission line from the territory of one State to another State;

(ii) the conveyance of electricity across the territory of an intervening State as well as conveyance within the State which is incidental to such inter-State transmission of electricity;

(iii) The transmission of electricity within the territory of a State on a system built, owned, operated, maintained or controlled by Central Transmission Utility.

(37) "intra -State transmission system" means any system for transmission of electricity other than an inter-State transmission system ;

(38) "licence" means a licence granted under section 14;

(39) " licensee " means a person who has been granted a licence under section 14;

(40) "line" means any wire, cable, tube , pipe, insulator, conductor or other similar thing (including its casing or coating) which is designed or adapted for use in carrying electricity and includes any line which surrounds or supports, or is surrounded or supported by or is installed in close proximity to, or is supported, carried or suspended in association with, any such line;

(41) "local authority" means any Nagar Panchayat, Municipal Council, municipal corporation, panchayat constituted at the village, intermediate and district levels, body or port commissioners or other authority legally entitled to, or entrusted by the Union or any State Government with, the control or management of any area or local fund;

(42) "main" means any electric supply-``` line through which electricity is, or is intended to be, supplied;

(43) "Member" means the Member of the Appropriate Commission or Authority or Joint Commission, or the Appellate Tribunal, as the case may be, and includes the Chairperson of such Commission or 6 may be, and includes the Chairperson of such Commission or Authority or appellate tribunal;

(44) "National Electricity Plan" means the National Electricity Plan notified under sub-section (4) of section 3;

(45) "National Load Despatch Centre" means the Centre established under sub-section (1) of section 26;

(46) "notification" means notification published in the Official Gazette and the expression " notify" shall be construed accordingly;

(47) "open access" means the non-discriminatory provision for the use of transmission lines or distribution system or associated facilities with such lines or system by any licensee or consumer or a person engaged in generation in accordance with the regulations specified by the Appropriate Commission;

(48) "overhead line" means an electric line which is placed above the ground and in the open air but does not include live rails of a traction system;

(49) "person" shall include any company or body corporate or association or body of individuals, whether incorporated or not, or artificial juridical person;

(50) "power system" means all aspects of generation, transmission, distribution and supply of electricity and includes one or more of the following, namely:-

(a) generating stations;

(b) transmission or main transmission lines;

(c) sub-stations;

(d) tie-lines;

(e) load despatch activities;

(f) mains or distribution mains;

(g) electric supply-lines;

(h) overhead lines;

(i) service lines;

(j) works;

(51) "premises" includes any land, building or structure;

(52) "prescribed" means prescribed by rules made by the Appropriate Government under this Act; 7

(53) "public lamp" means an electric lamp used for the lighting of any street;

(54) "real time operation" means action to be taken at a given time at which information about the electricity system is made available to the concerned Load Despatch Centre;

(55) "Regional Power Committee" means a committee established by resolution by the Central Government for a specified region for facilitating the integrated operation of the power systems in that region;

(56) "Regional Load Despatch Centre" means the centre established under sub-section (1) of section 27;

(57) "regulations" means regulations made under this Act;

(58) "repealed laws" means the Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948 and the Electricity Regulatory Commissions Act, 1998 repealed by section 185;

(59) "rules " means rules made under this Act;

(60) "schedule" means the schedule to this Act;

(61) "service-line" means any electric supply line through which electricity is, or is intended to be, supplied -

(a) to a single consumer either from a distributing main or immediately from the Distribution Licensee's premises; or

(b) from a distributing main to a group of consumers on the same premises or on contiguous premises supplied from the same point of the distributing main;

(62) "specified" means specified by regulations made by the Appropriate Commission or the Authority, as the case may be, under this Act;

(63) "stand alone system" means the electricity system set up to generate power and distribute electricity in a specified area without connection to the grid;

(64) "State Commission" means the State Electricity Regulatory Commission constituted under sub-section (1) of section 82 and includes a Joint Commission constituted under sub-section (1) of section 83;

(65) "State Grid Code" means the State Grid Code referred under clause (h) of sub-section (1) of section 86;

(66) "State Load Despatch Centre" means the centre established under subsection (1) of section 31;

(67) "State Transmission Utility" means the Board or the Government company specified as such by the State Government under sub-section (1) of section 39;

(68) "street" includes any way, road, lane, square, court, alley, passage or open space, whether a thoroughfare or not, over which the public have a right of way, and also the roadway and footway over any public bridge or causeway;

(69) "sub-station" means a station for transforming or converting electricity for the transmission or distribution thereof and includes transformers, converters, switchgears, capacitors, synchronous condensers, structures, cable and other appurtenant equipment and any buildings used for that purpose and the site thereof;

(70) "supply", in relation to electricity, means the sale of electricity to a licensee or consumer;

(71) "trading" means purchase of electricity for resale thereof and the expression "trade" shall be construed accordingly;

(72) "transmission lines" means all high pressure cables and overhead lines (not being an essential part of the distribution system of a licensee) transmitting electricity from a generating station to another generating station or a sub-station, together with any step-up and step-down transformers, switch-gear and other works necessary to and used for the control of such cables or overhead lines, and such buildings or part thereof as may be required to accommodate such transformers, switchgear and other works;

(73) "transmission licensee" means a licensee authorised to establish or operate transmission lines;

(74) "transmit" means conveyance of electricity by means of transmission lines and the expression "transmission" shall be construed accordingly;

(75) "utility" means the electric lines or electrical plant, and includes all lands, buildings, works and materials attached thereto belonging to any person acting as a generating company or licensee under the provisions of this Act;

(76) "wheeling" means the operation whereby the distribution system and associated facilities of a transmission licensee or distribution licensee, as the case may be, are used by another person for the conveyance of electricity on payment of charges to be determined under section 62;

(77) "works" includes electric line, and any building, plant, machinery, apparatus and any other thing of whatever description required to transmit, distribute or supply electricity to the public and to carry into effect the objects of a licence or sanction granted under this Act or any other law for the time being in force.

NATIONAL ELECTRICITY POLICY AND PLAN

National Electricity policy and plan [Section 3]

(1) The Central Government shall, from time to time, prepare the national electricity policy and tariff policy, in consultation with the State Governments and the Authority for development of the power system based on optimal utilisation of resources such as coal, natural gas, nuclear substances or materials, hydro and renewable sources of energy.

(2) The Central Government shall publish National Electricity Policy and tariff policy from time to time.

(3) The Central Government may, from time to time, in consultation with the State Governments and the Authority, review or revise, the National Electricity Policy and tariff policy referred to in sub-section (1).

(4) The Authority shall prepare a National Electricity Plan in accordance with the National Electricity Policy and notify such plan once in five years:

Provided that the Authority in preparing the National Electricity Plan shall publish the draft National Electricity Plan and invite suggestions and objections thereon from licensees, generating companies and the public within such time as may be prescribed:

Provided further that the Authority shall -

(a) notify the plan after obtaining the approval of the Central Government;

(b) revise the plan incorporating therein the directions, if any, given by the Central Government while granting approval under clause (a).

(5) The Authority may review or revise the National Electricity Plan in accordance with the National Electricity Policy.

National policy on standalone systems for rural areas and non-conventional energy systems [Section 4]

The Central Government shall, after consultation with the State Governments, prepare and notify a national policy, permitting stand alone systems (including those based on renewable sources of energy and non-conventional sources of energy) for rural areas.

National policy on electrification and local distribution in rural areas [Section 5]

The Central Government shall also formulate a national policy, in consultation with the State Governments and the State Commissions, for rural electrification and for bulk purchase of power and management of local distribution in rural areas through Panchayat Institutions, users' associations, co-operative societies, non- Governmental organisations or franchisees.

Joint responsibility of State Government and Central Government in rural electrification [Section 6]

The concerned State Government and the Central Government shall jointly endeavour to provide access to electricity to all areas including villages and hamlets through rural electricity infrastructure and electrification of households.

Generation Company and requirement for setting up of generating station [Section 7]

Any generating company may establish, operate and maintain a generating station without obtaining a licence under this Act if it complies with the technical standards relating to connectivity with the grid referred to in clause (b) of section 73.

Hydro- electric generation [Section 8]

(1) Notwithstanding anything contained in section 7, any generating company intending to set-up a hydro-generating station shall prepare and submit to the Authority for its concurrence, a scheme estimated to involve a capital expenditure exceeding such sum, as may be fixed by the Central Government, from time to time, by notification.

(2) The Authority shall, before concurring in any scheme submitted to it under sub-section (1) have particular regard to, whether or not in its opinion,-

(a) the proposed river-works will prejudice the prospects for the best ultimate development of the river or its tributaries for power generation, consistent with the requirements of drinking water, irrigation, navigation, flood-control, or other public purposes, and for this purpose the Authority shall satisfy itself, after consultation with the State Government, the Central Government, or such other agencies as it may deem appropriate, that an adequate study has been made of the optimum location of dams and other river-works;

(b) the proposed scheme meets, the norms regarding dam design and safety.

(3) Where a multi-purpose scheme for the development of any river in any region is in operation, the State Government and the generating company shall co-ordinate their activities with the activities of the person responsible for such scheme in so far as they are inter-related.

Captive Generation [Section 9]

(1) Notwithstanding anything contained in this Act, a person may construct, maintain or operate a captive generating plant and dedicated transmission lines:

Provided that the supply of electricity from the captive generating plant through the grid shall be regulated in the same manner as the generating station of a generating company.

Provided further that no licence shall be required under this Act for supply of electricity generated from a captive generating plant to any licensee in accordance with the provisions of this Act and the rules and regulations made thereunder and to any consumer subject to the regulations made under sub-section (2) of section 42.

(2) Every person, who has constructed a captive generating plant and maintains and operates such plant, shall have the right to open access for the purposes of carrying electricity from his captive generating plant to the destination of his use:

Provided that such open access shall be subject to availability of adequate transmission facility and such availability of transmission facility shall be determined by the Central Transmission Utility or the State Transmission Utility, as the case may be:

Provided further that any dispute regarding the availability of transmission facility shall be adjudicated upon by the Appropriate Commission.

Duties of Generating Companies [Section 10]

(1) Subject to the provisions of this Act, the duties of a generating company shall be to establish, operate and maintain generating stations, tie-lines, sub-stations and dedicated transmission lines connected therewith in accordance with the provisions of this Act or the rules or regulations made thereunder.

(2) A generating company may supply electricity to any licensee in accordance with this Act and the rules and regulations made thereunder and may, subject to the regulations made under sub-section (2) of section 42, supply electricity to any consumer.

(3) Every generating company shall -

(a) submit technical details regarding its generating stations to the Appropriate Commission and the Authority;

(b) co-ordinate with the Central Transmission Utility or the State Transmission Utility, as the case may be, for transmission of the electricity generated by it.

Direction to generating companies [Section 11]

(1) The Appropriate Government may specify that a generating company shall, in extraordinary circumstances operate and maintain any generating station in accordance with the directions of that Government.

Explanation.- For the purposes of this section, the expression " extraordinary circumstances" means circumstances arising out of threat to security of the State, public order or a natural calamity or such other circumstances arising in the public interest.

(2) The Appropriate Commission may offset the adverse financial impact of the directions referred to in sub-section (1) on any generating company in such manner as it considers appropriate.

Authorised persons to transmit, supply, etc., electricity [Section 12]

(a) transmit electricity; or

(b) distribute electricity; or

(c) undertake trading in electricity,

unless he is authorised to do so by a licence issued under section 14, or is exempt under section 13.

Power to exempt [Section 13]

The Appropriate Commission may, on the recommendations, of the Appropriate Government, in accordance with the national policy formulated under section 5 and in public interest, direct, by notification that subject to such conditions and restrictions, if any, and for such period or periods, as may be specified in the notification, the provisions of section 12 shall not apply to any local authority, Panchayat Institution, users' association, co-operative societies, nongovernmental organizations, or franchisees:

Grant of Licence [Section 14]

The Appropriate Commission may, on application made to it under section 15, grant any person licence to any person -

(a) to transmit electricity as a transmission licensee; or

(b) to distribute electricity as a distribution licensee; or

(c) to undertake trading in electricity as an electricity trader, in any area which may be specified in the licence:

Provided that any person engaged in the business of transmission or supply of electricity under the provisions of the repealed laws or any Act specified in the Schedule on or before the appointed date shall be deemed to be a licensee under this Act for such period as may be stipulated in the licence, clearance or approval granted to him under the repealed laws or such Act specified in the Schedule, and the provisions of the repealed laws or such Act specified in the Schedule in respect of such licence shall apply for a period of one year from the date of commencement of this Act or such earlier period as may be specified, at the request of the licensee, by the Appropriate Commission and thereafter the provisions of this Act shall apply to such business:

Provided further that the Central Transmission Utility or the State Transmission Utility shall be deemed to be a transmission licensee under this Act:

Provided also that in case an Appropriate Government transmits electricity or distributes electricity or undertakes trading in electricity, whether before or after the commencement of this Act, such Government shall be deemed to be a licensee under this Act, but shall not be required to obtain a licence under this Act:

Provided also that the Damodar Valley Corporation, established under sub-section (1) of section 3 of the Damodar Valley Corporation Act, 1948, shall be deemed to be a licensee under this Act but shall not be required to obtain a licence under this Act and the provisions of the Damodar Valley Corporation Act, 1948, in so far as they are not inconsistent with the provisions of this Act, shall continue to apply to that Corporation:

Provided also that the Government company or the company referred to in sub-section (2) of section 131 of this Act and the company or companies created in pursuance of the Acts specified in the Schedule, shall be deemed to be a licensee under this Act:

Provided also that the Appropriate Commission may grant a licence to two or more persons for distribution of electricity through their own distribution system within the same area, subject to the conditions that the applicant for grant of licence within the same area shall, without prejudice to the other conditions or requirements under this Act, comply with the additional requirements (including the capital adequacy, credit-worthiness, or code of conduct) as may be prescribed by the Central Government, and no such applicant who complies with all the requirements for grant of licence, shall be refused grant of licence on the ground that there already exists a licensee in the same area for the same purpose:

Provided also that in a case where a distribution licensee proposes to undertake distribution of electricity for a specified area within his area of supply through another person, that person shall not be required to obtain any separate licence from the concerned State Commission and such distribution licensee shall be responsible for distribution of electricity in his area of supply:

Provided also that where a person intends to generate and distribute electricity in a rural area to be notified by the State Government, such person shall not require any licence for such generation and distribution of electricity, but he shall comply with the measures which may be specified by the Authority under section 53:

Provided also that a distribution licensee shall not require a licence to undertake trading in electricity.

Procedure for Grant of Licence [Section 15]

(1) Every application under section 14 shall be made in such form and in such manner as may be specified by the Appropriate Commission and shall be accompanied by such fee as may be prescribed.

(2) Any person who has made an application for grant of licence shall, within seven days after

making such application, publish a notice of his application with such particulars and in such manner as may be specified and a licence shall not be granted -

(i) until the objections, if any, received by the Appropriate Commission in response to publication of the application have been considered by it:

Provided that no objection shall be so considered unless it is received before the expiration of thirty days from the date of the publication of such notice as aforesaid;

(ii) until, in the case of an application for a licence for an area including the whole or any part of any cantonment, aerodrome, fortress, arsenal, dockyard or camp or of any building or place in the occupation of the Government for defence purposes, the Appropriate Commission has ascertained that there is no objection to the grant of the licence on the part of the Central Government.

(3) A person intending to act as a transmission licensee shall, immediately on making the application, forward a copy of such application to the Central Transmission Utility or the State Transmission Utility, as the case may be.

(4) The Central Transmission Utility or the State Transmission Utility, as the case may be, shall, within thirty days after the receipt of the copy of the application referred to in sub-section (3), send its recommendations, if any, to the Appropriate Commission:

Provided that such recommendations shall not be binding on the Commission.

(5) Before granting a licence under section 14, the Appropriate Commission shall

(a) publish a notice in two such daily newspapers, as that Commission may consider necessary, stating the name of the person to whom it proposes to issue the licence;

(b) consider all suggestions or objections and the recommendations, if any, of the Central Transmission Utility or State Transmission Utility, as the case may be.

(6) Where a person makes an application under sub-section (1) of section 14 to act as a licensee, the Appropriate Commission shall, as far as practicable, within ninety days after receipt of such application, -

(a) issue a licence subject to the provisions of this Act and the rules and regulations made thereunder; or

(b) reject the application for reasons to be recorded in writing if such application does not conform to the provisions of this Act or the rules and regulations made thereunder or the provisions of any other law for the time being in force:

Provided that no application shall be rejected unless the applicant has been given an opportunity of being heard.

(7) The Appropriate Commission shall, immediately after issue of licence, forward a copy of the licence to the Appropriate Government , Authority, local authority, and to such other person as the Appropriate Commission considers necessary.

(8) A licence shall continue to be in force for a period of twenty five years unless such licence is revoked.

Conditions of licence [Section 16]

The Appropriate Commission may specify any general or specific conditions which shall apply either to a licensee or class of licensees and such conditions shall be deemed to be conditions of such licence:

Provided that the Appropriate Commission shall, within one year from the appointed date, specify any general or specific conditions of licence applicable to the licensees referred to in the first, second, third, fourth and fifth provisos to section 14 after the expiry of one year from the commencement of this Act.

Licensee not to do certain things [Section 17]

(1) No licensee shall, without prior approval of the Appropriate Commission, -

(a) undertake any transaction to acquire by purchase or takeover or otherwise, the utility of any other licensee; or

(b) merge his utility with the utility of any other licensee:

Provided that nothing contained in this sub-section shall apply if the utility of the licensee is situate in a State other than the State in which the utility referred to in clause (a) or clause (b) is situate.

(2) Every licensee shall, before obtaining the approval under subsection (1), give not less than one month's notice to every other licensee who transmits or distributes, electricity in the area of such licensee who applies for such approval.

(3) No licensee shall at any time assign his licence or transfer his utility, or any part thereof, by sale, lease, exchange or otherwise without the prior approval of the Appropriate Commission.

(4) Any agreement relating to any transaction specified in subsection (1) or sub-section (3), unless made with, the prior approval of the Appropriate Commission, shall be void.

Amendment of licence [Section 18]

(1) Where in its opinion the public interest so permits, the Appropriate Commission, may, on the application of the licensee or otherwise, make such alterations and amendments in the terms and conditions of a licence as it thinks fit:

Provided that no such alterations or amendments shall be made except with the consent of the licensee unless such consent has, in the opinion of the Appropriate Commission, been unreasonably withheld.

(2) Before any alterations or amendments in the licence are made under this section, the following provisions shall have effect, namely: -

(a) where the licensee has made an application under sub-section (1) proposing any alteration or modifications in his licence, the licensee shall publish a notice of such application with such particulars and in such manner as may be specified;

(b) in the case of an application proposing alterations or modifications in the area of supply comprising the whole or any part of any cantonment, aerodrome, fortress, arsenal, dockyard or camp or of any building or place in the occupation of the Government for defence purposes, the Appropriate Commission shall not make any alterations or modifications except with the consent of the Central Government;

(c) where any alterations or modifications in a licence are proposed to be made otherwise than on the application of the licensee, the Appropriate Commission shall publish the proposed alterations or modifications with such particulars and in such manner as may be specified;

(d) the Appropriate Commission shall not make any alterations or modification unless all suggestions or objections received within thirty days from the date of the first publication of the notice have been considered.

Revocation of licence [Section 19]

(1) If the Appropriate Commission, after making an enquiry, is satisfied that public interest so requires, it may revoke a licence in any of the following cases, namely: -

(a) where the licensee, in the opinion of the Appropriate Commission, makes wilful and prolonged default in doing anything required of him by or under this Act or the rules or regulations made thereunder;

(b) where the licensee breaks any of the terms or conditions of his licence the breach of which is expressly declared by such licence to render it liable to revocation;

(c) where the licensee fails, within the period fixed in this behalf by his licence, or any longer period which the Appropriate Commission may have granted therefor –

(i) to show, to the satisfaction of the Appropriate Commission, that he is in a position fully and efficiently to discharge the duties and obligations imposed on him by his licence; or and obligations imposed on him by his licence; or

(ii) to make the deposit or furnish the security, or pay the fees or other charges required by his licence;

(d) where in the opinion of the Appropriate Commission the financial position of the licensee is such that he is unable fully and efficiently to discharge the duties and obligations imposed on him by his licence.

(2) Where in its opinion the public interest so requires, the Appropriate Commission may, on application, or with the consent of the licensee, revoke his licence as to the whole or any part of his area of distribution or transmission or trading upon such terms and conditions as it thinks fit.

(3) No licence shall be revoked under sub-section (1) unless the Appropriate Commission has given to the licensee not less than three months'notice, in writing, stating the grounds on which it is proposed to revoke the licence, and has considered any cause shown by the licensee within the period of that notice, against the proposed revocation.

(4) The Appropriate Commission may, instead of revoking a licence under sub-section (1), permit it to remain in force subject to such further terms and conditions as it thinks fit to impose, and any further terms or conditions so imposed shall be binding upon and be observed by the licensee and shall be of like force and effect as if they were contained in the licence.

(5) Where the Commission revokes a licence under this section, it shall serve a notice of revocation upon the licensee and fix a date on which the revocation shall take effect.

(6) Where an Appropriate Commission has given notice for revocation of licence under sub-section (5), without prejudice to any penalty which may be imposed or prosecution proceeding which may be initiated under this Act, the licensee may, after prior approval of that Commission, sell his utility to any person who is found eligible by that Commission for grant of licence.

Sale of utilities of licensees [Section 20]

(1) Where the Appropriate Commission revokes under section 19 the licence of any licensee,the following provisions shall apply, namely:-

(a) the Appropriate Commission shall invite applications for acquiring the utility of the licensee whose licence has been revoked and determine which of such applications should be accepted, primarily on the basis of the highest and best price offered for the utility;

(b) the Appropriate Commission may, by notice in writing, require the licensee to sell his utility and thereupon the licensee shall sell his utility to the person (hereafter in this section referred to as the " purchaser") whose application has been accepted by that Commission;

(c) all the rights, duties, obligations and liabilities of the licensee, on and from the date of revocation of licence or on and from the date, if earlier, on which the utility of the licensee is sold to a purchaser, shall absolutely cease except for any liabilities which have accrued prior to that date;

(d) the Appropriate Commission may make such interim arrangements in regard to the operation of the utility as may be considered appropriate including the appointment of Administrators;

(e) The Administrator appointed under clause (d) shall exercise such powers and discharge such functions as the Appropriate Commission may direct.

(2) Where a utility is sold under sub-section (1), the purchaser shall pay to the licensee the purchase price of the utility in such manner as may be agreed upon.

(3) Where the Appropriate Commission issues any notice under subsection (1) requiring the licensee to sell the utility, it may, by such notice, require the licensee to deliver the utility, and thereupon the licensee shall deliver on a date specified in the notice, the utility to the designated purchaser on payment of the purchase price thereof.

(4) Where the licensee has delivered the utility referred to in subsection (3) to the purchaser but its sale has not been completed by the date fixed in the notice issued under that sub-section, the Appropriate Commission may, if it deems fit, permit the intending purchaser to operate and maintain the utility system pending the completion of the sale.

Vesting of utility in purchaser [Section 21]

Where a utility is sold under section 20 or section 24, then, upon completion of the sale or on the date on which the utility is delivered to the intending purchaser, as the case may be, whichever is earlier-

(a) the utility shall vest in the purchaser or the intending purchaser, as the case may be, free from any debt, mortgage or similar obligation of the licensee or attaching to the utility:

Provided that any such debt, mortgage or similar obligation shall attach to the purchase money in substitution for the utility; and

(b) the rights, powers, authorities, duties and obligations of the licensee under his licence shall stand transferred to the purchaser and such purchaser shall be deemed to be the licensee.

Provisions where no purchase takes place [Section 22]

(1) If the utility is not sold in the manner provided under section 20 or section 24, the Appropriate Commission may, to protect the interest of consumers or in public interest, issue such directions or formulate such scheme as it may deem necessary for operation of the utility.

(2) Where no directions are issued or scheme is formulated by the Appropriate Commission under sub-section (1), the licensee referred to in section 20 or section 24 may dispose of the utility in such manner as it may deem fit:

Provided that, if the licensee does not dispose of the utility, within a period of six months from the date of revocation under section 20 or section 24, the Appropriate Commission may cause the works of the licensee in, under, over, along, or across any street or public land to be removed and every such street or public land to be reinstated, and recover the cost of such removal and reinstatement from the licensee.

Directions to licensees [Section 23]

If the Appropriate Commission is of the opinion that it is necessary or expedient so to do for maintaining the efficient supply, securing the equitable distribution of electricity and promoting competition, it may, by order, provide for regulating supply, distribution, consumption or use thereof.

Suspension of distribution licence and sale of utility [Section 24]

(1) If at any time the Appropriate Commission is of the opinion that a distribution licensee –

(a) has persistently failed to maintain uninterrupted supply of electricity conforming to standards regarding quality of electricity to the consumers; or

(b) is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or

(c) has persistently defaulted in complying with any direction given by the Appropriate Commission under this Act; or

(d) has broken the terms and conditions of licence,

and circumstances exist which render it necessary for it in public interest so to do, the Appropriate Commission may, for reasons to be recorded in writing, suspend, for a period not exceeding one year, the licence of the distribution licensee and appoint an Administrator to discharge the functions of the distribution licensee in accordance with the terms and conditions of licence:

Provided that before suspending a licence under this section, the Appropriate Commission shall give a reasonable opportunity to the distribution licensee to make representations against the proposed suspension of license and shall consider the representations, if any, of the distrbution licensee.

(2) Upon suspension of license under sub-section (1) the utilities of the distribution licensee shall vest in the Administrator for a period not exceeding one year or up to the date on which such utility is sold in accordance with the provisions contained in section 20, whichever is later.

(3) The Appropriate Commission shall, within one year of appointment of the Administrator under sub-section (1) either revoke the licence in accordance with the provisions contained in section 19 or revoke suspension of the licence and restore the utility to the distribution licensee whose licence had been suspended, as the case may be.

(4) In case where the Appropriate Commission revokes the licence under sub-section (3), the utility of the distribution licensee shall be sold within a period of one year from the date of revocation of the licence in accordance with the provisions of section 20 and the price after deducting the administrative and other expenses on sale of utilities be remitted to the distribution licensee.

Inter-State, regional and Inter-Regional transmission [Section 25]

For the purposes of this Part, the Central Government may, make regionwise demarcation of the country, and, from time to time, make such modifications therein as it may consider necessary for the efficient, economical and integrated transmission and supply of electricity, and in particular to facilitate voluntary interconnections and co-ordination of facilities for the inter-State, regional and interregional generation and transmission of electricity.

National Load Despatch centre [Section 26]

(1) The Central Government may establish a centre at the national level, to be known as the National Load Despatch Centre for optimum scheduling and despatch of electricity among the Regional Load Despatch Centres.

(2) The constitution and functions of the National Load Despatch Centre shall be such as may be prescribed by the Central Government:

Provided that the National Load Despatch Centre shall not engage in the business of trading in electricity.

(3) The National Load Despatch Centre shall be operated by a Government company or any authority or corporation established or constituted by or under any Central Act, as may be notified by the Central Government.

Constitution of Regional Load Despatch Centre [Section 27]

(1) The Central Government shall establish a centre for each region to be known as the Regional Load Despatch Centre having territorial jurisdiction as determined by the Central Government in

accordance with section 25 for the purposes of exercising the powers and discharging the power and discharging the functions under this Part.

(2) The Regional Load Despatch Centre shall be operated by a Government Company or any authority or corporation established or constituted by or under any Central Act, as may be notified by the Central Government:

Provided that until a Government company or authority or corporation referred to in this sub-section is notified by the Central Government, the Central Transmission Utility shall operate the Regional Load Despatch Centre: Provided further that no Regional Load Despatch Centre shall engage in the business of generation of electricity or trading in electricity.

Functions of Regional Load Despatch Centre [Section 28]

(1) The Regional Load Despatch Centre shall be the apex body to ensure integrated operation of the power system in the concerned region.

(2) The Regional Load Despatch Centre shall comply with such principles, guidelines and methodologies in respect of the wheeling and optimum scheduling and despatch of electricity as the Central Commission may specify in the Grid Code.

(3) The Regional Load Despatch Centre shall -

(a) be responsible for optimum scheduling and despatch of electricity within the region, in accordance with the contracts entered into with the licensees or the generating companies operating in the region;

(b) monitor grid operations;

(c) keep accounts of the quantity of electricity transmitted through the regional grid;

(d) exercise supervision and control over the inter-State transmission system; and

(e) be responsible for carrying out real time operations for grid control and despatch of electricity within the region through secure and economic operation of the regional grid in accordance with the Grid Standards and the Grid Code.

(4) The Regional Load Despatch Centre may levy and collect such fee and charges from the generating companies or licensees engaged in inter-State transmission of electricity as may be specified by the Central Commission.

Compliance of directions [Section 29]

(1) The Regional Load Despatch Centre may give such directions and exercise such supervision and control as may be required for ensuring stability of grid operations and for achieving the maximum economy and efficiency in the operation of the power system in the region under its control.

(2) Every licensee, generating company, generating station, substation and any other person connected with the operation of the power system shall comply with the direction issued by the Regional Load Despatch Centres under sub-section (1).

(3) All directions issued by the Regional Load Despatch Centres to any transmission licensee of State transmission lines or any other licensee of the State or generating company (other than those connected to inter State transmission system) or sub-station in the State shall be issued through the State Load Despatch Centre and the State Load Despatch Centres shall ensure that such directions are duly complied with the licensee or generating company or sub-station.

(4) The Regional Power Committee in the region may, from time to time, agree on matters concerning the stability and smooth operation of the integrated grid and economy and efficiency in the operation of the power system in that region.

(5) If any dispute arises with reference to the quality of electricity or safe, secure and integrated operation of the regional grid or in relation to any direction given under sub-section (1), it shall be referred to the Central Commission for decision :

Provided that pending the decision of the Central Commission, the directions of the Regional Load Despatch Centre shall be complied with by the State Load Despatch Centre or the licensee or the generating company, as the case may be.

(6) If any licensee, generating company or any other person fails to comply with the directions issued under sub-section (2) or sub-section (3), he shall be liable to penalty not exceeding rupees fifteen lacs.

INTRA-STATE TRANSMISSION

Transmission within a State [Section 30]

The State Commission shall facilitate and promote transmission, wheeling and inter-connection arrangements within its territorial jurisdiction for the transmission and supply of electricity by economical and efficient utilisation of the electricity.

Constitution of state Load Despatch Centres [Section 31]

(1) The State Government shall establish a Centre to be known as the State Load Despatch Centre for the purposes of exercising the powers and discharging the functions under this Part.

(2) The State Load Despatch Centre shall be operated by a Government company or any authority or corporation established or constituted by or under any State Act, as may be notified by the State Government.

Provided that until a Government company or any authority or corporation is notified by the State Government, the State Transmission Utility shall operate the State Load Despatch Centre:

Provided further that no State Load Despatch Centre shall engage in the business of trading in electricity.

Functions of state Load Despatch Centres [Section 32]

(1) The State Load Despatch Centre shall be the apex body to ensure integrated operation of the power system in a State.

(2) The State Load Despatch Centre shall -

  (a) be responsible for optimum scheduling and despatch of electricity within a State, in accordance with the contracts entered into with the licensees or the generating companies operating in that State;

  (b) monitor grid operations;

  (c) keep accounts of the quantity of electricity transmitted through the State grid;

  (d) exercise supervision and control over the intra-state transmission system; and

  (e) be responsible for carrying out real time operations for grid control and despatch of electricity within the State through secure and economic operation of the State grid in accordance with the Grid Standards and the State Grid Code.

(3) The State Load Despatch Centre may levy and collect such fee and charges from the generating companies and licensees engaged in intra-State transmission of electricity as may be specified by the State Commission.

Compliance of directions [Section 33]

(1) The State Load Despatch Centre in a State may give such directions and exercise such supervision

and control as may be required for ensuring the integrated grid operations and for achieving the maximum economy and efficiency in the operation of power system in that State.

(2) Every licensee, generating company, generating station, substation and any other person connected with the operation of the power system shall comply with the direction issued by the State Load Depatch Centre under subsection (1).

(3) The State Load Despatch Centre shall comply with the directions of the Regional Load Despatch Centre.

(4) If any dispute arises with reference to the quality of electricity or safe, secure and integrated operation of the State grid or in relation to any direction given under sub-section (1) , it shall be referred to the State Commission for decision:

Provided that pending the decision of the State Commission, the direction of the State Load Despatch Centre shall be complied with by the licensee or generating company.

(5) If any licensee, generating company or any other person fails to comply with the directions issued under sub-section(1), he shall be liable to penalty not exceeding rupees five lacs.

Other provisions relating to transmission

Grid Standards [Section 34]

Every transmission licensee shall comply with such technical standards, of operation and maintenance of transmission lines, in accordance with the Grid Standards, as may be specified by the Authority.

Intervening transmission facilities [Section 35]

The Appropriate Commission may, on an application by any licensee, by order require any other licensee owning or operating intervening transmission facilities to provide the use of such facilities to the extent of surplus capacity available with such licensee.

Provided that any dispute regarding the extent of surplus capacity available with the licensee, shall be adjudicated upon by the Appropriate Commission.

Charges for intervening transmission facilities [Section 36]

(1) Every licensee shall, on an order made under section 35, provided his intervening transmission facilities at rates, charges and terms and conditions as may be mutually agreed upon :

Provided that the Appropriate Commission may specify rates, charges and terms and conditions if these cannot be mutually agreed upon by the licensees.

(2) The rates, charges and terms and conditions referred to in subsection (1) shall be fair and reasonable, and may be allocated in proportion to the use of such facilities.

Explanation. - For the purposes of section 35 and 36, the expression " intervening transmission facilities" means the electric lines owned or operated by a licensee where such electric lines can be utilised for transmitting electricity for and on behalf of another licensee at his request and on payment of a tariff or charge.

Direction by appropriate Government [Section 37]

The Appropriate Government may issue directions to the Regional Load Despatch Centres or State Load Despatch Centres, as the case may be, to take such measures as may be necessary for maintaining smooth and stable transmission and supply of electricity to any region or State.

Central Transmission Utility and functions [Section 38]

(1) The Central Government may notify any Government company as the Central Transmission Utility:

Provided that the Central Transmission Utility shall not engage in the business of generation of electricity or trading in electricity:

Provided further that, the Central Government may transfer, and vest any property, interest in property, rights and liabilities connected with, and personnel involved in transmission of electricity of such Central Transmission Utility, to a company or companies to be incorporated under the Companies Act, 1956 to function as a transmission licensee, through a transfer scheme to be effected in the manner specified under Part XIII and such company or companies shall be deemed to be transmission licensees under this Act.

(2) The functions of the Central Transmission Utility shall be -

(a) to undertake transmission of electricity through inter-State transmission system;

(b) to discharge all functions of planning and co-ordination relating to inter-state transmission system with -

(i) State Transmission Utilities;

(ii) Central Government;

(iii) State Governments;

(iv) generating companies;

(v) Regional Power Committees;

(vi) Authority;

(vii) licensees;

(viii) any other person notified by the Central Government in this behalf;

(c) to ensure development of an efficient, co-ordinated and economical system of inter-State transmission lines for smooth flow of electricity from generating stations to the load centres;

(d) to provide non-discriminatory open access to its transmission system for use by-

(i) any licensee or generating company on payment of the transmission charges; or

(ii) any consumer as and when such open access is provided by the State Commission under sub-section (2) of section 42, on payment of the transmission charges and a surcharge thereon, as may be specified by the Central Commission:

Provided that such surcharge shall be utilised for the purpose of meeting the requirement of current level cross-subsidy:

Provided further that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the Central Commission:

Provided also that the manner of payment and utilisation of the surcharge shall be specified by the Central Commission:

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

State Transmission Utility and functions [Section 39]

(1) The State Government may notify the Board or a Government company as the State Transmission Utility:

Provided that the State Transmission Utility shall not engage in the business of trading in electricity:

Provided further that the State Government may transfer, and vest any property, interest in property, rights and liabilities connected with, and personnel involved in transmission of electricity, of such State Transmission Utility, to a company or companies to be incorporated under the Companies Act, 1956 to function as transmission licensee through a transfer scheme to be effected in the manner specified under Part XIII and such company or companies shall be deemed to be transmission licensees under this Act.

(2) The functions of the State Transmission Utility shall be -

(a) to undertake transmission of electricity through intra-State transmission system;

(b) to discharge all functions of planning and co-ordination relating to intra-state transmission system with -

(i) Central Transmission Utility;

(ii) State Governments;

(iii) generating companies;

(iv) Regional Power Committees;

(v) Authority;

(vi) licensees;

(vii) any other person notified by the State Government in this behalf;

(c) to ensure development of an efficient, co-ordinated and economical system of intra-State transmission lines for smooth flow of electricity from a generating station to the load centres;

(d) to provid non-discriminatory open access to its transmission system for use by-

(i) any licensee or generating company on payment of the transmission charges ; or

(ii) any consumer as and when such open access is provided by the State Commission under sub-section (2) of section 42, on payment of the transmission charges and a surcharge thereon, as may be specified by the State Commission:

Provided that such surcharge shall be utilised for the purpose of meeting the requirement of current level cross-subsidy:

Provided further that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the State Commission:

Provided also that the manner of payment and utilisation of the surcharge shall be specified by the State Commission.

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

Duties of Transmission licensees [Section 40]

It shall be the duty of a transmission licensee -

(a) to build, maintain and operate an efficient, co-ordinated and economical inter-State transmission system or intra-State transmission system, as the case may be;

(b) to comply with the directions of the Regional Load Despatch Centre and the State Load Despatch Centre as the may be;.

(c) to provide non-discriminatory open access to its transmission system for use by-

(i) any licensee or generating company on payment of the transmission charges; or

(ii) any consumer as and when such open access is provided by the State Commission under sub-section (2) of section 42, on payment of the transmission charges and a surcharge thereon, as may be specified by the State Commission:

Provided that such surcharge shall be utilised for the purpose of meeting the requirement of current level cross-subsidy:

Provided further that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the Appropriate Commission:

Provided also that the manner of payment and utilisation of the surcharge shall be specified by the Appropriate Commission:

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

Other business of Transmission Licensee [Section 41]

A transmission licensee may, with prior intimation to the Appropriate Commission , engage in any business for optimum utilisation of its assets:

Provided that a proportion of the revenues derived from such business shall, as may be specified by the Appropriate Commission, be utilised for reducing its charges for transmission and wheeling:

Provided further that the transmission licensee shall maintain separate accounts for each such business undertaking to ensure that transmission business neither subsidies in any way such business undertaking nor encumbers its transmission assets in any way to support such business:

Provided also that no transmission licensee shall enter into any contract or otherwise engage in the business to in trading electricity.

Provisions with respect to distribution licensees

Duties of distribution Licensee and open access [Section 42]

(1) It shall be the duty of a distribution licensee to develop and maintain an efficient, co-ordinated and economical distribution system in his area of supply and to supply electricity in accordance with the provisions contained in this Act.

(2) The State Commission shall introduce open access in such phases and subject to such conditions, (including the cross subsidies, and other operational constraints) as may be specified within one year of the appointed date by it and in specifying the extent of open access in successive phases and in determining the charges for wheeling, it shall have due regard to all relevant factors including such cross subsidies, and other operational constraints:

Provided that such open access shall be allowed on payment of a surcharge in addition to the charges for wheeling as may be determined by the State Commission :

Provided further that such surcharge shall be utilised to meet the requirements of current level of cross subsidy within the area of supply of the distribution licensee :

Provided also that such surcharge and cross subsidies shall be progressively reduced in the manner as may be specified by the State Commission:

Provided also that such surcharge shall not be leviable in case open access is provided to a person who has established a captive generating plant for carrying the electricity to the destination of his own use.

(3) Where any person, whose premises are situated within the area of supply of a distribution licensee, (not being a local authority engaged in the business of distribution of electricity before

the appointed date) requires a supply of electricity from a generating company or any licensee other than such distribution licensee, such person may, by notice, require the distribution licensee for wheeling such electricity in accordance with regulations made by the State Commission and the duties of the distribution licensee with respect to such supply shall be of a Common carrier providing non-discriminatory open access.

(4) Where the State Commission permits a consumer or class of consumers to receive supply of electricity from a person other than the distribution licensee of his area of supply, such consumer shall be liable to pay an additional surcharge on the charges of wheeling, as may be specified by the State Commission, to meet the fixed cost of such distribution licensee arising out of his obligation to supply.

(5) Every distribution licensee shall, within six months from the appointed date or date of grant of licence, whichever is earlier, establish a forum for redressal of grievances of the consumers in accordance with the guidelines as may be specified by the State Commission.

(6) Any consumer, who is aggrieved by non-redressal of his grievances under sub-section (5), may make a representation for the redressal of his grievance to an authority to be known as Ombudsman to be appointed or designated by the State Commission.

(7) The Ombudsman shall settle the grievance of the consumer within such time and in such manner as may be specified by the State Commission.

(8) The provisions of sub-sections (5),(6) and (7) shall be without prejudice to right which the consumer may have apart from the rights conferred upon him by those sub-sections.

Duty to supply on request [Section 43]

(1) Save as Otherwise provided in this Act, every distribution licensee, shall, on an application by the owner or occupier of any premises, give supply of electricity to such premises, within one month after receipt of the application requiring such supply:

Provided that where such supply requires extension of distribution mains, or commissioning of new sub-stations, the distribution licensee shall supply the electricity to such premises immediately after such extension or commissioning or within such period as may be specified by the Appropriate commissioning or within such period as may be specified by the Appropriate Commission.

Provided further that in case of a village or hamlet or area wherein no provision for supply of electricity exists, the Appropriate Commission may extend the said period as it may consider necessary for electrification of such village or hamlet or area.

Explanation.-For the purposes of this sub-section, "application" means the application complete in all respects in the appropriate form, as required by the distribution licensee, along with documents showing payment of necessary charges and other compliances.

(2) It shall be the duty of every distribution licensee to provide, if required, electric plant or electric line for giving electric supply to the premises specified in sub-section (1) :

Provided that no person shall be entitled to demand, or to continue to receive, from a licensee a supply of electricity for any premises having a separate supply unless he has agreed with the licensee to pay to him such price as determined by the Appropriate Commission .

(3) If a distribution licensee fails to supply the electricity within the period specified in sub-section (1), he shall be liable to a penalty which may extend to one thousand rupees for each day of default.

Exceptions from duty to supply electricity [Section 44]

Nothing contained in section 43 shall be taken as requiring a distribution licensee to give supply of electricity to any premises if he is prevented from doing so by cyclone, floods, storms or other occurrences beyond his control.

Power to recover charges [Section 45]

(1) Subject to the provisions of this section, the prices to be charged by a distribution licensee for the supply of electricity by him in pursuance of section 43 shall be in accordance with such tariffs fixed from time to time and conditions of his licence.

(2) The charges for electricity supplied by a distribution licensee shall be -

(a) fixed in accordance with the methods and the principles as may be specified by the concerned State Commission ;

(b) published in such manner so as to give adequate publicity for such charges and prices.

(3) The charges for electricity supplied by a distribution licensee may include -

(a) a fixed charge in addition to the charge for the actual electricity supplied;

(b) a rent or other charges in respect of any electric meter or electrical plant provided by the distribution licensee.

(4) Subject to the provisions of section 62, in fixing charges under this section a distribution licensee shall not show undue preference to any person or class of persons or discrimination against any person or class of persons.

(5) The charges fixed by the distribution licensee shall be in accordance with the provisions of this Act and the regulations made in this behalf by the concerned State Commission.

Power to recover expenditure [Section 46]

The State Commission may, by regulations, authorise a distribution licensee to charge from a person requiring a supply of electricity in pursuance of section 43 any expenses reasonably incurred in providing any electric line or electrical plant used for the purpose of giving that supply.

Power to require security [Section 47]

(1) Subject to the provisions of this section, a distribution licensee may require any person, who requires a supply of electricity in pursuance of section 43, to give him reasonable security, as determined by regulations, for the payment to him of all monies which may become due to him -

(a) in respect of the electricity supplied to such persons; or

(b) where any electric line or electrical plant or electric meter is to be provided for supplying electricity to person, in respect of the provision of such line or plant or meter,

and if that person fails to give such security, the distribution licensee may, if he thinks fit, refuse to give the supply or to provide the line or plant or meter for the period during which the failure continues.

(2) Where any person has not given such security as is mentioned in subsection (1) or the security given by any person has become invalid or insufficient, the distribution licensee may, by notice, require that person, within thirty days after the service of the notice, to give him reasonable security for the payment of all monies which may become due to him in respect of the supply of electricity or provision of such line or plant or meter.

(3) If the person referred to in sub-section(2) fails to give such security, the distribution licensee may, if he thinks fit, discontinue the supply of electricity for the period during which the failure continues.

(4) The distribution licensee shall pay interest equivalent to the bank rate or more, as may be specified by the concerned State Commission, on the security referred to in sub-section (1) and refund such security on the request of the person who gave such security.

(5) A distribution licensee shall not be entitled to require security in pursuance of clause (a) of sub-

section (1) if the person requiring the supply is prepared to take the supply through a pre-payment meter.

Additional terms of supply [Section 48]

A distribution licensee may require any person who requires a supply of electricity in pursuance of section 43 to accept -

(a) any restrictions which may be imposed for the purpose of enabling the distribution licensee to comply with regulations made under section 53;

(b) any terms restricting any liability of the distribution licensee for economic loss resulting from negligence of the person to whom the electricity is supplied.

Agreements with respect to supply or purchase of electricity [Section 49]

Where the Appropriate Commission has allowed open access to certain consumers under section 42, such consumers notwithstanding the provisions contained in clause (d) of sub-section (1) of section 62, may enter into an agreement with any person for supply or purchase of electricity on such terms and conditions (including tariff) as may be agreed upon by them.

The Electricity Supply Code [Section 50]

The State Commission shall specify an electricity supply code to provide for recovery of electricity charges, intervals for billing of electricity charges, disconnection of supply of electricity for non-payment thereof, restoration of supply of electricity, measures for preventing tampering, distress or damage to electrical plant or electrical line or meter, entry of distribution licensee or any person acting on his behalf for disconnecting supply and removing the meter, entry for replacing, altering or maintaining electric lines or electrical plants or meter and such other matters.

Provisions with respect to electricity trader [Section 52]

(1) Without prejudice to the provisions contained in clause (c) of section 12, the Appropriate Commission may, specify the technical requirement, capital adequacy requirement and credit worthiness for being an electricity trader.

(2) Every electricity trader shall discharge such duties, in relation to supply and trading in electricity, as may be specified by the Appropriate Commission.

Provisions relating to safety and electricity supply [Section 53]

(1) The Authority may in consultation with the State Government, specify suitable measures for–

(a) protecting the public (including the persons engaged in the generation, transmission or distribution or trading) from dangers arising from the generation, transmission or distribution or trading of electricity, or use of electricity supplied or installation, maintenance or use of any electric line or electrical plant;

(b) eliminating or reducing the risks of personal injury to any person, or damage to property of any person or interference with use of such property ;

(c) prohibiting the supply or transmission of electricity except by means of a system which conforms to the specification as may be specified;

(d) giving notice in the specified form to the Appropriate Commission and the Electrical Inspector, of accidents and failures of supplies or transmissions of electricity;

(e) keeping by a generating company or licensee the maps, plans and sections relating to supply or transmission of electricity;

(f) inspection of maps, plans and sections by any person authorized by it or by Electrical Inspector or by any person on payment of specified fee;

(g) specifying action to be taken in relation to any electric line or electrical plant, or any electrical appliance under the control of a consumer for the purpose of eliminating or reducing a risk of personal injury or damage to property or interference with its use;

Control of transmission and use of electricity [Section 54]

(1) Save as otherwise exempted under this Act, no person other than Central Transmission Utility or a State Transmission Utility, or a licensee shall transmit or use electricity at a rate exceeding two hundred and fifty watts and one hundred volts –

(a) in any street, or

(b) in any place,-

(i) in which one hundred or more persons are ordinarily likely to be assembled; or

(ii) which is a factory within the meaning of the Factories Act, 1948 or a mine within the meaning of the Mines Act, 1952; or

(iii) to which the State Government, by general or special order, declares the provisions of this sub-section to apply, without giving, before the commencement of transmission or use of electricity, not less than seven days' notice in writing of his intention to the Electrical Inspector and to the District Magistrate, or the Commissioner of Police, as the case may be, containing particulars of the electrical installation and plant, if any, the nature and the purpose of supply and complying with such of the provisions of Part XI of this Act, as may be applicable:

Provided that nothing in this section shall apply to electricity used for the public carriage of passengers, animals or goods, on, or for the lighting or ventilation of the rolling stock of any railway or tramway subject to the provisions of the Railways Act, 1989.

(2) Where any difference or dispute arises as to whether a place is or is not one in which one hundred or more persons are ordinarily likely to be assembled, the matter shall be referred to the State Government, and the decision of the State Government thereon shall be final.

(3) The provisions of this section shall be binding on the Government.

Use, etc., of meters [Section 55]

(1) No licensee shall supply electricity, after the expiry of two years from the appointed date, except through installation of a correct meter in accordance with regulations to be made in this behalf by the Authority:

Provided that the licensee may require the consumer to give him security for the price of a meter and enter into an agreement for the hire thereof, unless the consumer elects to purchase a meter:

Provided further that the State Commission may, by notification extend the said period of two years for a class or classes of persons or for such area as may be specified in that notification.

(2) For proper accounting and audit in the generation, transmission and distribution or trading of electricity, the Authority may direct the installation of meters by a generating company or licensee at such stages of generation, transmission or distribution or trading of electricity and at such locations of generation, transmission or distribution or trading , as it may deem necessary.

(3) If a person makes default in complying with the provisions contained in this section or regulations made under sub-section (1), the Appropriate Commission may make such order as it thinks fit for requiring the default to be made good by the generating company or licensee or by any officers of a company or other association or any other person who is responsible for its default.

Disconnection of supply in default of payment [Section 56]

(1) Where any person neglects to pay any charge for electricity or any sum other than a charge for electricity due from him to a licensee or the generating company in respect of supply, transmission or distribution or wheeling of electricity to him, the licensee or the generating company may, after giving not less than fifteen clear days notice in writing, to such person and without prejudice to his rights to recover such charge or other sum by suit, cut off the supply of electricity and for that purpose cut or disconnect any electric supply line or other works being the property of such licensee or the generating company through which electricity may have been supplied, transmitted, distributed or wheeled and may discontinue the supply until such charge or other sum, together with any expenses incurred by him in cutting off and reconnecting the supply, are paid, but no longer:

Provided that the supply of electricity shall not be cut off if such person deposits , under protest, -

(a) an amount equal to the sum claimed from him, or

(b) the electricity charges due from him for each month calculated on the basis of average charge for electricity paid by him during the preceding six months, whichever is less, pending disposal of any dispute between him and the licensee.

(2) Notwithstanding anything contained in any other law for the time being in force, no sum due from any consumer, under this section shall be recoverable after the period of two years from the date when such sum became first due unless such sum has been shown continuously as recoverable as arrear of charges for electricity supplied and the licensee shall not cut off the supply of the electricity:

Standard of performance of licensee [Section 57]

(1) The Appropriate Commission may, after consultation with the licensees and persons likely to be affected, specify standards of performance of a licensee or a class of licensees.

(2) If a licensee fails to meet the standards specified under subsection (1), without prejudice to any penalty which may be imposed or prosecution be initiated, he shall be liable to pay such compensation to the person affected as may be determined by the Appropriate Commission: Provided that before determination of compensation, the concerned licensee shall be given a reasonable opportunity of being heard.

(3) The compensation determined under sub-section (2) shall be paid by the concerned licensee within ninety days of such determination.

Different Standards of performance by licensee [Section 58]

The Appropriate Commission may specify different standards under subsection (1) of section 57 for a class or classes of licensee.

Information with respect to levels of performance [Section 59]

(1) Every licensee shall, within the period specified by the Appropriate Commission, furnish to the Commission the following information, namely:-

(a) the level of performance achieved under sub-section (1) of the section 57;

(b) the number of cases in which compensation was made under subsection (2) of section 57 and the aggregate amount of the compensation.

(2) The Appropriate Commission shall at least once in every year arrange for the publication, in such form and manner as it considers appropriate, of such of the information furnished to it under sub-section (1).

Market destination [Section 60]

The Appropriate Commission may such issue directions as it considers appropriate to a licensee or a generating company if such licensee or generating company enters into any agreement or abuses its dominant position or enters into a combination which is likely to cause or causes an adverse effect on competition in electricity industry.

TARIFF

Tariff Regulations [Section 61]

The Appropriate Commission shall, subject to the provisions of this Act, specify the terms and conditions for the determination of tariff, and in doing so, shall be guided by the following, namely:-

(a) the principles and methodologies specified by the Central Commission for determination of the tariff applicable to generating companies and transmission licensees;

(b) the generation, transmission, distribution and supply of electricity are conducted on commercial principles;

(c) the factors which would encourage competition, efficiency, economical use of the resources, good performance and optimum investments;

(d) safeguarding of consumers' interest and at the same time, recovery of the cost of electricity in a reasonable manner;

(e) the principles rewarding efficiency in performance;

(f) multi year tariff principles;

(g) that the tariff progressively reflects the cost of supply of electricity and also, reduces cross-subsidies in the manner specified by the Appropriate Commission;

(h) the promotion of co-generation and generation of electricity from renewable sources of energy;

(i) the National Electricity Policy and tariff policy:

Provided that the terms and conditions for determination of tariff under the Electricity (Supply) Act, 1948, the Electricity Regulatory Commission Act, 1998 and the enactments specified in the Schedule as they stood immediately before the appointed date, shall continue to apply for a period of one year or until the terms and conditions for tariff are specified under this section, whichever is earlier.

Determination of Tariff [Section 62]

(1) The Appropriate Commission shall determine the tariff in accordance with provisions of this Act for –

(a) supply of electricity by a generating company to a distribution licensee:

Provided that the Appropriate Commission may, in case of shortage of supply of electricity, fix the minimum and maximum ceiling of tariff for sale or purchase of electricity in pursuance of an agreement, entered into between a generating company and a licensee or between licensees, for a period not exceeding one year to ensure reasonable prices of electricity;

(b) transmission of electricity ;

(c) wheeling of electricity;

(d) retail sale of electricity.

Provided that in case of distribution of electricity in the same area by two or more distribution licensees, the Appropriate Commission may, for promoting competition among distribution licensees, fix only maximum ceiling of tariff for retail sale of electricity.

(2) The Appropriate Commission may require a licensee or a generating company to furnish separate details, as may be specified in respect of generation, transmission and distribution for determination of tariff.

(3) The Appropriate Commission shall not, while determining the tariff under this Act, show undue preference to any consumer of electricity but may differentiate according to the consumer's load factor, power factor, voltage, total consumption of electricity during any specified period or the time at which the supply is required or the geographical position of any area, the nature of supply and the purpose for which the supply is required.

(4) No tariff or part of any tariff may ordinarily be amended more frequently than once in any financial year, except in respect of any changes expressly permitted under the terms of any fuel surcharge formula as may be specified.

(5) The Commission may require a licensee or a generating company to comply with such procedures as may be specified for calculating the expected revenues from the tariff and charges which he or it is permitted to recover.

(6) If any licensee or a generating company recovers a price or charge exceeding the tariff determined under this section, the excess amount shall be recoverable by the person who has paid such price or charge along with interest equivalent to the bank rate without prejudice to any other liability incurred by the licensee.

Determination of tariff by bidding process [Section 63]

Notwithstanding anything contained in section 62, the Appropriate Commission shall adopt the tariff if such tariff has been determined through transparent process of bidding in accordance with the guidelines issued by the Central Government.

Procedure for tariff order [Section 64]

(1) An application for determination of tariff under section 62 shall be made by a generating company or licensee in such manner and accompanied by such fee, as may be determined by regulations.

(2) Every applicant shall publish the application, in such abridged form and manner, as may be specified by the Appropriate Commission.

(3) The Appropriate Commission shall, within one hundred and twenty days from receipt of an application under sub-section (1) and after considering all suggestions and objections received from the public,-

 (a) issue a tariff order accepting the application with such modifications or such conditions as may be specified in that order;

 (b) reject the application for reasons to be recorded in writing if such application is not in accordance with the provisions of this Act and the rules and regulations made thereunder or the provisions of any other law for the time being in force:

 Provided that an applicant shall be given a reasonable opportunity of being heard before rejecting his application.

(4) The Appropriate Commission shall, within seven days of making the order, send a copy of the order to the Appropriate Government, the Authority, and the concerned licensees and to the person concerned.

(5) Notwithstanding anything contained in Part X, the tariff for any inter-State supply, transmission or wheeling of electricity, as the case may be, involving the territories of two States may, upon application made to it by the parties intending to undertake such supply, transmission or wheeling,

be determined under this section by the State Commission having jurisdiction in respect of the licensee who intends to distribute electricity and make payment therefore:

(6) A tariff order shall, unless amended or revoked, shall continue to be in force for such period as may be specified in the tariff order.

Provision of subsidy by State Government [Section 65]

If the State Government requires the grant of any subsidy to any consumer or class of consumers in the tariff determined by the State Commission under section 62, the State Government shall, notwithstanding any direction which may be given under section 108, pay, within in advance in the manner as may be specified , by the State Commission the amount to compensate the person affected by the grant of subsidy in the manner the State Commission may direct, as a condition for the licence or any other person concerned to implement the subsidy provided for by the State Government:

Provided that no such direction of the State Government shall be operative if the payment is not made in accordance with the provisions contained in this section and the tariff fixed by State Commission shall be applicable from the date of issue of orders by the Commission in this regard.

Development of market [Section 66]

The Appropriate Commission shall endeavour to promote the development of a market (including trading) in power in such manner as may be specified and shall be guided by the National Electricity Policy referred to in section 3 in this regard..

WORKS

Works of licensees

Provision as to opening up of streets, railways etc. [Section 67]

(1) A licensee may, from time to time but subject always to the terms and conditions of his licence, within his area of supply or transmission or when permitted by the terms of his licence to lay down or place electric supply lines without the area of supply, without that area carry out works such as -

(a) to open and break up the soil and pavement of any street, railway or tramway;

(b) to open and break up any sewer, drain or tunnel in or under any street, railway or tramway;

(c) to alter the position of any line or works or pipes, other than a main sewer pipe;

(d) to lay down and place electric lines, electrical plant and other works;

(e) to repair, alter or remove the same;

(f) to do all other acts necessary for transmission or supply of electricity.

(2) The Appropriate Government may, by rules made by it in this behalf, specify, -

(a) the cases and circumstances in which the consent in writing of the Appropriate Government, local authority, owner or occupier, as the case may be, shall be required for carrying out works;

(b) the authority which may grant permission in the circumstances where the owner or occupier objects to the carrying out of works;

(c) the nature and period of notice to be given by the licensee before carrying out works;

(d) the procedure and manner of consideration of objections and suggestion received in accordance with the notice referred to in clause (c);

(e) the determination and payment of compensation or rent to the persons affected by works under this section;

(f) the repairs and works to be carried out when emergency exists;

(g) the right of the owner or occupier to carry out certain works under this section and the payment of expenses therefor;

(h) the procedure for carrying out other works near sewers, pipes or other electric lines or works;

(i) the procedure for alteration of the position of pipes, electric lines, electrical plant, telegraph lines, sewer lines, tunnels, drains, etc.;

(j) the procedure for fencing, guarding, lighting and other safety measures relating to works on streets, railways, tramways, sewers, drains or tunnels and immediate reinstatement thereof;

(k) the avoidance of public nuisance, environmental damage and unnecessary damage to the public and private property by such works;

(1) the procedure for undertaking works which are not reparable by the Appropriate Government, licensee or local authority;

(m) the manner of deposit of amount required for restoration of any railways, tramways, waterways, etc.;

(n) the manner of restoration of property affected by such works and maintenance thereof;

(o) the procedure for deposit of compensation payable by the licensee and furnishing of security; and

(p) such other matters as are incidental or consequential to the construction and maintenance of works under this section.

(3) A licensee shall, in exercise of any of the powers conferred by or under this section and the rules made thereunder, cause as little damage, detriment and inconvenience as may be, and shall make full compensation for any damage, detriment or inconvenience caused by him or by any one employed by him.

(4) Where any difference or dispute [including amount of compensation under sub-section (3)] arises under this section, the matter shall be determined by the Appropriate Commission.

(5) The Appropriate Commission, while determining any difference or dispute arising under this section in addition to any compensation under sub-section (3), may impose a penalty not exceeding the amount of compensation payable under that sub-section.

Provisions relating to overhead lines

Overhead lines [Section 68]

(1) An overhead line shall, with prior approval of the Appropriate Government, be installed or kept installed above ground in accordance with the provisions of sub-section (2).

(2) The provisions contained in sub-section (1) shall not apply-

(a) in relation to an electric line which has a nominal voltage not exceeding 11 kilovolts and is used or intended to be used for supplying to a single consumer;

(b) in relation to so much of an electric line as is or will be within premises in the occupation or control of the person responsible for its installation; or

(c) in such other cases as may be prescribed.

(3) The Appropriate Government shall, while granting approval under sub-section (1), impose such conditions (including conditions as to the ownership and operation of the line) as appear to it to be necessary

(4) The Appropriate Government may vary or revoke the approval at any time after the end of such period as may be stipulated in the approval granted by it.

(5) Where any tree standing or lying near an overhead line or where any structure or other object which has been placed or has fallen near an overhead line subsequent to the placing of such line, interrupts or interferes with, or is likely to interrupt or interfere with, the conveyance or transmission of electricity or the accessibility of any works, an Executive Magistrate or authority specified by the Appropriate Government may, on the application of the licensee, cause the tree, structure or object to be removed or otherwise dealt with as he or it thinks fit.

(6) When disposing of an application under sub-section (5), an Executive Magistrate or authority specified under that sub-section shall, in the case of any tree in existence before the placing of the overhead line, award to the person interested in the tree such compensation as he thinks reasonable, and such person may recover the same from the licensee.

Explanation. - For purposes of this section, the expression "tree" shall be deemed to include any shrub, hedge, jungle growth or other plant.

Notice to telegraph authority [Section 69]

(1) A licensee shall, before laying down or placing, within ten meters of any telegraph line, electric line, electrical plant or other works, not being either service lines, or electric lines or electrical plant, for the repair, renewal or amendment of existing works of which the character or position is not to bealtered,-

(a) submit a proposal in case of a new installation to an authority to be designated by the Central Government and such authority shall take a decision on the proposal within thirty days;

(b) give not less than ten days' notice in writing to the telegraph authority in case of repair, renewal or amendment or existing works , specifying-

(i) the course of the works or alterations proposed ;

(ii) the manner in which the works are to be utilised ;

(iii) the amount and nature of the electricity to be transmitted;

(iv) the extent to, and the manner in which (if at all), earth returns are to be used , and the licensee shall conform to such reasonable requirements, either general or special, as may be laid down by the telegraph authority within that period for preventing any telegraph line from being injuriously affected by such works or alterations:

Provided that in case of emergency (which shall be stated by the licensee in writing to the telegraph authority) arising from defects in any of the electric lines or electrical plant or other works of the licensee, the licensee shall be required to give only such notice as may be possible after the necessity for the proposed new works or alterations has arisen.

(2) Where the works of the laying or placing of any service line is to be executed the licensee shall, not less than forty-eight hours before commencing the work, serve upon the telegraph authority a notice in writing of his intention to execute such works.

Grants, Fund, Accounts, Audit and Report

Grants and loans by Central Government [Section 98]

The Central Government may, after due appropriation made by Parliament in this behalf, make to the Central Commission grants and loans of such sums of money as that Government may consider necessary.

Establishment of Fund by Central Government [Section 99]

(1) There shall be constituted a Fund to be called the Central Electricity Regulatory Commission Fund and there shall be credited thereto-

(a) any grants and loans made to the Central Commission by the Central Government under section 98;

(b) all fees received by the Central Commission under this Act;

(c) all sums received by the Central Commission from such other sources as may be decided upon by the Central Government.

(2) The Fund shall be applied for meeting –

(a) the salary, allowances and other remuneration of Chairperson, Members, Secretary, officers and other employees of the Central Commission;

(b) the expenses of the Central Commission in discharge of its function under section 79;

(c) the expenses on objects and for purposes authorised by this Act.

(3) The Central Government may, in consultation with the Comptroller and Auditor-General of India, prescribe the manner of applying the Fund for meeting the expenses specified in clause (b) or clause (c) of sub-section (2).

Accounts and Audit of Central Commission [Section 100]

(1) The Central Commission shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.

(2) The accounts of the Central Commission shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Central Commission to the Comptroller and Auditor General of India.

(3) The Comptroller and Auditor-General of India and any person appointed by him in connection with the auditing of the accounts of the Central Commission under this Act shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General of India has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Central Commission.

(4) The accounts of the Central Commission, as certified by the Comptroller and Auditor- General of India or any other person appointed by him in this behalf, together with the audit report thereon, shall be forwarded annually to the Central Government and that Government shall cause the same to be laid, as soon as may be after it is received, before each House of Parliament.

Annual Report of Central Commission [Section 101]

(1) The Central Commission shall prepare once every year, in such form and at such time as may be prescribed, an annual report giving a summary of its activities during the previous year and copies of the report shall be forwarded to the Central Government.

(2) A copy of the report received under sub-section (1) shall be laid, as soon as may be after it is received, before each House of Parliament.

Grants and Loans by State Government [Section 102]

The State Government may, after due appropriation made by Legislature of a State in this behalf, make to the State Commission grants and loans of such sums of money as that Government may consider necessary.

Establishment of Fund by state Government [Section 103]

(1) There shall be constituted a Fund to be called the State Electricity Regulatory Commission fund and there shall be credited thereto-

(a) any grants and loans made to the State Commission by the State Government under Section 102;

(b) all fees received by the State Commission under this Act;

(c) all sums received by the State Commission from such other sources as may be decided upon by the State Government.

(2) The Fund shall be applied for meeting –

(a) the salary, allowances and other remuneration of Chairperson, Members, Secretary, officers and other employees of the State Commission;

(b) the expenses of the State Commission in discharge of its function under Section 86; and

(c) the expenses on objects and for purposes authorised by this Act.

(3) The State Government may, in consultation with the Comptroller and Auditor-General of India, prescribe the manner of applying the Fund for meeting the expenses specified in clause (b) or clause (c) of sub-section (2).

Accounts and audit of State Commission [Section 104]

(1) The State Commission shall maintain proper accounts and other relevant records and prepare annual statement of accounts in such forms as may be prescribed by the State Government in consultation with the Comptroller and Auditor-General of India.

(2) The Accounts of the State Commission shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the State Commission to the Comptroller and Auditor- General of India.

(3) The Comptroller and Auditor-General of India and any person appointed by him in connection with the audit of the accounts of the State Commission under this Act shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General of India generally has in connection with the audit of Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the State Commission.

(4) The accounts of the State Commission, as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf, together with the audit report thereon shall be forwarded annually to the State Government and that Government shall cause the same to be laid, as soon as may be after it is received, before the State Legislature.

Annual report of State Commission [Section 105]

(1) The State Commission shall prepare once every year in such form and at such time as may be prescribed, an annual report giving a summary of its activities during the previous year and copies of the report shall be forwarded to the State Government.

(2) A copy of the report received under sub-section (1) shall be laid, as soon as may be after it is received, before the State Legislature.

Budget of Appropriate Commission [Section 106]

The Appropriate Commission shall prepare, in such form and at such time in each financial year as may be prescribed, its budget for the next financial year, showing the estimated receipts and expenditure of that Commission and forward the same to the Appropriate Government.

Directions by Central Government [Section 107]

(1) In the discharge of its functions, the Central Commission shall be guided by such directions in matters of policy involving public interest as the Central Government may give to it in writing.

(2) If any question arises as to whether any such direction relates to a matter of policy involving public interest, the decision of the Central Government thereon shall be final.

Directions by State Government [Section 108]

(1) In the discharge of its functions, the State Commission shall be guided by such directions in matters of policy involving public interest as the State Government may give to it in writing.

(2) If any question arises as to whether any such direction relates to a matter of policy involving public interest, the decision of the State Government thereon shall be final.

Directions to Joint Commission [Section 109]

Notwithstanding anything contained in this Act, where any Joint Commission is established under section 83 –

(a) the Government of the State, for which the Joint Commission is established, shall be competent to give any direction under this Act only in cases where such direction relates to matter within the exclusive territorial jurisdiction of the State;

(b) the Central Government alone shall be competent to give any direction under this Act where such direction relates to a matter within the territorial jurisdiction of two or more States or pertaining to a Union territory if the participating Governments fail to reach an agreement or the participating States or majority of them request the Central Government to issue such directions.

Establishment of Appellate Tribunal [Section 110]

The Central Government shall, by notification, establish an Appellate Tribunal to be known as the Appellate Tribunal for Electricity to hear appeals against the orders of the adjudicating officer or the Appropriate Commission under this Act.

Appeal to Appellate Tribunal [Section 111]

(1) Any person aggrieved by an order made by an adjudicating officer under this Act (except under section 127) or an order made by the Appropriate Commission under this Act may prefer an appeal to the Appellate Tribunal for Electricity:

Provided that any person appealing against the order of the adjudicating officer levying and penalty shall, while filling the appeal , deposit the amount of such penalty:

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, it may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation 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 officer or the Appropriate Commission 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 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 officer or the Appropriate Commission, 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 endeavour 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 of 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 officer or legality, propriety or correctness of any order made by the adjudicating officer or the Appropriate Commission under this Act, as the case may be, in relation to any proceeding, on its own motion or otherwise, call for the records of such proceedings and make such order in the case as it thinks fit.

Composition of Appellate Tribunal [Section 112]

(1) The Appellate Tribunal shall consist of a Chairperson and three other Members.

(2) Subject to the provisions of this Act,-

(a) the jurisdiction of the Appellate Tribunal may be exercised by Benches thereof;

(b) a Bench may be constituted by the Chairperson of the Appellate Tribunal with two or more Members of the Appellate Tribunal as the Chairperson of the Appellate Tribunal may deem fit:

Provided that every Bench constituted under this clause shall include at least one Judicial Member and one Technical Member;

(c) the Benches of the Appellate Tribunal shall ordinarily sit at Delhi and such other places as the Central Government may, in consultation with the Chairperson of the Appellate Tribunal, notify;

(d) 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 of the Appellate Tribunal may transfer a Member of the Appellate Tribunal from one Bench to another Bench.

Explanation.- For the purposes of this Chapter,-

(i) " Judicial Member" means a Member of the Appellate Tribunal appointed as such under sub-clause (i) of caluse (b) of sub-section (1) of section 113, and includes the Chairperson of the Appellate Tribunal;

(ii) " Technical Member" means a Member of the Appellate Tribunal appointed as such under sub-clause (ii) or sub-clause (iii) of clause (b) of subsection (1) of section 113.

Qualifications for appointment of Chairperson and Member of the Appellate Tribunal [Section 113]

(1) A person shall not be qualified for appointment as the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal unless he-

(a) in the case of the Chairperson of the Appellate Tribunal, is, or has been, a judge of the Supreme Court or the Chief Justice of a High Court; and

(b) in the case of a Member of the Appellate Tribunal,-

(i) is, or has been, or is qualified to be, a Judge of a High Court; or

(ii) is, or has been, a Secretary for at least one year in the Ministry or Department of the Central Government dealing with economic affairs or matters or infrastructure; or

(iii) is, or has been, a person of ability and standing, having adequate knowledge or experience in dealing with the matters relating to electricity generation, transmission and distribution and regulation or economics, commerce, law or management.

(2) The Chairperson of the Appellate Tribunal shall be appointed by the Central Government after consultation with the Chief Justice of India.

(3) The Members of the Appellate Tribunal shall be appointed by the Central Government on the recommendation of the Selection Committee referred to in section 78.

(4) Before appointing any person for appointment as Chairperson or other Member of the Appellate Tribunal, the Central Government shall satisfy itself that such person does not have any financial or other interest which is likely to affect prejudicially his functions as such Chairperson or Member.

Term of office [Section 114]

The Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall hold office as such for a term of three years from the date on which he enters upon his office:

Provided that such Chairperson or other Member shall be eligible for reappointment for a second term of three years:

Provided further that no Chairperson of the Appellate Tribunal or Member of the Appellate Tribunal shall hold office as such after he has attained,-

(a) in the case of the Chairperson of the Appellate Tribunal , the age of seventy years;

(b) in the case of a Member of the Appellate Tribunal, the age of sixty-five years.

Terms and conditions of service [Section 115]

The salary and allowances payable to, and the other terms and conditions of service of, the Chairperson of the Appellate Tribunal and Members of the Appellate Tribunal shall be such as may be prescribed by the Central Government :

Provided that neither the salary and allowances nor the other terms and conditions of service of the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall be varied to his disadvantage after appointment.

Vacancies [Section 116]

If, for reason other than temporary absence, any vacancy occurs in the office of the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal, the Central Government shall appoint another person in accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Appellate Tribunal from the stage at which the vacancy is filled.

Resignation and removal [Section 117]

(1) The Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of term of office, whichever is the earliest.

(2) The Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by a judge of the Supreme Court as the Central Government may appoint for this purpose in which the Chairperson or a Member of the Appellate Tribunal concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of such charges.

Member to act as Chairperson in certain circumstances [Section 118]

(1) In the event of the occurrence of any vacancy in the office of the Chairperson of the Appellate Tribunal by reason of his death, resignation or otherwise, the senior-most Member of the Appellate Tribunal shall act as the Chairperson of the Appellate Tribunal until the date on which a new Chairperson, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office.

(2) When the Chairperson of the Appellate Tribunal is unable to discharge his functions owing to absence, illness or any other cause, the senior most Member of the Appellate Tribunal shall discharge the functions of the Chairperson of the Appellate Tribunal until the date on which the Chairperson of the Appellate Tribunal resumes his duties.

Officers and other employees of Appellate Tribunal [Section 119]

(1) The Central Government shall provide the Appellate Tribunal with such officers and other employees as it may deem fit.

(2) The officers and other employees of the Appellate Tribunal shall discharge their functions under the general superintendence of the Chairperson of the Appellate Tribunal.

(3) The salaries and allowances and other terms and conditions of service of the officers and other employees of the Appellate Tribunal shall be such as may be prescribed by the Central Government.

Procedure and powers of Appellate Tribunal [Section 120]

(1) The Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Appellate Tribunal shall have powers to regulate its own procedure.

(2) The Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:-

  (a) summoning and enforcing the attendance of any person and examining him on oath;
  (b) requiring the discovery and production of documents;
  (c) receiving evidence on affidavits;
  (d) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office;
  (e) issuing commissions for the examination of witnesses or documents;
  (f) reviewing its decisions;
  (g) dismissing a representation of default or deciding it ex parte;
  (h) setting aside any order of dismissal or any representation for default or any order passed by it ex parte;
  (i) any other matter which may be prescribed by the Central Government.

(3) An order made by the Appellate Tribunal under this Act shall be executable by the Appellate Tribunal as a decree of civil court and, for this purpose, the Appellate Tribunal shall have all the powers of a civil court.

(4) Notwithstanding anything contained in sub-section (3), the Appellate Tribunal may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by that court.

(5) All proceedings before the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code and the Appellate Tribunal shall be deemed to be a civil court for the purposes of section 345 and 346 of the Code of Criminal Procedure, 1973.

Power of Chairperson of Appellate Tribunal [Section 121]

The Chairperson of the Appellate Tribunal shall exercise general power of super-intendance and control over the Appropriate Commission.

Distribution of business amongst Benches and transfer of cases from one Bench to another Bench [Section 122]

(1) Where Benches are constituted, the Chairperson of the Appellate Tribunal may, from time to time, by notification, make provisions as to the distribution of the business of the Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with by each Bench.

(2) On the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairperson of the Appellate Tribunal may transfer any case pending before one Bench, for disposal, to any other Bench.

Decision to be by majority [Section 123]

If the Members of the Appellate Tribunal of a Bench consisting of two Members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairperson of the Appellate Tribunal who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other Members of the Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the Members of the Appellate Tribunal who have heard the case, including those who first heard it.

Right of appellant to take assistance of legal practitioner and of Appropriate Commission to appoint presenting officers [Section 124]

(1) A person preferring an appeal to the Appellate Tribunal under this Act may either appear in person or take the assistance of a legal practitioner of his choice to present his case before the Appellate Tribunal, as the case may be.

(2) The Appropriate Commission may authorise one or more legal practitioners or any of its officers to act as presenting officers and every person so authorised may present the case with respect to any appeal before the Appellate Tribunal, as the case may be.

Appeal to Supreme Court [Section 125]

Any person aggrieved by any decision or order of the Appellate Tribunal, may, file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal, to him, on any one or more of the grounds specified in section 100 of the Code of Civil Procedure,1908:

Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Study Note - 8

CORPORATE GOVERNANCE

This Study Note includes

8.1 OVERVIEW-ISSUES AND CONCEPTS

'Corporate Governance' has become one of the most commonly used phrases in the current global business vocabulary. This raises the question, 'is corporate governance a vital component of successful business or is it simply another fad that will fade away over time? The notorious collapse of Enron in 2001, one of America's largest companies, has focused international attention on company failures and the role that strong corporate governance needs to play them. The UK has responded by producing the Higgs Report (2003) and the Smith Report (2003), whereas the US produced the Sarbanes – Oxley Act (2002). Nations around the world are instigating far-reaching programmes for Corporate governance reform, as evidenced by the proliferation of Corporate Governance codes and policy documents, voluntary or mandatory, both at the national and supra-national level. We believe that the present focus on corporate governance will be maintained into the future and that, over time, corporate governance issues grow in importance, rather than fade into insignificance. The phenomenal growth of interest in Corporate Governance has been accompanied by a growing body of academic research. As the discipline matures, far greater definition and clarity are being achieved concerning the nature of corporate governance. In this chapter we consider the broad-ranging nature of corporate governance and the many ways of defining the subject. We discuss Corporate Governance from a theoretical perspective.

Concept and Definition

There is no single, accepted definition of Corporate Governance. There are substantial differences in definition according to which country we are considering. Arriving at 'a' definition of Corporate Governance is no easy task. Corporate Governance as a discipline in its own right is relatively new. We consider that the subject may be treated in a narrow or a broad manner, depending on the viewpoint of the policy maker, practitioner, researcher or theorist. It seems that existing definitions of Corporate Governance fall on to a spectrum, with 'narrow' views at one end and more inclusive, 'broad' views placed at the other. Once approach toward Corporate Governance adopts a narrow view, where Corporate Governance is restricted to the relationship between a company and its shareholders. This is the traditional finance paradigm, expressed in 'agency theory'. At the other end of the spectrum, corporate governance may be seen as a web of relationships, not only between a company and its owners (shareholders) but also between a company and a broad range of other 'stakeholders': employees, customers, supplies, bondholders, to name but a few. such a view tends to be expressed in 'stakeholder theory'. This is a more inclusive and broad way of treating the subject of corporate governance and one which is gradually attracting greater attention.

Corporate governance is…

- The process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders (Parkinson, 1994). – Strongly agree
- The governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries (Tricker, 1984). – Agree
- The governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership trusteeship of assets, their management and their deployment (cannon, 1994). – Agree
- The relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by voting at AMs and by regular meetings with companies' senior management). Increasingly, this includes shareholder 'activism' which involves a campaign by a shareholder or a group of shareholders to achieve change in companies (the Corporate Governance Handbook, 1996). – Some agreement
- The structures, process, cultures and systems that engender the successful operation of the Organization (Keasey and Wright, 1993). – Some agreement
- The system by which companies are directed and controlled (The Cadbury Report, 1992) – slight agreement

We consider some published definitions of corporate governance each of which adopt a different view of the subject and provide a consensus on the relative importance of these definitions. These definitions were not intended to discriminate completely between different views, but rather each was chosen to emphasize slightly different interpretations of the Corporate Governance function. The selection represents a range of definitions, starting from the narrowest which described the basic role of Corporate Governance (The Cadbury Report, 1992; see also, Cadbury, 2002) to a solely financial perspective involving only shareholders and company management (Parkinson, 1994) and extending to a broader definition that encompassed corporate accountability to a wide range of stakeholders and society at large (Tricker, 1984). We also included a definition that emphasized the importance of shareholder activism, as this allowed us to gauge institutional investors' views on their own role in Corporate Governance (The Corporate Governance Handbook, 1996). The selection also included definitions that were regulation-centered (Cannon, 1994) or focused on corporate success (Keasey and Wright, 1993). The definitions are ranked according to the institutional investors' views of their relative importance.

In general the definitions of Corporate Governance found in the literature tend to share certain characteristics, one of which is the notion of accountability. Narrow definitions are oriented around corporate accountability to shareholders. Some narrower, shareholder-oriented definitions of Corporate Governance focus specifically on the ability of a country's legal system to protect minority shareholder rights (e.g., La Porta et al., 1998). However, such definitions are mainly applicable to cross-country comparisons of Corporate Governance. We return to the legal influence on different systems of corporate governance around the world.

Broader definitions of Corporate Governance stress a broader level of accountability to shareholders and other stakeholders. We can see that Tricker's (1984) definition, encompassing accountability to a broader group of people than just the shareholders. This demonstrates an interest within the financial community in a broader, stakeholder- oriented approach to Corporate Governance. The broadest definitions consider that companies are accountable to the whole of society, future generations and the natural world. Relatively broad, definitions consider that companies are accountable to the whole of society, future generations and the natural world. We suggest that corporate governance is the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.

Theoretical frameworks that suggest companies should be accountable only to their shareholders are not necessarily inconsistent with theoretical frameworks that champion stakeholder accountability. The reason underlying this argument is that shareholders' interest can only be satisfied by taking account of stakeholder interests, as companies that are accountable to all of their stakeholders are over the long term more successful and more prosperous. Definition of Corporate Governance therefore rests on the perception that companies can maximize value creation over the long term, by discharging their accountability to all of their stakeholders and by optimizing their system of Corporate Governance.

Overall, this perception is growing among the professional community and academic research is beginning to provide empirical in support of this view of corporate governance, accountability and corporate profitability. However, this is the 'business case' for corporate governance and, more generally, for corporate social responsibility. Should companies improve corporate governance and discharge accountability to all of their stakeholders purely because it is ethical? We discuss these ethical issues in the subsection on stakeholder theory. In the real world, it is unlikely that businessmen and investors will be interested in acting ethically unless there are positive financial returns to be made from so doing, as there appears to be a strong business case underlying corporate governance reform and stakeholder accountability, then the corporate and financial communities are more likely to embrace these approaches.

8.2 CORPORATE GOVERNANCE PRACTICES/CODES IN - UK, GERMANY, JAPAN, INDIA AND USA

CORPORATE GOVERNANCE IN THE UK

The UK has a well-developed market with a diverse shareholder base including institutional investors, financial institutions, and individuals. The UK illustrates well the problems that may be associated with the separation of the ownership and control of corporations and hence has many of the associated agency problems. These agency problems, including misuse of corporate assets by directors and a lack of effective control over, and accountability of, directors' actions, contributed to a number of financial scandals in the UK.

As in other countries, the development of corporate governance in the UK was initially the findings of a trilogy of codes: the Cadbury Report (1992), the Greenbury Report (1995), and the Hampel Report (1998).

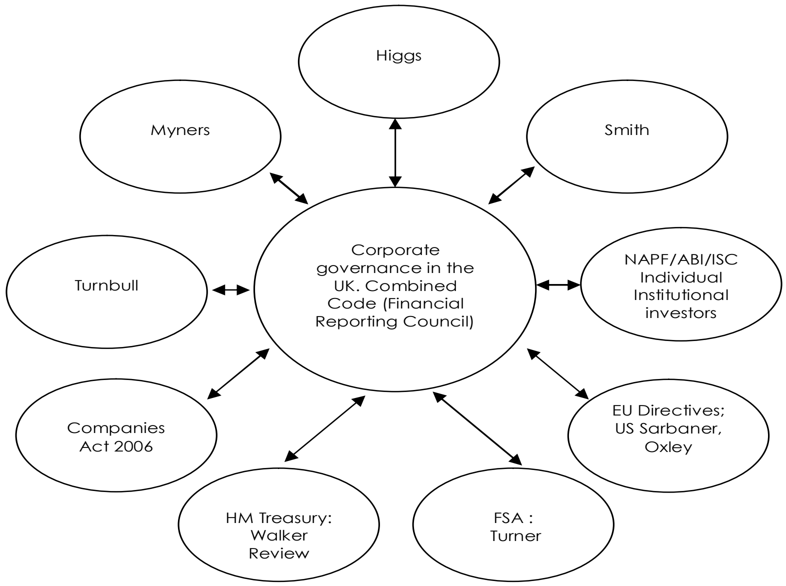


Figure: Development of corporate governance in the UK

Figure illustrates the development of corporate governance in the UK. The centre oval represents the Combined Code published in 2008 by the Financial Reporting Council. Around the centre oval, we can see the various influences since 1998 (the original Combined Code, published in 1998, encompassed the Cadbury, Greenbury, and Hampel report recommendations). These influences can be split into four broad areas. First, there are reports that have looked at specific areas of Corporate Governance: the Turnbull Report on Internal Controls the Myners review of Institutional Investment, the Higgs Review of the role and effectiveness of non-executive directors, and the Smith Review of Audit Committees. Secondly, there has been the influence of institutional investors and their representative groups. Thirdly, influences affecting the regulatory framework within which corporate governance in the UK operates have included the UK company law review, the Walker Review for HM Treasury and the Financial Services Authority Review. Fourthly, there have been what might be termed 'external influences' such as the EU review of company law and the US Sarbanes-Oxley Act. Each of these is now discussed in turn.

Various Reports on Governance:

Cadbury Report (1992)

Following various financial scandals and collapses (Coloroll and Polly Peck, to name but two) and a perceived general lack of confidence in the financial reporting of many UK companies, the Financial Reporting Council, the London Stock Exchange, and the accountancy profession established the Committee on the Financial Aspects of Corporate Governance in May 1991. After the Committee was set up, the scandals at BCCI and Maxwell happened, and as a result, the committee interpreted its remit more widely and looked beyond the financial aspects to Corporate Governance as a whole. The Committee was chaired by Sir Adrian Cadbury and, when the Committee reported in December 1992, the report became widely known as 'the Cadbury Report'.

The recommendations covered: the operation of the main board; the establishment, composition, and operation of key board committees; the importance of, and contribution that can be made by, non-executive directors; the reporting and control mechanisms of a business. The Cadbury Report recommended a code of Best Practice with which the boards of all listed companies registered in the UK should comply, and utilized a 'comply or explain' mechanism. this mechanism means that a company should comply with the code but, if it cannot comply with any particular aspect of it, then it should explain why it is unable to do so. This disclosure gives investors detailed information about any instances of non-compliance and enables them to decide whether the company's non-compliance is justified.

Greenbury Report (1995)

The Greenbury committee was set up in response to concern at both the size of directors' remuneration packages and their inconsistent and incomplete disclosure in companies' annual reports. It made, in 1995, comprehensive recommendations regarding disclosure of directors' remuneration packages. There has been much discussion about how much disclosure there should be of directors' remuneration and how useful detailed disclosures might be. Whilst the work of the Greenbury Committee focused on the directors of public limited companies, it hoped that both smaller listed companies and unlisted companies would find its recommendations useful.

Central to the Greenbury report recommendations were strengthening accountability and enhancing the performance of directors. These two aims were to be achieved by (i) the presence of a remuneration committee comprised of independent non-executive directors who would report fully to the shareholders each year about the company's executive remuneration policy, including full disclosure of the elements in the remuneration of individual directors; and (ii) the adoption of performance measures linking rewards to the performance of both the company and individual directors, so that the interests of directors and shareholders were more closely aligned.

Since that time (1995), disclosure of directors' remuneration has become quite prolific in UK company accounts.

Hampel Report (1998)

The Hampel Committee was set up in 1995 to review the implementation of the Cadbury and Greenbury Committee recommendations. The Hampel Committee reported in 1998. The Hampel Report said: 'We endorse the overwhelming majority of the findings of the two earlier committees'. There has been much discussion about the extent to which a company should consider the interests of various stakeholders, such as employees, customers, suppliers, providers of credit, the local community, etc., as well as the interests of its shareholders. The Hampel report stated that the directors as a board are responsible *for relations with* stakeholders; but they are accountable *to* the shareholders'. However, the report does also state that directors can meet their legal duties to shareholders, and can pursue the objective of long-term shareholder value successfully, only by developing and sustaining these stakeholder relationships'.

The Hampel Report, like its precursors, also emphasized the important role that institutional investors have to play in the companies in which they invest (investee companies). It is highly desirable that companies and institutional investors engage in dialogue and that institutional investors make considered use of their shares in other words, institutional investors should consider carefully the resolutions on which they have a right to vote and reach a decision based on careful thought, rather than engage in 'box ticking'.

Combined Code (1998)

The Combined Code drew together the recommendations of the Cadbury, Greenbury, and Hampel reports. It has two sections, one aimed at Companies and another aimed at Institutional Investors. The combined code operates on the 'comply or explain' basis mentioned above. In relation to the internal controls of the business, the combined code states that 'the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets' and that 'the directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational, and compliance controls and risk management'. The Turnbull Report issued in 1999 gave directors guidance on carrying out this review.

Turnbull (1999)

The Turnbull Committee, chaired by Nigel Turnbull, was established by the Institute of Chartered Accountants in England and Wales (ICAEW) to provide guidance on the implementation of the internal control requirements of the Combined Code. The Turnbull Report confirms that it is the responsibility of the board of directors to ensure that the company has a sound system of internal control, and that the controls are working as they should. The board should assess the effectiveness of internal controls and report on them in the annual report. Of course, a company is subject to new risks both from the outside environment and as a result of decisions that the board makes about corporate strategy and objectives. In the managing of risk, boards will need to take into account the existing internal control system in the company and also whether any changes are required to ensure that new risks are adequately and effectively managed.

Myners (2001, 2008)

The Myners report on Institutional investment, issued in 2001 by HM Treasury, concentrated more on the trusteeship aspects of institutional investors and the legal requirements for trustees, with the aim of raising the standards and promoting greater shareholder activism. For example, the Myners report expects that institutional investors should be more proactive, especially in the stance they take with underperforming companies. Some institutional investors have already shown more of a willingness to engage actively with companies to try to ensure that shareholder value is not lost by underperforming companies.

In 2007, the NAPF published the results of its review of the extent to which Pension Fund trustees were complying with the principles. The report stated 'the recommendations set out in this report provide a framework for developing further the Principles so that they remain relevant for the world in which pension fund trustees operate today'. Subsequently HM Treasury published *Updating the Myners Principles: A Response to Consultation* in 2008. There are six principles identified: effective decision-making; clear objectives; risk and liabilities; performance assessment; responsible ownership; transparency; and reporting. The report emphasized greater industry ownership of the principles and places the onus on trustees to report on their own practices.

Higgs (2003)

The Higgs Review, chaired by Derek Higgs, reported in January 2003 on the role and effectiveness of non-executive directors. Higgs offered support for the Combined Code whilst making some additional recommendations. These recommendations included : stating the number of meetings of the board and its main committees in the annual report, together with the attendance records of individual directors; that a chief executive director should not also become chairman of the same company; non-executive directors should meet as a group at least once a year without executive directors being present, and the annual report should indicate whether such meetings have occurred; chairmen and chief executives should consider implementing executive development programmes to train and develop suitable individuals in their companies for future director roles; the board should inform shareholders as to why they believe a certain individual should be appointed to a non-executive directorship and how they may meet the requirements of the role; there should be a comprehensive induction programme for new non-executive directors, and resources should be available for ongoing development of directors; the performance of the board, its committees and its individual members, should be evaluated at least once a year, the annual report should state whether these reviews are being held and how they are conducted; a full time executive director should not hold more than one non-executive directorship or become chairman of a major company; no one non-executive director should sit on all three principal board committees (audit, remuneration, nomination). There was substantial opposition to some of the recommendations but they nonetheless helped to inform the Combined Code. Good practice suggestions from the Higgs Report were published in 2006.

Following a recommendation in chapter 10 of the Higgs Review, a group led by Professor Laura Tyson, looked at how companies might utilize broader pools of talent with varied skills and experience, and different perspectives to enhance board effectiveness. The Tyson report was published in 2003.

Smith (2003)

the Smith Review of Audit Committees, a group appointed by the Financial reporting council, reported in January 2003. The review made clear the important role of the audit committee: 'While all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control' . The review defined the audit committee's role in terms of a high-level overview-it needs to satisfy itself that there is an appropriate system of controls in place but it does not undertake the monitoring itself .

Combined Code (2003)

The revised Combined Code, published in July 2003, incorporated the substance of the Higgs and Smith reviews. However, rather than stating that no one non-executive director should sit on all three board committees, the Combined Code stated that 'undue reliance' should not be placed on particular individuals. The Combined Code also clarified the roles of the Chairman and the Senior Independent director (sid), emphasizing the Chairman's role in providing leadership to the non-executive directors and in communicating shareholders' views to the board; it also provided for a 'formal and rigorous annual evaluation' of the board's, the committees', and the individual directors' performance. At least half the board in larger listed companies was to be independent non-executive directors.

Revised Turnbull Guidance (2005)

In 2005, revised guidance on the Turnbull Report (1999) was published. There were few substantive changes but boards were encouraged to review their application of the guidance on a continuing basis and to look on the internal control statement as an opportunity to communicate to their shareholders how they manage risk and internal control. They should notify shareholders, in the annual report, of how any 'significant failings or weaknesses' in the effectiveness of the internal control system have been dealt with.

Combined Code (2006)

An updated version of the Combined Code was issued in June 2006. There were three main changes made:

(i) to allow the company chairman to serve on (but not to chair) the remuneration committee where he is considered independent on appointment as chairman;

(ii) to provide a 'vote withheld' option on proxy appointment forms to enable a shareholder to indicate that they wish to withhold their vote;

(iii) to recommend that companies publish on their website the details of proxies lodged at general meetings where votes were taken on a show of hands.

Combined Code (2008)

The findings of the Financial Reporting Council (FRC) *Review of the Impact of the Combined Code* were published in December 2007. The overall findings indicated that the Combined Code (2006) had general support and that the FRC would concentrate on improving the practical application of the Combined Code.

In June 2008, the FRC published a new edition of the Combined Code which introduced two changes. These changes were (i) to remove the restriction on an individual chairing more than one FTSE 100 company; and (ii) for listed companies outside the FTSE 350, to allow the company chairman to sit on the audit committee where he or she was considered independent on appointment.

The FRC stated on their website that The revised Code took effect at the same time as new FSA Rules implementing EU requirements relating to corporate governance statements and audit committees. The revised code and new rules will apply to accounting periods beginning on or after 29 June 2008. In practice this means most companies will begin to apply them in 2009, and will report against them for the first time in 2010.

Revised Smith Guidance (2008)

A new edition of the guidance was issued in October 2008. The main changes to the guidance as detailed on the FRC website are:

Audit committees are encouraged to consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning; companies are encouraged to include in the audit committee's report information on the appointment, reappointment or removal of the auditor, including supporting information on tendering frequency, the tenure of the incumbent auditor and any contractual obligations that acted to restrict the committee's choice of auditor; a small number of detailed changes have been made to the section dealing with the independence of the auditor, to bring the guidance in line with the Auditing Practices Board's Ethical Standards [2004, revised 2008) for auditors, which have been issued since the guidance was first published in 2003; and an appendix has been added containing guidance on the factors to be considered if a group is contemplating employing firms from more than one network to undertake the audit.

Institutional Investors and their Representative Groups

Large institutional investors, mainly insurance companies and pension funds, usually belong to one of two representative bodies that act as a professional group 'voice' for their views: the Association of British Insurers (ABI) and the national association of Pension Funds (NAPF). Both the ABI and the NAPF have best practice Corporate Governance guidelines that encompass the recommendations of the Combined Code. They monitor the corporate governance activities of companies and provide advice to members.

Some large institutional investors are very active in their own right in terms of their corporate governance activities. Hermes is a case in point, and it has published the hermes Principles, which detail how it perceives its relationship with the companies in which it invests (investee companies), what its expectations are of investee companies, and what investee companies can expect from hermes.

Companies Act 2006

In the UK, the corporate law has been in need of a thorough review for some years and the Modern Company Law Review culminated in July 2002 in the publication of out line proposals for extensive modernization of company law, including various aspects of corporate governance. These proposals included: statutory codification of directors' common law duties; enhanced company reporting and audit requirements, including a requirement that economically significant companies produce an annual operating and financial review; disclosure on corporate websites of information relating to the annual report and accounts, and disclosure relating to voting.

The government published the Company Law Reform Bill in November 2005, and the Companies Act 2006 was enacted in late 2006. The Act updates previous Companies' Acts legislation, but does not completely replace them, and it contains some significant new provisions which impacts on various constituents including directors, shareholders, auditors and company secretaries. The act draws on the findings of the Company Law Review proposals'.

The main features are as follows:

- directors' duties are codified;
- companies can make greater use of electronic communications for communicating with shareholders;
- directors can file service addresses on public record rather than their private home addresses;
- shareholders will be able to agree limitations on directors' liability;
- there will be simpler model Articles of Association for private companies, to reflect the way in which small companies operate;
- private companies will not be required to have a company secretary;
- private companies will not need to hold an annual general meeting unless they agree to do so;
- the requirement for an operating and Financial review (OFR) has not been reinstated, rather companies are encouraged to produce a high quality Business Review;
- nominee shareholders can elect to receive information in hard copy form or electronically if they wish to do so;
- shareholders will receive more timely information;
- enhanced proxy rights will make it easier for shareholders to appoint theirs to attend and vote at general meetings;
- shareholders of quoted companies may have a shareholder proposal (resolution);
- circulated at the company's expense if received by the financial year end;
- whilst there has been significant encouragement over a number of years to encourage institutional investors to disclose how they use their votes, the act provides a power which could be used to require institutional investors to disclose how they have voted.

Overall there seems to be an increasing burden for quoted companies whilst on the other hand the burden seems to have been reduced for private companies. In terms of the rights of shareholders these are enhanced in a number of ways including greater use of electronic communications, more information, enhanced proxy rights, and provision regarding the circulation of shareholder proposals at the company's expense. Equally there is a corresponding emphasis on shareholders' responsibilities with encouragement for institutional shareholders to be more active and to disclose how they have voted.

Financial Services Authority

In September 2002, the Financial Services Authority (FSA) launched a review of the listing regime with the main aim being to assess the existing rules and identify which should be retained, and which changed. The areas covered by the review were: Corporate Governance; continuing obligations (encompassing corporate communication, and shareholders' rights and obligations); financial information; the sponsor regime.

The FSA Review took place against the background of potentially significant changes in both the EU and UK regulatory environments, and although some changes were made, there was much continuity in the proposals introduced in 2005.

Following the global banking crisis, Lord Adair Turner, Chairman of the FSA, was asked by the Chancellor of the Exchequer to carry out a review and make recommendations for reforming UK and international approaches to the way banks are regulated. The Turner Review was published in the Spring 2008. Issues highlighted include remuneration policies designed to avoid incentives for undue risk taking; whether changes in governance structure are needed to increase the independence of risk management functions; and consideration of the skill and time commitment-required for non-executive directors of large complex banks to effectively perform their role.

Financial Reporting Council

The Financial Reporting Council (FRC) has six operating bodies: the Accounting Standards Board (ASB), the Auditing Practices Board (APB), the Board for Actuarial Standards (BAS), the Professional oversight Board, the Financial Reporting Review Panel (FRRP), and the Accountancy and Actuarial Discipline Board (AADB).

The importance placed on corporate governance is evidenced by the fact that, in March 2004, the FRC set up a new committee to lead its work on corporate governance.

Overall, the FRC is responsible for promoting high standards of corporate governance. It aims to do so by:

- maintaining an effective Combined Code on Corporate Governance and promoting its widespread application;
- ensuring that related guidance, such as that on internal control, is current and relevant;
- influencing EU and Global Corporate Governance developments;
- helping to promote boardroom professionalism and diversity;
- encouraging constructive interaction between company boards and institutional shareholders.

The FRC has carried out several consultative reviews of the Combined Code which led to the amended Combined Code in 2006, and subsequently in 2008 (discussed earlier). The latest review took place in 2008. The frequency of the reviews are both an indicator of the FRC's responsibility for corporate governance of UK companies which involves leading public debate in the area and its response to the global financial crisis which has, in turn, affected confidence in aspects of corporate governance.

The FRC website mentions the independent review of the governance of banks and other financial institutions carried out by Sir David Walker. The Walker Review published its draft recommendations in July 2009, some of the recommendations could be taken forward through amendments to the Combined Code. The FRC is considering the extent to which the Walker Review recommendations may be applicable for some or all listed companies in other sectors.

'External' Influences

The report of the EU High Level Group of Company Law Experts had implications for company law across Europe including the UK, and is further discussed below in the context of an international development. The impact of recent legislation in the USA, the Sarbanes Oxley Act, has also made its influence felt in the UK, and is also discussed in detail below.

CORPORATE GOVERNANCE IN GERMANY

Charkham (1994) stated that 'if there were a spectrum with "confrontation" at one end and "co-operation" at the other, we would confidently place German attitudes and behaviour far closer to the "co-operation" end than, say, those of the British or Americans'. This is an important statement in the context of understanding the philosophy of the German approach to business and to companies, whereby the shareholders are but one of a wider set of stakeholder interest with the employees and customers being given more emphasis. Charkham (1994) finds this approach evidenced in the industrial relations of German companies: 'Good industrial relations . . . would not be prominent in works on corporate governance systems in most countries, or at best would be regarded as peripheral. In Germany, however, good industrial relations are much nearer centre stage.' This is evidenced in the Works Constitution Act 1972, which sets out the rights of the works council and, broadly speaking, deals with all matters pertaining to the employees' conditions of employment. Works councils are part of the co-operative process between workers and employers, the idea being that **co-determination** (the right to be kept informed about the company's activities and to participate in decisions that may affect the workers) means that there is a basis for more trust and co-operation between workforce and employers. The Co-determination Act 1976 defines the proportion of employee and shareholder representatives on the supervisory board *(Aufsichtsrat)* and also stipulates that the management board has special responsibility for labour-related matters.

The business structure in Germany is detailed in Wymeersch (1998) where he identifies the most used business types in various continental European states. In Germany, as far as the larger business entities are concerned, the business types tend to be either public *(Aktiengesellschan AG)* or private companies limited by shares *(Gesellschaft mit beschrankter Ha(tung, GmbH)*. However, he identifies a hybrid that is also used in Germany- specifically, a hybrid of the *GmbH* & *Co. KG,* combining the advantages of the unincorporated *Kommanditgesellschaft* and the limited liability of *GmbH*.

In Germany, as in many continental European countries and the UK, there is a trend away from individual share ownership. The most influential shareholders are financial and non-financial companies, and there are significant cross-holdings, which mean that when analysing share ownership and control in Germany, one needs to look also at the links between companies. Banks, and especially a few large banks, play a central role in German corporate governance with representation on the supervisory boards of companies and links with other companies. Charkham (1994) identifies a number of reasons as to why banks are influential in Germany. First, there is direct ownership of company shares by banks; second, German shareholders generally lodge their shares with banks authorized to carry out their voting instructions (deposited share voting rights, or DSVR); third, banks tend to lend for the long term and hence develop a longer term relationship with the company (relationship lending); fourth, banks offer a wide range of services that the company may find it useful to draw upon. Given these factors, banks tend to build up a longer term, deeper relationship with companies, and their expertise is welcomed on the supervisory boards. hence the German corporate governance system could be termed an 'insider' system.

The German Corporate Governance system is based around a dual board system, and essentially, the dual board system comprises a management board *(Vorstand)* and a supervisory board *(Aufsichtsrat)*. The management board is responsible for managing the enterprise. Its members are jointly accountable for the management of the enterprise and the chairman of the management board co-ordinates the work of the management board. On the other hand, the supervisory board appoints, supervises, and advises the members of the management board and is directly involved in decisions of fundamental importance to the enterprise. The chairman of the supervisory board co-ordinates the work of the supervisory board. The members of the supervisory board are elected by the shareholders in general meetings. The co-determination principle provides for compulsory employees representation. So, for firms or companies which have more than five hundred or two thousand employees in Germany, employees are also represented in the supervisory board which then comprises one-third employee representative or one-half employee representative respectively. The representatives elected by the shareholders and representatives of the employees are equally obliged to act in the enterprise's best interests.

The idea of employee representation on boards is not always seen as a good thing because the employee representatives on the supervisory board may hold back decisions being made that are in the best interests of the company as a whole but not necessarily in the best interests of the employees as a group. An example, would be where a company wishes to rationalize its operations and close a factory but the practicalities of trying to get such a decision approved by employee representatives on the supervisory board, and the repercussions of such a decision on labour relations, prove too great for the strategy to be made a reality.

Table Key characteristics influencing German corporate governance

Feature	**Key characteristic**
Main business form	Public or private companies limited by shares
Predominant ownership structure	Financial and non-financial companies
Legal system	civil law
Board structure	dual
Important aspect	compulsory employee representation on supervisory board.

The committee on corporate governance in Germany was chaired by dr Gerhard cromme and is usually referred to as the Cromme Report or Cromme Code. The code harmonizes a wide variety of laws and regulations and contains recommendations and also suggestions for complying with international best practice on Corporate Governance.

The Cromme Code was published in 2002 and is split into a number of sections, starting with a section on shareholders and the general meeting. The Cromme Code also reflects some of the latest developments in technology. The Cromme Code was amended in 2005. Whilst it remains substantially the same, there are some significant changes, which are shown in bold in the relevant sections (i)-(vi) below.

(i) Shareholders and the general meeting

At the general meeting, the management board submits the annual, and consolidated, financial statement, and the general meeting decides on the appropriation of net income and approves the decisions of the management board and the supervisory board. An important aspect of the general meeting is that it elects the shareholders representatives to the supervisory board and also, generally, the auditors.

Interestingly, the Cromme Code makes explicit provision that the management board shall not only provide the report and accounts and other documents required by law for the general meeting but should also publish them on the company's website together with the agenda. Similarly, the use of technology is encouraged as the general meeting should be capable of being followed on the internet or similar media.

The shareholders' right to vote is facilitated in a number of ways, including by the personal exercise of shareholders voting rights, and by the use of proxies.

(ii) Co-operation between the management board and the supervisory board

It is essential that the management board and the supervisory board co-operate closely for the benefit of the enterprise. The Cromme Code defines the management board's role as to co-ordinate the enterprise's strategic approach with the supervisory board and to discuss the implementation of strategy with the supervisory board at regular intervals. There are certain situations, such as those relating to the enterprise's planning, business development, risk situation, and risk management, when the management board should inform the supervisory board immediately of any issues.

The supervisory board is able to specify the management board's information and reporting duties in more detail. It is essential that there is open discussion between the management board and supervisory board as well as amongst the members within each of those two boards. The management board and the supervisory board report each year on the enterprise's corporate governance in the annual report and they should explain any deviations from the Cromme Code. The company shall keep previous declarations of conformity with the Code available for viewing on its website for five years.

(iii) Management board

The composition of the management board is determined by the supervisory board, and should be reported in the notes to the accounts. Any conflict of interest should be disclosed to the supervisory board. The Cromme Code states that 'the management board is responsible for independently managing the enterprise' with a view to acting in the enterprise's best interest, and endeavouring to increase the sustainable value of the enterprise. As mentioned earlier, the management board develops the enterprise's strategy and co-ordinates with the supervisory board on this issue.

The Cromme Report provides for the compensation to be comprised of a fixed salary and variable component. As in many other countries, the variable compensation element should be linked to the business performance as well as long-term incentives. Stock options are mentioned as one possible element of variable compensation components and these should be linked to certain performance criteria such as the achievement of predetermined share prices.

(iv) Supervisory board

It is important that the composition of the supervisory board reflects a suitable level of knowledge, ability, and experience to be able properly to carry out the tasks relevant to the business. There should be an adequate number of independent members.

'Independence' will mean no business or personal relations with the company or its management board which cause a conflict of interest. To help maintain its independence, not more than two former members of the management board should be members of the supervisory board. the former management board chairman or a management board member should not generally become supervisory board chairman or chairman of a supervisory board committee. Supervisory board members should · not have director ships or similar positions or indeed have advisory roles with important competitors of the enterprise.

The supervisory board carries out a number of important functions as follows:

(i) it provides independent advice and supervision regularly to the management board on the management of the business;

(ii) the management board and the supervisory board should ensure that there is a long-term succession plan in place;

(iii) the supervisory board may delegate some duties to other committees, which include compensation and audit committees;

(iv) the chairman of the supervisory board, who should not be the chairman of the audit committee, co-ordinates work within the supervisory board and chairs its meetings and attends to the affairs of the supervisory board externally.

It is worth elaborating on the committees that may be formed with a remit for various delegated areas. These may include the audit committee (the chairman of the audit committee should not be a former member of the management board of the company); the chairman of the audit committee should have specialist knowledge and experience in the application of accounting principles and internal control processes, and a compensation committee to look at the compensation of the management board. This committee may also look at the appointment of members of the management board.

The Cromme Code also states that members of the management board of a listed company should not be on more than five supervisory boards in non-group listed companies. The compensation of members of the supervisory board is specified either by a resolution of the general meeting or in the articles of association. Members of the supervisory board may receive performance-related compensation as well as fixed compensation. The compensation of the supervisory board members should be disclosed in the Corporate Governance Report.

An interesting disclosure required by the Cromme Code is that if a supervisory board member takes part in less than half of the meetings of the supervisory board in a financial year, then this will be noted in the report of the supervisory board. Any conflicts of interest should be reported to the supervisory board and the supervisory board would then inform the general meeting of any conflicts of interest together with how these conflicts have been treated.

(v) Transparency

The code provides that the management board should disclose immediately any facts that might affect the enterprise's activities and which are not publicly known. The report emphasizes that all shareholders should be treated equally in respect of information disclosure and that the company may use appropriate media, such as the internet, to inform the shareholders and investors in an efficient and timely manner. there is disclosure required in terms of the shareholdings, including options and derivatives, that are held by individual management board and supervisory board members. These must be reported if they directly or indirectly exceed 1 per cent of the shares issued by the company. The code also states: 'If the entire holdings of all members of the management board and supervisory board exceed 1 per cent of the shares issued by the company, these shall be reported separately according to the management board and supervisory board.' These disclosures should all be included in the corporate Governance report.

(vi) Reporting and audit of the annual financial statements

The code states that the supervisory board or the audit committee should obtain a statement from the proposed auditor clarifying whether there are any 'professional, financial or other relationships' that might call the auditor's independence into question.

Interestingly, this statement should include the extent to which other services have been performed for the company in the past year, especially in the field of consultancy, or which are contracted for the following year. It is the supervisory board that concludes agreement on the auditors fee.

From the discussion above, it can be seen that the defining feature of Germany's corporate governance system is the significant role played by the supervisory board. In addition, the supervisory board has compulsory representation of workers via the co-determination rules. This can have an important impact on key strategic decisions, for example, if a German company decides that it needs to close one of its subsidiaries, then it may prefer to close down a subsidiary overseas, in a country such as the UK, which has a unitary board structure and hence no supervisory board with employee representation. Employees in the UK would therefore be in a weaker position than their German counterparts, and have less influence over any closure decision.

It is interesting to note that Charkham (2005), in reviewing corporate governance developments in Germany, is of the opinion that 'internal and external developments have put pressure on it, but its main provisions remain intact. The factors for change have been the diminishing role of the banks, the international governance codes and principles, and the international capital markets'.

In November 2005, Germany abolished the requirement for shares to be blocked in advance of a shareholder meeting. Blocking had meant that shares could not be traded for a period of time before a company's general meeting, if the holder of the shares wished to be able to vote on the resolutions tabled for the general meeting. therefore, it had effectively been a deterrent to voting because institutional investors often could not afford to be in a position whereby they were unable to trade their shares.

Recent legal changes now require companies to disclose pay details for executive directors, effective for annual reports for 2006 onwards. However, company management may propose that disclosure is limited and if the proposal is approved by 75 per cent of its shareholders, then the additional disclosure does not have to be given. An amended version of the German corporate Governance code was published in 2006 and recommended that various executive remuneration disclosures should be made in the corporate Governance report. Companies would be obliged to disclose if they were to deviate from these recommendations.

There were minor amendments to the German Corporate Governance Code in 2007 and 2008. In the forward to each of these codes, it is mentioned that the European company or Society Europaean (SE) gives German enterprises the opportunity to opt for the unitary board system in which case the form that co-determination would take would be a matter for agreement between the company management and the employees. Also there is now a recommendation in the section on the 'supervisory Board' that the supervisory board should form a nomination committee composed exclusively of shareholder representatives which should propose suitable candidates to the supervisory board for recommendation to the company's general meeting.

Goergen *et al.* (2008) review the governance role of large shareholders, creditors, the product market and the supervisory board, and also discuss the importance of mergers and acquisitions, the market in block trades, and the lack of a hostile takeover market. They find that, the German system is characterised by a market for partial corporate control, large shareholders and bank/ creditor monitoring, a two-tier (management and supervisory) board with co-determination between shareholders and employees on the supervisory board, a disciplinary product-market, and Corporate Governance regulation largely based on EU directives but with deep roots in the German codes and legal doctrine. Another important feature of the German system is its Corporate Governance efficiency criterion which is focused on the maximisation of stakeholder value rather than shareholder value. However, the German corporate governance system has experienced many important changes over the last decade. First, the relationship between ownership or control concentration and profitability has changed over time. Second, the pay- for-performance relation is unfluenced by large shareholder control: in firms with controlling blockholders and when a uni versal bank is simultaneously an equity- and debtholder, the pay-for-performance relation is lower than in widely-held firms or blockholder-controlled firms. Third, since 1995 several major regulatory initiatives (including voluntary codes) have increased transparency and accountability.

Odenius (2008) reviews Germany's corporate governance system and the effectiveness of recent reforms. He states that since the early 1990s far-reaching reforms have complemented the traditional stakeholder system with important elements of the shareholder system. he raises the important question of whether these reforms have created sufficient flexibility for the market to optimize its corporate governance structure within well established social and legal norms. he concludes that there is scope for enhancing flexibility in three core areas, relating to: firstly internal control mechanisms, especially the flexibility of board structures; secondly self-dealing; and thirdly external control, particularly take-over activity.

CORPORATE GOVERNANCE IN JAPAN

Japan's economy developed very rapidly during the second half of the twentieth century. Particularly during the period 1985-89, there was a 'bubble economy', characterized by a sharp increase in share prices and the value of land; the early 1990s saw the bubble burst as share prices fell and land was devalued, as well as shareholders and landowners finding themselves losing vast fortunes, banks found that they had severe problems too. During the bubble period, the banks had lent large amounts of money against the value of land and, as the repayments and the banks were left with large non-performing loans. The effect of the fall in share prices and land values spread through the Japanese economy, which became quite stagnant, and the effects spread to other countries' economies, precipitating a regional recession.

The Japanese government wished to restore confidence in the Japanese economy and in the stock market, and to attract foreign direct investment to help regenerate growth in companies. Improved corporate governance was seen as a very necessary step in this process.

Japan's Corporate Governance System is often likened to that of Germany because banks can play an influential role in companies in both countries. However, there are fundamental differences between the systems, driven partly by culture and partly by the Japanese shareholding structure with the influence of the keiretsu (broadly, associations of companies). Charkham (1994) sums up three main concepts that affect Japanese attitudes towards Corporate Governance: obligation, family, and consensus. The first of these, obligation, is evidenced by the Japanese feeling of obligation to family, a company, or country; the second, family, is the strong feeling of being part of a 'family' whether this is a family person, or a company; finally, the third concept, consensus, means that there is an emphasis on agreement rather than antagonism. These three concepts deeply influence the Japanese approach to Corporate Governance.

The *keiretsu* sprang out of the *zaibatsu*. Okumura (2002) states: 'Before World War II, when *zaibatsu* (giant pre-war conglomerates) dominated the Japanese economy, individuals or families governed companies as major stockholders. By contrast, after the war, by virtue of corporate capitalism, companies in the form of corporations became large stockowners, and companies became major stockholders of each other's stock.' The com panies forming the *keiretsu* may be in different industries, forming a cluster often with a bank at the centre. Charkham (1994) states that 'banks are said to have encouraged the formation and development of groups of this kind, as a source of mutual strength and reciprocal help'. Indeed, banks themselves have a special relationship with the companies they lend to, particularly if they are the lead or main bank for a given company. Banks often buy shares in their customer companies to firm up the relationship between com pany and bank. However, they are limited to as per cent holding in a given company but, in practk, the combination of the traditional bank relationship with its client and the shareholding mean that they can be influential, and often very helpful, if the company is in financial difficulties, viewing it as part of their obligation to the company to try to help it find a way out of its difficulties.

When compared to the German system, it should be noted that there is no automatic provision for employees to sit on the supervisory board. However, employees have traditionally come to expect that they will have lifelong employment with the same company - unfortunately, in times of economic downturn, this can no longer be guaranteed.

TheJapan Corporate Governance Committee published its revised Corporate Governance Code in 2001. The code had six chapters, which contained a total of 14 principles. the code had an interesting introduction, part of which stated 'a good company maximizes the profits of its shareholders by efficiently creating value, and in the process contributes to the creation of a more prosperous society by enriching the lives of its employees and improving the welfare of its other stakeholders'.

Summary of key characteristics influencing Japanese Corporate Governance

Feature Key characteristic

Main business form Public limited company

Predominant ownership structure *Keiretsu;* but institutional investor ownership is increasing

Legal system civil law

Board structure dual

Important aspect Influence of *keiretsu*

Hence the Code tried to take a balanced view of what a company is all about, and clearly the consideration of stakeholders is seen to be an important aspect. The foreword to the Code discussed and explained some of the basic tenets of Corporate Governance to help familiarize readers of the code with areas including the role and function of the board of directors, the supervisory body, indepen dent directors, incentive-based compensation, disclosure, and investor relations.

(i) Mission and role of the board of directors

This first chapter contained five principles relating to: the position and purpose of the board of directors; the function and powers of the board of directors; the organization of the board of directors; outside directors and their independence; the role of the leader of the board of directors.

The board should be comprised of outside directors (someone who has never been a full-time director, executive, or employee of the company)- preferably a majority- and inside directors (executives or employees of the company). Independent directors are outside directors who can make their decisions independently. The board of directors' role is seen as one of management supervision including approving important strategic decisions, nominating candidates for director positions, appointment and removal of the CEO, and general oversight of accounting and auditing. the board of directors may also be required to approve certain decisions made by the CEO.

(ii) Mission and role of the committees established within the board of directors

The board is recommended to establish various committees including an audit committee, compensation committee, and nominating committee., Each committee established should comprise at least three directors, and an outside director appointed as chair of each committee. The majority of directors on the audit committee should be inde pendent directors, whilst the majority of directors on the audit committee should be independent directors, whilst the majority of directors on the other two committees should be outside directors, of whom at least one should be an independent director.

The roles of the various committees are broadly defined and cover the usual areas that one would expect for each of these committees.

(iii) Leadership responsibility of the CEO

The CEO'S role is to formulate management strategies with the aim of maximizing corporate value in the long term. The CEO is supervised by the board of directors. the CEO may set up an executive management committee to assist him in conducting all aspects of the business. The CEO may not be a member of the committees listed above in (ii).

(iv) Addressing Shareholder Derivative Litigation

A litigation committee, comprised a majority of independent directors, may be established to determine whether litigation action should be made against directors or executives against whom the company/ shareholders may have a claim.

(v) Securing fairness and transparency for executive management

Two important areas were covered in this section of the Code: internal control and disclosure. The CEO should ensure that there is an effective Corporate Governance System with adequate internal control. the audit committee should evaluate the CEO's policies on internal audit and control. The CEO should prepare an annual report about the internal audit and control, which should preferably be audited by a certified public accountant.

Disclosure should be made by the CEO of any information that may influence share prices; also information should be disclosed to the various stakeholder groups as appropriate.

(vi) Reporting To The Shareholders And Communicating With Investors

The shareholders' general meeting is seen as an opportunity for shareholders to listen to the reports of the directors and executives, and to obtain further information about the company through asking questions. Should the questions go unanswered in the general meeting, then the answer should be put on the company's website subsequent to the general meeting.

The company's executives are encouraged to meet analysts and others who can convey information to investors and shareholders about the company. Information should also be posted on the internet to try to ensure equality of access to information amongst the various investors.

The Commercial Code in Japan provides for the appointment of statutory auditors to monitor the various aspects of the company's activities. However, in 2002, there was an extensive revision of the commercial code essentially providing companies with the option of adopting a 'Us-style' corporate governance structure. The US-style structure would have a main board of directors to carry out the oversight function, and involve the establishment of audit, remuneration, and nomination committees, each with at least three members, a majority of whom should be non-executive. A board of corporate executive officers would also be appointed who would be in charge of the day to-day business operations. Under the Us-style structure, the board of statutory auditors would be abolished. it can be seen that the Japanese Corporate Governance Committee's Code's recommendations dovetailed with the revised Commercial Code.

In 2004, the Tokyo Stock Exchange issued the *Principles of Corporate Governance for Listed Companies*. In the preface, the purpose of the Principles is described as being 'to provide a necessary common base for recognition, thereby enhancing corporate governance through the integration of voluntary activities by listed companies and demands by shareholders and investors'. The five principles are based around the OECD Principles of corporate Governance.

The first principle relates to exercising various rights of shareholders, including the right to participate and vote in general meetings, voting on such issues as the election and dismissal of directors and auditors, and fundamental corporate changes, the basic right to share various profits such as dividends, and the special right to make derivative lawsuits and injunction of activities in contravention of laws, regulations, and other rules. the voting environment should be developed and improved so that shareholders can exercise their votes appropriately and participate in general meetings of shareholders.

The second principle relates to the equitable treatment of shareholders, including minority and foreign shareholders. To this end, there should be an adequate system to prohibit transactions through the abuse of officers, employees, and controlling share holders, which are against the primary interests of the company or shareholders. There should be enhanced disclosure where it seems that such actions might occur, and there should be prohibition of special benefits to specified shareholders.

The third principle is the relationship with stakeholders in corporate governance. Whilst Corporate Governance should help to create corporate value and jobs, the fact that companies sustain and improve their strengths and enhance value over time is 'the result of the provision of company resources by all stakeholders', so the establishment of good relationships with stakeholders is important. To this end, companies should cultivate a corporate culture and internal systems, which respect the various stakeholder groups and ensure timely and accurate disclosure of information relating to them.

The fourth principle relates to disclosure and transparency. companies should ensure timely and accurate disclosure on all material matters, including the financial state and performance of the company and ownership distribution, through both quantitative and qualitative disclosures. The company should seek to ensure that investors can access infor mation easily and that there is equal access to information. internal systems should seem to ensure the accuracy and timeliness of disclosure.

The final principle relates to the responsibilities of the board of directors, auditors, board of corporate auditors, and other relevant groups. corporate governance should enhance the supervision of management by the aforementioned groups and ensure their account ability to shareholders. Systems should be developed, or enhanced, to ensure that these requirements can be met.

Finally, it is important to note that the legal framework in Japan, via the Commercial Code Revision on Boards (2003), provides for two corporate governance structures: a corporate auditors' system, consisting of general meetings with shareholders, the board of directors, representative directors, executive directors, corporate auditors, and the board of corporate auditors, and a committees system, where there are general meetings of the shareholders, the board of directors, and committees composed of members of the board of directors (nomination committee, audit committee, and compensation com mittee), representative executive officers, and executive officers. It is up to the company which system it chooses. In each case, the general meeting of shareholders is the decision-making body on matters of fundamental importance to the company. A key difference between the two structures is that companies with a committee system need to re-elect their directors annually through the general meeting of shareholders, because the board of directors has the authority regarding the definitive plan for the distribution of profit, whereas in the corporate auditors' system, this power lies with the general meetings of shareholders.

Charkham (2005) discusses the various changes that have taken place in the context of Corporate Governance in Japan and states:

The important part the banks played has greatly diminished. In its place there are now better structured boards, more effective company auditors, and occasionally more active shareholders. an increase of interest, and, where appropriate, action on their part, might restore the balance that the banks' withdrawal from the scene has impaired.

Ahmadjian and Okumura (2006) also discuss the changes that have taken place in Japan in recent years:

Over the last decade, the debate on corporate governance has contrasted two extremes - whether to become "like the US" or retain the post-war Japanese system of governance. Yet, as we noted earlier, retaining the "traditional" post-war governance system is no longer an option, since it has been severely weakened by the demise of the role of the main bank, unwinding of cross-shareholdings, changes in accounting standards and increased investment by foreigners.

It is interesting to note that Japan is now using poison pills much more to ward off hostile takeover bids (an undesirable development), whereas it does not have the huge problems associated with perceived excessive director remuneration as its directors are not paid the vast multiples of the salary of the ordinary employees as this would be considered culturally unacceptable.

In 2008, the Asian Corporate Governance Association (ACGA) published its 'White Paper on Corporate Governance in Japan'. It states, While a number of leading companies in Japan have made strides in corporate governance in recent years, we submit that the system of governance in most listed companies is not meeting the needs of stakeholders or the nation at large in three ways:

- By not providing for adequate supervision of corporate strategy;
- By protecting management from the disdpline of the market, thus rendering the development of a healthy and effident market in corporate control all but impossible;
- By failing to provide the returns that are vitally necessary to protect Japan's soda!safety net-its pension system.

It then advocates six areas for improvement: shareholders acting as owners; utilizing capital efficiently; independent supervision of management; pre-emption rights; poison pills and takeover defences; shareholder meetings and voting.

CORPORATE GOVERNANCE OF LISTING AGREEMENT IN INDIA

Applicability of Clause 49

The Clause 49 of the Listing Agreement shall be applicable to all companies whose equity shares are listed on a recognized stock exchange. However, compliance with the provisions of Clause 49 shall not be mandatory, for the time being, in respect of the following class of companies:

a. Companies having paid up equity share capital not exceeding ₹10 crore and Net Worth not exceeding ₹25 crore, as on the last day of the previous financial year;

   Provided that where the provisions of Clause 49 becomes applicable to a company at a later date, such company shall comply with the requirements of Clause 49 within six months from the date on which the provisions became applicable to the company.

b. Companies whose equity share capital is listed exclusively on the SME and SME-ITP Platforms.

The company agrees to comply with the provisions of Clause 49 which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below. In case of any ambiguity, the said provisions shall be interpreted and applied in alignment with the principles.

A. The Rights of Shareholders

The company should seek to protect and facilitate the exercise of shareholders' rights. The company should provide adequate and timely information to shareholders. The company should ensure equitable treatment of all shareholders, including minority and foreign shareholders.

B. Role of stakeholders in Corporate Governance

The company should recognise the rights of stakeholders and encourage cooperation between company and the stakeholders.

C. Disclosure and transparency

The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.

D. Responsibilities of the Board

Members of the Board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the company.

The Board and top management should conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture for good decision-making.

E. Composition of Board

The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non-executive directors.

Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the company does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.

Provided that where the regular non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

F. Independent Directors

For the purpose of the clause A, the expression 'independent director' shall mean a non-executive director, other than a nominee director of the company:

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) apart from receiving director's remuneration, has or had no material pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

G. Limit on number of directorships

A person shall not serve as an independent director in more than seven listed companies. Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

H. Maximum tenure of Independent Directors

The maximum tenure of Independent Directors shall be in accordance with the Companies Act, 2013 and clarifications/circulars issued by the Ministry of Corporate Affairs, in this regard, from time to time.

I. Non-executive Directors' compensation and disclosures

All fees / compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate.

Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 2013 for payment of sitting fees without approval of the Central Government.

Provided further that independent directors shall not be entitled to any stock option.

J. <u>Audit Committee</u>

(i) Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
3. The Chairman of the Audit Committee shall be an independent director;
4. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

5. The Audit Committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
6. The Company Secretary shall act as the secretary to the committee.

(ii) Meeting of Audit Committee

The Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

(iii) Powers of Audit Committee

The Audit Committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

(iv) Role of Audit Committee

The role of the Audit Committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;
2. Recommendation for appointment, remuneration and terms of appointment of auditors of the company;
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors;
4. Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
   (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013
   (b) Changes, if any, in accounting policies and practices and reasons for the same
   (c) Major accounting entries involving estimates based on the exercise of judgment by management
   (d) Significant adjustments made in the financial statements arising out of audit findings
   (e) Compliance with listing and other legal requirements relating to financial statements
   (f) Disclosure of any related party transactions
   (g) Qualifications in the draft audit report
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval;
6. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds

utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter;

K. Nomination and Remuneration Committee

The company through its Board of Directors shall constitute the nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

Provided that the chairperson of the company (whether executive or nonexecutive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

L. Subsidiary Companies

At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non-listed Indian subsidiary company.

The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.

The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

M. Related Party Transactions

A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.

For the purpose of Clause 49 (VII), an entity shall be considered as related to the company if:

(i) such entity is a related party under Section 2(76) of the Companies Act, 2013; or

(ii) such entity is a related party under the applicable accounting standards.

N. Disclosures

Disclosure relating to –

A. Related Party Transactions

B. Disclosure of Accounting Treatment

C. Remuneration of Directors

D. Management

E. Shareholders

F. Proceeds from public issues, rights issue, preferential issues, etc.

O. CEO/CFO certification

The CEO or the Managing Director or manager or in their absence, a Whole Time Director appointed in terms of Companies Act, 2013 and the CFO shall certify to the Board that:

(i) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :

   1. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

   2. these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.

(ii) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.

(iii) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

(iv) They have indicated to the auditors and the Audit committee:

1. significant changes in internal control over financial reporting during the year;
2. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
3. instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

P. Report on Corporate Governance

There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non- compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in **Annexure - XII to the Listing Agreement** and list of non-mandatory requirements is given in **Annexure - XIII to the Listing Agreement.**

The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in **Annexure – XI to the Listing Agreement**. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

Q. Compliance

The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

The non-mandatory requirements given in **Annexure - XIII to the Listing Agreement** may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

CORPORATE GOVERNANCE IN USA

"The world moves forward on the character of good men" —Rev. Edmund A. Walsh. S. J.

The period between thursday, august 2, 2012 and saturday, august 4, 2012 was an auspicious time in the practice of internal auditing in Ghana. during that time, The Institute of Internal Auditors (Ghana), hosted Mr. Philip tarling, the 2012-2013 Global chairman of the institute of internal auditors (iia) worldwide, the first by a Global Chairman. During his visit, Mr. Tarling delivered a public lecture at the British Council Hall, Accra, on the topic "Expanding the Frontiers of Internal auditing – A perspective from the Global Chairman". He also held sessions with key stakeholders of the profession in the country including chief executive officers, their chief internal auditors and IIA representatives from the West African Institutes. A presidential dinner was held in his honour.

The Institute of Internal Auditors is the global body for the internal audit profession. Established in 1941, The Institute of Internal Auditors (IIA) is an international professional association with global headquarters in altamonte springs, Florida, USA. The IIA is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate, and principal educator. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security. Historians have traced the roots of internal auditing to ancient times, as merchants verified receipts for grain brought to market. The real growth of the profession occurred in the 19th and 20th centuries with the expansion of corporate business. Demand grew for systems of control in companies conducting operations in many locations and employing thousands of people. Traditionally, internal auditing has been concerned with accounting and financial activities. Historically, internal auditing emerged to satisfy some well defined management needs in the areas of accounting and financial matters. Management needed to satisfy itself whether:

(a) The assets of the entity were properly protected;

(b) The policies of the entity were being complied with;

(c) Financial records were accurate and reliable.

Additionally, prevention and detection of fraud was a major focus of management. In that environment, the internal auditor was a financially oriented person with limited responsibility in the management process. He was seen more as a policeman and a checker and less as a co-worker. Internal auditing was also seen as an extension of external auditing.

The role of the internal auditor has been changing greatly over a period of time, leading to a greater reliance on him by management and the expansion of the internal audit function. This has resulted from the complexity of modern day businesses which are taking the form of multiple multi-national business units as well as the additional demands on management from various stakeholders. Competition dictates that organizations should be managed more effectively and efficiently if they are to survive and achieve growth. There is the need to optimize business performance and obtain operational excellence through greater effectiveness and efficiency. Cost reduction schemes must be implemented. Introduction of information technology into business operations have also brought its own challenges. There is therefore the need for greater protection against inefficiency, misconduct and fraudulent and illegal practices. along the line, the realization dawned that the internal auditor could play an enhanced role in offering expanded protection all the new challenges facing management have therefore dictated the changing role of the internal auditing. Modern internal auditing today reflects two broad roles: assurance and consulting. Today, internal auditing has moved from the more routine compliance level when it used to be integrated with regular accounting activities where it was carried out entirely or substantially only in the strictly financial areas to higher levels in all operational areas of management where it has established itself as a valued and respected part of top management practice. Apart from compliance reviews and analysis of financial information, the modern internal auditor performs other functions as the examination and assessment of risk management, emerging technologies, and global issues.

The year 1941 marked a major turning point. Victor Z. Brink authored the first major book on internal auditing. And at the same time, John B. Thurston, internal auditor for the North American Company in New York, had been contemplating establishing an organization for internal auditors. He and Robert B. Milne had served together on an internal auditing subcommittee formed jointly by the Edison Electric institute and the american Gas association, and they agreed that further progress in bringing internal auditing to its proper level of recognition would be best made possible by forming an independent organization for internal auditors. When Brink's book came to the attention of Thurston, the three men got together and found they had a mutual interest in furthering the role of internal auditing.

As an organizing committee, Brink, Milne, Thurston, contacted a small group of internal audit practitioners throughout the United states who expressed interest in forming a national – even international – organization for internal auditors. The IIA's certificate of incorporation was filed on November 17, 1941, and just prior to the first annual meeting on December 9, 1941, the Williams Club located at 24 East 39th Street in New York City, 24 charter members were accepted for membership. Thurston was elected as the first president of The IIA. Membership grew quickly. It went from the original 24 members to 104 by the end of the first year, to 1,018 at the end of five years. By 1957, membership had expanded to 3,700 and 20 percent were located outside of the United states. More than 70 years later, the IIA is a dynamic global organization with more than 175,000 members worldwide. Today, many people associate the genesis of modern internal auditing with the establishment of the IIA.

The Institute of Internal Auditors (Ghana) was formally registered in april 2001 in Ghana under the Professional Bodies Registration Decree, 1973 (NRCD 143) as a professional association dedicated to the promotion and development of the practice of internal auditing in Ghana. The institute was formally inaugurated on Friday, May 13, 2005 by the then Hon. Minister of Finance & Economic Planning on behalf of His Excellency the President of the Republic of Ghana. The IIA (Ghana) is a full-fledged member institute of the Global internal audit family. It also actively pursues collaboration and partnership with sister national institutes, particularly the african institutes. iia Ghana is a founding member of AFIIA – the African Federation of Institutes of Internal Audit, and currently represents west africa on its governing council.

IIA Ghana is governed by a nine-member council supported by the immediate Past-President of the Institute who is an ex-officio member. The present Council (2011-2012) comprising the following members, was elected in February 2011 and will serve until the 2012 annual General Meeting, which will be held in February 2013:

(a) Eric N. Yankah (***President***);

(b) Richard ntim (***Vice President***);

(c) Juliet Aboagye-Wiafe (Mrs.);

(d) Thomas M. Atuam;

(e) Elsie Bunyan (Mrs.);

(f) Leonard B.L. Donkoh;

(g) Rebecca a. Lomo (Ms.)

(h) Kofi Okofo-Dartey;

(i) Daniel Kwame Opare;

(j) John Djanie (***Immediate Past President***)

BY Kwame Gyasi

On November 16, 2012, Institutional Shareholder Services Inc. ("ISS") released the 2013 Updates to its U.s. **Corporate Governance** Policy (the "2013 Updates"). The 2013 Updates will be effective for shareholder meetings on or after February 1, 2013, unless otherwise noted below.

Issues affecting advisory votes on executive compensation

Investors continue to rank executive compensation as the top **corporate governance** topic. the 2013

Updates to the pay-for-performance evaluation undertaken in advance of an advisory "say-on-pay" vote on executive compensation refine how the subject companies' peer groups are selected, adjusting the criteria in an effort to include within the relevant peer group companies that have more in common with the subject company. The 2013 Updates also add the concept of "realizable pay" to the qualitative analysis for large cap companies.

Peer Groups

The 2013 Updates generally retain the methodology used by iss in 2012 to evaluate a say-on-pay proposal, utilizing both a quantitative and qualitative analysis to assess the alignment between pay and performance and determine the recommendation of iss on the proposal. As part of the quantitative analysis, the previous methodology focused the selection of a peer group on the subject company's Global Industry Classification Standard ("GICS") industry group. The GICS classification, however, does not always capture the multiple business lines in which a company operates, which may lead to the omission of direct competitors from a company's peer group or the inclusion of companies without much relation to the business of the subject company.

The 2013 Updates expand the scope of companies selected for a peer group. Instead of relying on only the company's GICS classification, the 2013 Updates provide for use of the peers from the subject company's GICS group as well as from GICS industry groups represented in the peer group the company has self-selected in benchmarking its executive compensation, while maintaining approximate proportions of these industries in the final peer group. The new methodology additionally focuses initially at an 8-digit GICS level rather than more specific levels, to be better aligned in terms of industry. ISS will prioritize for inclusion peers that (a) maintain the subject company near the median of the peer group in revenue/asset size, (b) are in the subject company's peer group and (c) have chosen the subject company as a peer. iss' selection criteria will continue to focus on companies that are reasonably similar in industry profile, size and capitalization.

Other changes to the peer group methodology include using slightly relaxed size requirements, especially at very small and very large companies, and using revenue instead of assets for certain financial companies.

Realizable Pay

The 2013 Updates expand the list of qualitative factors used to analyze pay-for-performance alignment at large cap companies to include "realizable pay", which may ultimately mitigate or exacerbate pay- for-performance concerns. While the grant date pay disclosed in a company's summary compensation Table reflects the intent of the Compensation Committee's pay decisions, it does not necessarily reflect the final payouts of performance awards or changes in value due to gains or losses in the subject company's stock price.

Realizable pay will consist of the sum of relevant cash and equity-based grants and awards made during the specific performance period being measured, based on equity award values for actual earned awards, or target values for ongoing awards, calculated using the stock price at the end of the performance measurement period. Stock options and SARs will be re-valued using the remaining term and updated assumptions, as of the performance period, using the Black-Scholes option pricing model.

Golden Parachute Proposals

The Dodd-Frank Act requires companies to hold separate shareholder votes on potential "golden parachute" payments when they seek approval for mergers, sales and certain other transactions. In determining the recommendation with respect to a golden parachute proposal, the 2013 Updates include the consideration of any existing change-in-control arrangements maintained with named executive officers, rather than focusing only on the new or extended arrangements. The list of features considered problematic has been refined. Recent amendments that incorporate problematic features will tend to carry more weight in the overall analysis. However, close scrutiny will also be given if multiple legacy problematic features are present.

Issues affecting votes on Director Nominees in Uncontested elections

Hedging and Pledging

current iss policy provides for the recommendation of a negative vote for directors, whether individually or as part of a committee or the entire board, due to material failures of risk oversight at the company. The 2013 Updates expand the examples of a failure of "risk oversight" to include, among other things, the hedging of company stock and the significant pledging of company stock as collateral for a loan.

These practices are seen as severing the alignment of interests between the officers and directors and the shareholders. Hedging of company stock at any level and in any form poses enough of a problem to warrant a negative vote recommendation. For companies in which officers or directors have pledged company stock as collateral, ISS considers the following factors in determining vote recommendations for the election of directors:

- Presence in the company's proxy statement of an anti-pledging policy that prohibits future pledging activity;

- Magnitude of aggregate pledged shares in terms of total common shares outstanding or market value or trading volume;
- Disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;
- Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
- Any other relevant factors.

Majority Supported Shareholder Proposals

As the expectations of institutional investors, and the responsiveness of issuers, regarding majority supported shareholder proposals continue to advance, ISS has adjusted its policies accordingly. Beginning with board elections in 2014, ISS will recommend a negative vote on individual directors, committee members or the entire board, as appropriate, when the board has failed to take sufficient action on a shareholder proposal that received the support of a majority of the shares cast on such proposal in the previous year.

The 2013 Updates allow for greater flexibility in recommending a vote against only certain board members, rather than the full board. The 2013 Updates also provide more guidance for evaluating the sufficiency of a company's response to a majority supported shareholder proposal. Responses that involve less than full implementation of the proposal will be evaluated on a case-by-case basis, considering the following the factors:

- The subject matter of the proposal;
- The level of support and opposition provided to the resolution in past meetings;
- Disclosed outreach efforts by the board to shareholders in the wake of the vote;
- Actions taken by the board in response to its engagement with shareholders;
- The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
- Other factors as appropriate.

The revised FaQs to be issued by iss in december may provide more guidance with respect to the implementation evaluation.

Overboarded Directors

Current iss policy recommends a negative vote on directors who are CEOS of other public companies and sit on board of more than two public companies besides their own – with the withhold recommendation only covering their outside boards. The 2013 Updates eliminate the previous exception that counted the boards of a public company parent and its public company subsidiary as a single board so long

As the parent owned at least 20% of the subsidiary. The 2013 Updates now count these parent and subsidiary boards as two separate boards.

Shareholder Proposals Addressing Social and Environmental Issues

Environmental, Social, and Governance Compensation-Related Proposals

The 2013 Updates modify ISS policy from generally recommending a vote against to making a vote recommendation on a case-by-case basis with respect to proposals that link executive compensation to sustainability criteria, including various environmental and social criteria. As these non-financial performance metrics become more common among certain industries, specifically the extractive industry sectors, and are increasingly addressed in international investor initiatives, the 2013 Updates recognize the increasing interest of institutional investors in sustainability issues as part of the evaluation process.

Lobbying

The 2013 Updates provide for vote recommendations on a case-by-case basis when evaluating proposals requesting information on a company's lobbying activities. The 2013 Updates clarify the scope and focus of lobbying activities covered, adding indirect lobbying activities as well as lobbying procedures and principles to the list that previously included only direct lobbying and grassroots lobbying within the specific policy.

New corporate legislation comes into effect in the Netherlands on 1 October 2012 and 1 January 2013.

It is important to be aware of this as it concerns, amongst other things, **Corporate Governance** issues.

The new management and supervision act (including the one tier board)

As of 1 January 2013 there will be a new **Corporate Governance** and supervision act. it affects public companies ("NVs") and private companies with limited liability ("BVs"); some clauses are also applicable to foundations.

The most important changes are:

- One tier board versus two tier board: in addition to the two tier board, the one tier board is now established. Until today, only a two tier board, with the management board and the supervisory board as a separate body, was laid down in dutch law. This new law brings the possibility, with certain limitations, to create a board with executive management board members and non executive (supervisory) management board members, both with their own duties. We are coming closer to the US and the UK. The one tier board differs from the two tier board in that the non-executive members in a one-tier board system are part of the management board and are therefore subject to director's liability.
- Conflict of Interest: the members of the management board and the supervisory board who have an (in) direct conflict of interest can no longer be part of the decision-making process regarding the underlying specific subject.
- Composition: for so called large entities there are new rules relating to the composition of the management and supervisory board. The number of permitted positions is limited. Furthermore, in large nvs and Bvs (and structure regimes) at least 30% of the positions on the management board and supervisory board must be held by women and at least 30% by men. This is done to stimulate the appointment of women on the company boards. It is, initially, a temporary rule (up to 1 January 2016).
- Responsibility: on the basis of the new legislation reference can be made to allocation of tasks in the articles of association. Although under Dutch law a division of tasks does not prejudice the joint responsibility of all members of the management board, it might under circumstances help by the so called individual exculpation possibility.
- Employment: management board members of listed companies will no longer be protected against dismissals or in case of illness, as the relationship between a board member and a listed company can no longer be based upon an employment agreement (but only on a management (service) agreement).

There are transitional provisions, but some clauses will apply immediately.

A Dutch BV is much more flexible as per 1 October 2012

On 1 October 2012 the Flex BV act entered into force. This Flex BV act brings major changes for BVs.

Some corporate provisions have changed while other have been deleted.

Amongst other things, amendments relate to the introduction of non-voting shares, capital requirements, the appointment of directors and supervisory board members, distributions, capital reduction, repurchase, vacancy of managing directors, financial assistance and convening general meetings.

The new legislation applies to all Bv's as of 1 october 2012.

Conclusion

Please review the current articles and decision making arrangements of your Dutch BV/NV in light of the possible consequences, and consider bringing the articles of association in line with new (coming) dutch law.

8.3 CORPORATE GOVERNANCE IN FAMILY BUSINESS

Introduction

The dominant form of business around the world is the family-owned business. In many instances, the family-owned business cakes the form of a small family business whilst in other cases, it is a large business interest employing hundreds, or even thousands, of staff. The family-owned business can encompass sole traders, partnerships, private companies, and public companies. In fact, family ownership is prevalent not only amongst privately held firms but also in publicly traded firms in many countries across the globe. However, whatever the size of the business, it can benefit from having a good governance structure. Firms with effective governance structures will tend to have a more focused view of the business, be willing to take into account, and benefit from, the views of `outsiders' (that is, non-family members), and be in a better position to evolve and grow into the future.

Ownership structures around the world

La Porta *et al.* (1999) analysed the ownership structure in a number of countries and found that the family-owned firm is quite common. Analysing a sample of large firms in 27 countries, La Porta *et al.* used as one of their criteria, a 10 per cent chain definition of control. This means that they analysed the shareholdings to see if there were 'chains' of ownership: for example, if company B held shares in company C, who then held company B's shares. On this 10 per cent chain definition of control, only 24 per cent of the large companies are widely held, compared to 35 per cent that are family-controlled, and 20 per cent state-controlled. Overall, they show that:

(1) Controlling shareholders often have control rights in excess of their cash flow rights.(2) This is true of families, who are so often the controlling shareholders. (3) Controlling families participate in the management of the firms they own. (4) Banks do not exercise much control over firms as shareholders... (5) Other large shareholders are usually not there to monitor the controlling share-holders. Family control of firms appears to be common, significant, and typically unchallenged by other equity holders.

La Porta *et* al.'s paper made an important contribution to our understanding of the prevalence of family-owned/controlled firms in many countries across the world.

A key influence on the type of ownership and control structure is the legal system. Traditionally, common law legal systems, such as in the UK and USA, have better protection of minority shareholders' rights than do civil law systems, such as those of France, Germany, and Russia. Often, if the legal environment does not have good protection of shareholders' rights, then this discourages a diverse shareholder base whilst being more conducive to family-owned firms where a relatively small group of individuals can retain ownership, power, and control. For example, in the UK and USA, where the rights of minority shareholders are well protected by the legal system, there are many more companies with diversified shareholder bases and family-controlled businesses are much less common.

However, research by Franks *et al.* (2004 and 2005) highlighted that, in the UK in the first half of the twentieth century, there was an absence of minority investor protection as we know it today, and yet there still occurred a move from family ownership to a more dispersed share ownership. This was attributable to the issuance of shares through acquisitions and mergers, although families tried to retain control of the board by holding a majority of the seats. Franks *et al.* (2004) state, the rise of hostile takeovers and institutional shareholders made it increasingly difficult for families to maintain control without challenge. Potential targets attempted to protect themselves through dual class shares and strategic share blocks but these were dismantled in response to opposition by institutional shareholders and the London Stock Exchange. The result was a regulated market in corporate control and a capital market that looked very different from its European counterparts. Thus, while acquisitions facilitated the growth of family controlled firms in the first half of the century, they also diluted their ownership and ultimately their control in the second half.

On the other hand, in many countries, including European countries such as France, many Asian countries, and South American countries, the legal protection of minority shareholders is today still either non-existent or ineffective, and so families often retain control in companies because non-family investors will not find the businesses an attractive investment when their rights are not protected.

However, many countries are recognizing that, as the business grows and needs external finance to pursue its expansion, then non-family investors will only be attracted to the business if there is protection of their rights, both in the context of the country's legal framework and also in the corporate governance of the individual companies in which they invest. This is leading to increasing pressure both for legal reforms to protect shareholders' rights and for corporate governance reforms within the individual companies. On the other hand, balanced against the pressures for reform are the, often very powerful, voices of family shareholders with controlling interests who may not wish to see reform to give better protection to minority interests because this would effectively dilute their control.

Family-owned firms and governance

Whilst a family-owned business is relatively small, the family members themselves will be able to manage and direct it. One advantage of a family-owned firm is that there should be less chance of the type of agency problems discussed in Chapter 2. This is because ownership and control rather than being split are still one and the same, and so the problems of information asymmetry and opportunistic behaviour should (in theory, at least) be lessened. As a result of this overlap of ownership and control, one would hope for higher levels of trust and hence less monitoring of management activity should be necessary. However, problems may still occur and especially in terms of potential for minority shareholder oppression, which may be more acute in family-owned firms. Morck and Yeung (2003) point out some of the potential agency costs in family-owned firms:

In family business group firms, the concern is that managers may act for the controlling family, but not for shareholders in general. These agency issues are: the use of pyramidal groups to separate ownership from control, the entrenchment of controlling families, and non-arm's-length transactions (aka 'tunneling') between related companies that are detrimental to public investors.

In some countries, remedies such as formal shareholder agreements, in which the nature of each shareholder's participation in the company is recorded, may be utilized as a mechanism to help resolve the potential oppression of minorities. Furthermore, the EU Commission's proposed Shareholder Rights Directive, issued in January 2006, is designed to help strengthen the role of shareholders by ensuring that they have relevant information in a timely manner and are able to vote in an informed way. Although the proposed directive is aimed at listed companies, and so likely primarily to affect institutional investors, Member States are free to extend to non-listed companies some or all of the provisions of the proposed Directive.

Another advantage of family-owned firms may be their ability to be less driven by the short-term demands of the market. Of course, they still ultimately need to be able to make a profit but they may have more flexibility as to when and how they do so.

However, even when a family business is still relatively small, there may be tensions and divisions within the family as different members may wish to take different courses of action that will affect the day-to-day way the business operates and its longer term development. In the same way as different generations of a family will have diverse views on various aspects of life, so they will in the business context as well. Similarly, as siblings may argue about various things, so they will most probably differ in their views of who should hold power within the business and how the business should develop. Even in the early stages of a family firm, it is wise to have some sort of forum where the views of family members regarding the business and its development can be expressed. One such mechanism is the family meeting or assembly, where family members can meet, often on a formal pre-arranged basis, to express their views. As time goes by and the family expands with family by marriage and new generations, then the establishment of a family council may be advisable. Neubauer and Lank (1998) suggest that a family council may be advisable once there are more than 30-40 family members.

When a business is at the stage where family relationships are impeding its efficient operation and development, or even if family members just realize that they are no longer managing the business as effectively as they might, then it is definitely time to develop a more formal governance structure. There may be an intermediate stage where the family are advised by an advisory board, although this would not provide the same benefits to the family firm as a defined board structure with independent non-executive directors. Figure 5.1 illustrates the possible stages in a family firm's governance development.

Cadbury (2000) states that establishing a board of directors in a family firm is a means of progressing from an organisation based on family relationships to one that is based primarily on business relationships. The structure of a family firm in its formative years is likely to be informal and to owe more to past history than to present needs. Once the firm has moved beyond the stage where authority is vested in the founders, it becomes necessary to clarify responsibilities and the process for taking decisions.

The advantages of a formal governance structure are several. First of all, there is a defined structure with defined channels for decision-making and clear lines of responsibility. Secondly, the board can tackle areas that may be sensitive from a family viewpoint but which nonetheless need to be dealt with - succession planning is a case in point (deciding who would be best to fill key roles in the business should the existing incumbents move on, retire, or die). Succession planning is important too in the context of raising external equity because, once a family business starts to seek external equity investment, then shareholders will usually want to know that succession planning is in place. The third advantage of a formal governance structure is also one in which external shareholders would take a keen interest: the appointment of non-executive directors. It may be that the family firm, depending on its size, appoints just one, or maybe two, non-executive directors. The key point about the non-executive director appointments is that the persons appointed should be independent; it is this trait that will make their contribution to the family firm a significant one. Of course, the independent non-executive directors should be appointed on the basis of the knowledge and experience that they can bring to the family firm: their business experience,

Family assembly	Family council	Advisory board	Board of directors (including outside directors

Possible stages in a family firm's governance

or a particular knowledge or functional specialism of relevance to the firm, which will enable them to `add value' and contribute to the strategic development of the family firm.

Cadbury (2000) sums up the three requisites for family firms to manage successfully the impacts of growth: `They need to be able to recruit and retain the very best people for the business, they need to be able to develop a culture of trust and transparency, and they need to define logical and efficient organisational structures'. A good governance system will help family firms to achieve these requisites.

Bammens and Voordeckers (2009), in a study of family firms in Belgium, find that 'contrary to traditional agency wisdom, family firm boards devote substantial attention to controlling the management team… those family firms that employ trust and control in a complementary manner will be most effective'.

In the context of succession planning, Bennedsen *et* at (2006), in a study of family firms in Denmark, report that their empirical results demonstrate that professional, non-family CEOs provide extremely valuable services to the organizations they head. On the other hand, they report that family CEO underperformance is particularly large in fast-growing industries, industries with a highly skilled labor force and relatively large firms.

Smaller quoted companies

In the UK, many firms with family control will be smaller quoted companies, either on the main market or on the UK's Alternative Investment Market (AIM), which can be seen as a way for smaller firms to obtain market recognition and access to external sources of finance, often before moving on to the main market.

The Combined Code 2008 forms part of the UK Listing Authority's Rules and is applicable to all UK listed companies. This means that there should be no distinction between the governance standards expected of larger and smaller companies. The Combined Code states that it encourages smaller companies to adopt the Code's approach. However, in relation to smaller companies (those outside the FTSE 350), it states that they should have at least two independent non-executive directors (rather than half the board being independent non-executive directors, which is the requirement for larger companies); and also for listed companies outside the FTSE 350, it allows the company chairman to sit on the audit committee where he or she was considered independent on appointment.

The Quoted Companies Alliance (QCA), formerly the City Group for Smaller Companies (CISCO), is an association representing the interests of smaller companies and their advisers. The QCA fully embraces the principles of corporate governance contained in the Combined Code and advocates that these principles should be adopted by all public quoted companies in so far as it is practicable for their size. *QCA Guidance for Smaller Companies* (2001), updated in 2004, urges smaller companies to comply with the Combined Code as far as they are able, but where they are unable to comply fully, then they should explain why they are unable to comply. The QCA Corporate Governance Committee (2005, updated in 2007) published a corporate governance guide for AIM companies to help smaller companies seeking to develop their governance, or to meet the expectations of institutional investors.

There has been a distinct lack of research into aspects of corporate governance in small companies, with a few exceptions being Collier (1997) on audit committees in smaller listed companies, and Mallin and Ow-Yong (1998a, 1998b) on corporate governance in AIM companies and corporate governance in small companies on the main market. Mallin and Ow-Yong (2008) carried out a further study of corporate governance in AIM companies and highlighted a concern that 'with the rapid expansion of AIM and the increasing number of overseas companies, from countries whose culture of good governance may be weaker than that of the UK, a damaging financial scandal or collapse is only a matter of time'. They recommended that the role of the NOMAD [nominated advisor] be re-examined; the admission of overseas companies to AIM should be more closely scrutinized; small boards which may not be able to institute all the features of 'good' corporate governance should consider increasing the number of directors on their board, subject to resource constraints; and the regulatory authorities should monitor more closely the governance of AIM companies which have yet to start trading.

Another strand of the literature concentrates on firm-level characteristics that may serve to differentiate large and small firms. Larger firms tend to be more complex, whereas smaller firms adopt simpler systems and structures; smaller firms tend to have more concentrated leadership, whilst in a larger firm control may be more diffuse, or more subject to question by a larger board (Fama and Jensen 1983; Begley and Boyd 1987). In terms of the impact on corporate governance structures, it can be expected that in general, small and medium-sized firms will have simpler corporate governance structures than large firms - this may include: combining various of the key committees (audit, remuneration, nomination); a smaller number of non-executive directors (NEDs); a combined chair/CEO; longer contractual terms for directors due to the more difficult labour market for director appointments into small and medium-sized companies.

The role and importance of NEDs was emphasized in the Cadbury Report (1992) and in the Code of Best Practice it is stated that NEDs 'should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct'. Similarly, the Hampel Report (1998) stated: 'Some smaller companies have claimed that they cannot find a sufficient number of independent non-executive directors of suitable calibre. This is a real difficulty, but the need for a robust independent voice on the board is as strong in smaller companies as in large ones'. The importance of the NED selection process is also emphasized: they 'should be selected through a formal process and both this process and their appointment should be a matter for the board as a whole'.

From the above diagram, it can be seen that the areas where potential difficulties are most likely to arise tend to be those relating to the appointment of directors, particularly non-executive directors, which has implications for board structure. These differences arise partly because of the difficulties of attracting and retaining suitable non-executive directors in small companies.

Mallin and Ow-Yong (1998b) found that the most important attribute for small businesses when recruiting non-executive directors was their business skills and experience. Overall, the inference could be made that the ability to `add value' to the business is the most important factor influencing NED appointments, which is in line with a study by Collier (1997). Similarly, the Hampel Committee (1998) stated 'particularly in smaller companies, non-executive directors may contribute valuable expertise not otherwise available to management'.

Areas of the Combined Code that may prove difficult for smaller companies

Combined Code recommendations	Potential difficulty
Minimum two independent NEDs	Recruiting and remunerating independent NEDs
Split roles of chair/CEO	May not be enough directors to split the roles
Audit committee comprised of two NEDs	Audit committee may include executive directors
NEDs should be appointed for specific terms	NEDs often appointed for term

However, many small companies do not have a nomination committee, and therefore non-executive director appointments are often made by the whole board. Interestingly, Mallin and Ow-Yong (2008) found that the factor that was considered to be most influential when making non-executive director appointments was considered to be `objectivity and integrity' followed by `relevant business skills and experience'. This perhaps highlights the impact of various corporate scandals and collapses in bringing to the fore the importance of these characteristics of objectivity and integrity.

In terms of the adoption of board committees, such as audit, remuneration, and nomination committees, small companies tend to have adopted audit and remuneration committees fairly widely but not nomination committees. In some smaller companies, the committees may carry out combined roles where, for example, the remuneration and nomination committees are combined into one committee; often the board as a whole will carry out the function of the nomination committee rather than trying to establish a separate committee from a small pool of non-executive directors.

A word of caution should be sounded though in relation to quoted companies where there is still a large block of family ownership (or indeed any other form of controlling shareholder). Charkham and Simpson (1999) point out:

the controlling shareholders' role as guardians is potentially compromised by their interest as managers. Caution is needed. The boards may be superb and they may therefore be fortunate enough to participate in a wonderful success, but such businesses can decline at an alarming rate so that the option of escape through what is frequently an illiquid market anyway may be unattractive.

The points made are twofold: first, that despite a good governance structure on paper, in practice, controlling shareholders may effectively be able to disenfranchise the minority shareholders; secondly, that in a family-owned business, or other business with a con-trolling shareholder, the option to sell one's shares may not be either attractive or viable at a given point in time.

Conclusions

In many countries, family-owned firms are prevalent. Corporate governance is of relevance to family-owned firms, which can encompass a number of business forms including private and publicly quoted companies, for a number of reasons. Corporate governance structures can help the company to develop successfully - they can provide the means for defined lines of decision-making and accountability, enable the family firm to benefit from the contribution of independent non-executive directors, and help to ensure a more transparent and fair approach to the way the business is organized and managed. Family-owned firms may face difficulties in initially finding appropriate independent non-executive directors but the benefits that such directors can bring is worth the time and financial investment that the family-owned firm will need to make.

SUMMARY

- Family ownership of firms is the prevalent form of ownership in many countries around the globe.
- The legal system of a country tends to influence the type of ownership that develops, so that in common law countries with good protection for minority shareholders' rights, the shareholder base is more diverse, whereas in civil law countries with poor protection for minority shareholders' rights, there tends to be more family ownership and control.
- The governance structure of a family firm may develop in various stages such as starting with a family assembly, then a family council, advisory board, and finally, a defined board structure with independent non-executive directors.
- The advantages to the family firm of a sound governance structure are that it can provide a mechanism for defined lines of decision-making and accountability, enable the family firm to benefit from the contribution of independent non-executive directors, and help to ensure a more transparent and fair approach to the way the business is organized and managed.

Example: Cadbury plc; UK

This is an example of a family firm that grew over tune, developed an appropriate governance and became an international business.

Today, Cadbury is a household name in homes across the world. It was founded in the first part of the nineteenth century when John Cadbury decided to establish a business based on the manufacture and marketing of cocoa His two sons joined the firm in 1861 and, over the years, more family members joined, and subsequently the firm became a private limited liability company, Cadbury Brothers td. A board of directors was formed comprising of members of the family.

Non-family directors were first appointed to the firm in 1943, and in 1962, the firm became a publicly quoted company with the family members still being the majority on the board and holding a controlling interest (50 per.cent plus) in the shares. Cadbury merged with Schweppes in the late 1960s, and over the next 40 years, Cadbury Schweppes developed a diverse shareholder base and a board of directors appointed from the wider business community. The direct family involvement, via either large shareholdings or board membership, therefore declined over the years. In the Spring of 2007, Cadbury Schweppes revealed plans to split its business into two separate entities: one focusing On its main chocolate and canfectionery market; the other on its US drinks business. The demerger took effect in May 2008 so that Cadbury Schweppes plc became Cadbury plc (focusing on the former market) and Dr Pepper Snapple Group Inc: (focusing on the QS drinks business).

In 2009, Kraft launched a hostile takeover bid for Cadbury. Cadbury decided to fight to retain its independence.

Example: Hutchison Whampoa, Hong Kong

This is an example of an international company where there is controlling ownership by a family via a pyramid shareholding.

Hutch son Whampoa is a multinational conglomerate with five core businesses including ports and related services, property and hotels, telecommunications, retail and manufacturing, energy and infrastructure. It ranks as one of the Most valuable companies in Hong Kong and a large proportion of it is controlled by Cheung Kong Holdings in which the Li Ka Shing family have a significant interest which means that the Li Ka Shing family has significant influence over both companies, one through direct ownership, the other via an indirect, or pyramid, shareholding.

Hutchison Whampoa has, for many years, been the recipient of various awards and accolades. In 2005, it was voted the best-managed company in Hong Kong in a poll of institutional investors and equity analysts carried out for the Finance Asia annual awards. In the same poll, it was voted Asia's Best Conglomerate and its CFO received the Best CFO Award in Hong Kong. The Hong Kong Institute of Certified Public Accountants awarded its significant improvement Award in the Hang Seng Index Category to Hutchison Whampoa in 2005 for its 'very clear arid positive approach to upgrading its corporate governance practice'. Whilst having a controlling family interest, Hutchison Whampoa is committed to good corporate governance and to its wider shareholder base. More recently, in 2008, it was recognized by Corporate Governance Asia as one of 'The Best of Asia', that is one of Asia's Best Companies for Corporate Governance.

Mini case study: Fiat, Italy

This is a good example of a firm where the founding family still have significant influence through a complex shareholding structure.

Fabbrica Italiana Automobile Torino, better known as Fiat, was founded in 1899 by a group of investors including Giovanni Agnelli. Fiat automobiles were immediately popular not just in Italy but internationally too. Fiat expanded rapidly in the 1950s and, in 1966, the founder's grandson, also Giovanni Agnelli, became the company's chairman. As well as cars, Fiat's business empire included commercial vehicles, agricultural, and construction equipment, insurance, aviation, the press, electric power and natural gas distribution. In past years, it has achieved enormous financial success.

More than 90 per cent of Italian registered companies are family owned, with many companies being run by Italian families who wield great power. Traditionally, control has been achieved, often with the minimum of capital outlay, through a complex structure involving a series of holding companies. In the case of Fiat, control by the Agnelli family is via pyramids (indirect holdings) and voting trusts particularly Ifi (a financial holding company) in which the Agnelli family have control of all the votes.

By 2002, Fiat had significant financial problems with losses of US$1.2 billion in 2002. General Motors, which had acquired a 20 per cent shareholding in Fiat at a cost of US$2.4 billion, was asked to invest further in Fiat but was reluctant to do so. In 2003, the group restructured its core business area by again focusing manufacturing and service activities on the traditional motor vehicle sector.

In 2003, Umberto Agnelli died, and in 2004, Luca Cordero di Montezemolo was nominated as Chairman. Also in 2004, Sergio Marchionne was appointed as Chief Executive of Fiat and this marked a turning point in the company's fortunes. An astute and experienced businessman, Mr Marchionne oversaw changes to various areas of the Fiat business. At the beginning of 2005, Fiat announced the creation of fiat Powertrain Technologies, a new industrial unit designed to integrate the groups' innovation capabilities and expertise in engines and transmissions. In February 2005, the boards of directors of Fiat and General Motors met to approve t} contract to terminate the master agreement and related joint ventures between the two companies The Chairman of Fiat, Luca Cordero di Montezemolo, said:

We are delighted to have been able to conclude this agreement with General Motors While highly beneficial to both Fiat and GM since 2000, the arrangements had become too confining for the development of Fiat Auto in today's market environment. We now have all the necessary freedom to develop strategic growth alternatives for Fiat Auto, while retaining a base on which to build a much more construction relationship with GM in the future.

There were also important changes to Fiat's corporate governance structure in June 2005, with Fiat extending its board of directors to 15 members, so that the board comprised a majority of independent non-executive directors. At the same time, Fiat strengthened its independence requirements for directors. In its press release, it stated:

After a thorough review of current international practice on this issue, the Company has adopted a set of criteria which are designed to ensure that the independence qualification is held to the highest possible standard. As an example, directors who have served on the Board for more than nine years, even though not consecutively, are deemed not to be independent. Furthermore, board members who are executive directors of other companies on whose board[s] sit executive board members of Fiat are also deemed not to be independent.

In January 2006, Fiat announced another significant strategic change with the signing of an agreement to co-operate on dealer networks with Tate Motors Ltd., which meant that Fiat cars could be distributed via the Tata network in India. Late in January 2006, Fiat announced that it had seen its first positive quarterly trading profit after 17 successive quarters of losses.

With the revision of Italian corporate governance provisions, the Fiat Group adopted and abides by the Corporate Governance Code of Italian Listed Companies issued in March 2006. Fiat provides information regarding how it meets the individual principles and criteria of the Corporate Governance code by providing a reprise of the individual principles and criteria, and then summarizing how each of these is implemented at Fiat.

2006 saw the strengthening of Fiat's presence in Europe and the gain no of access into markets including China, India, and Russia. In 2007, Sergio Marchionne announced the 2007-2010 plan geared towards growth. In 2009 he unveiled his plan to put Fiat at the heart of the car-making industry globally by forging an alliance with the giant troubled US car manufacturers Chrysler and General Motors (Opel, the European arm) in June 2009, Fiat and Chrysler announced that they had finalised a global strategic partnership to begin immediately. The ultimate success of the alliance will depend on many factors and will likely have implications for the workforces in the various countries affected including Germany and the UK.

8.4 CORPORATE GOVERNANCE IN STATE-OWNED BUSINESS - THE MOU SYSTEM

Most of the industrialization in developing countries was initiated by governments due to the inherent problems associated with the mobilization of capital for the purpose of industrialization. Also, the pursuit of economic systems and ideologies such as socialism or communism required such countries either to wholly depend on or at least sustain with the initiatives of the public sector. While many countries initiated steps to gradually do away with the whole concept of the public sector except in strategically important areas such as defence or space research like the US or UK, the Government of India has been following a policy where the public sector co-exists with the private sector even though a great deal of effort has been taken at privatization of government-owned enterprises or part divestment of government stakes in the public sector companies. Corporate governance has become applicable to many of the public sector enterprises (PSEs) as they have chosen to raise funds from the capital markets, either through public offers of equity capital or through a process of divestment of equity in favour of private corporate bodies or institutional investors.

Difficulties Encountered in Governance

While routine governance regulations become applicable for public sector companies formed under the Companies Act, 1956 and come under the purview of SEBI regulations the moment they mobilize funds from the public, the typical organizational structure of PSUs makes it difficult for the implementation of corporate governance practices as applicable to other publicly-listed private enterprises. The typical difficulties faced are:

- The board of directors will comprise essentially of bureaucrats drawn from various ministries which are interested in the PSU In addition, there may be nominee directors from banks or financial institutions who have loan or equity exposures to the unit. The effect will be to have a board much beyond the required size, rendering decision-making a difficult process.

- The chief executive or managing director (or chairman and managing director) and other functional directors are likely to be bureaucrats and not necessarily professionals with the required expertise. This can affect the efficient running of the enterprise.
- Difficult to attract expert professionals as independent directors. The laws and regulations may necessitate a percentage of independent component on the board; but many professionals may not be enthused as there are serious limitations on the impact they can make.
- Due to their very nature, there are difficulties in implementing better governance practices. Many public sector corporations are managed and governed according to the whims and fancies of politicians and bureaucrats. Many of them view PSUs as a means to their ends. A lot of them have turned sick due to overdoses of political interference, even when their areas of operations offered enormous opportunities for advancement and growth. And when the economy was opened up, many of them lacked the competitiveness to fight it out with their counterparts from the private sector.

OECD Guidelines for Corporate Governance of State-owned Enterprises

Many of the developing countries still continue to have a dominant presence of state-owned enterprises. Hence, OECD thought it appropriate to evolve a set of governance guidelines for the state-owned enterprises as it did for the private enterprises in member countries. According to OECD, A major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as, the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company. Another important challenge is to ensure that there is a level playing field in markets where private sector companies can compete with the state-owned enterprises, and that governments do not distort competition in the way they use their regulatory or supervisory powers.'

According to OECD, the guidelines 'suggest that the state should exercise its ownership functions through a centralized ownership entity, or effectively co-ordinated entities, which should act independently and in accordance with a publicly disclosed ownership policy. The guidelines also suggest the strict separation of the state's ownership and regulatory functions. If properly implemented, these and other recommended reforms would go a long way to ensure that state ownership is exercised in a professional and accountable manner, and that the state plays a positive role in improving corporate governance across all sectors of our economies. The result would be healthier, more competitive, and transparent enterprises'.

The major recommendations in OECD guidelines are as discussed below.

Ensuring an effective legal and regulatory framework for state-owned enterprises

- There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.
- SOEs should not be exempt from the application of general laws and regulations. Stakeholders including competitors, should have access to efficient redress and an even-handed ruling when they believe that their rights have been violated.
- SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions, and other state-owned companies, should be based on purely commercial grounds.

State acting as an owner

The state should act as an informed and active owner, and establish a clear and consistent ownership policy, ensuring that governance of state-owned enterprises is carried out in a transparent and accountable manner with the necessary degree of professionalism and effectiveness.

- The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in corporate governance of SOEs, and how it will implement its ownership policy.
- The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.
- The state should let SOE boards exercise their responsibilities and respect their independence.
- •The state should exercise its ownership rights according to the legal structure of each company. Keeping this in mind, it should ensure that remuneration schemes for SOE board members foster the long-term interest of the company, and can attract and motivate qualified professionals.

Equitable treatment of shareholders

The SOEs should recognize the rights of all shareholders and in accordance with the OECD principles of corporate governance, ensure their equitable treatment and equal access to corporate information.

- SOEs should observe a high degree of transparency towards all shareholders.
- The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equally.
- The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions, such as board election.

Relations with stakeholders

The state ownership policy should fully recognize the state-owned enterprises' responsibilities towards stakeholders and report their relations with them.

- Listed on large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

Transparency and disclosure

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

- SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.
- SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures dots not substitute for an independent external audit.

Responsibilities of the boards of state-owned enterprises

The boards of state-owned enterprises should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management They should act with integrity and be held accountable for their actions.

- The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equally.
- SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.

- The boards of SOEs should be so composed that they can exercise objective and independent judgement. Good practice calls for the chair to be separate from the CEO.
- SOE boards should carry out an annual evaluation to appraise their performance.

Conflicts of Interest

Conflicts of interest are a major challenge to the establishment and maintenance of good governance practices, and can occur and exist irrespective of the ownership structures. While some of the conflicts may be similar in nature, others may be typical to the type of ownership structure.

Most of the conflicts of interest in PSUs occur because of the roles played by bureaucrats and politicians in the running and management of the enterprise. For example, polticians or bureaucrats may try to have their candidate as the chairman and/or managing director in order to push through their private agendas rather than getting the best professional to run the PSU. There have also been many instances where the chairman and/or managing director, or other senior executives of the PSU has placed orders or awarded contracts at rates higher than the best prices, and earned hefty commissions on these. Orders or contracts may also be given to those who do not have the necessary capabilities to execute them. What is best for the PSU usually gets neglected. There may also be issues such as ministers or politicians yielding to recommendations of their cadre and sometimes even creating positions or designations that are not at all needed, leading the PSU to have a bloated workforce and driving it into the sick category. Politicians or bureaucrats may even harp on the flimsy reason that PSUs have employment generation as one of their aims. Most of the conflicts of interest with regret to PSUs dwell on the area of decision-making, which is very often not founded on merit.

Public Sector Enterprises and the Memorandum Of Understanding:

After Independence, Public Sector Enterprises (CPSEs) were set up in India with an objective to promote rapid economic development through the creation and expansion of infrastructure by the government. With different phases of development, the role of CPSEs has changed and their operations have extended to a wide range of activities in manufacturing, engineering, steel, heavy machinery, machine tools, fertilizers, drugs, textiles, pharmaceuticals, petro-chemicals, extraction and refining of crude oil and services such as telecommunication, trading, tourism, warehousing, etc. as well as a range of consultancy services. While there have been many CPSEs that have performed very well in competition with private sector enterprises, there are also many CPSEs that have performed very poorly. In an economic environment that has changed considerably in the last two decades, the role of CPSEs has changed and they have been increasingly guided to reduce their dependence on the Government. They have been listed on the stock exchange and few of them have been privatized. The Government has provided CPSEs the necessary flexibility and autonomy to operate effectively in a competitive environment. However, there are a few issues with the operation and management of CPSEs which still persist and need to be attended to. There is a need to develop a mechanism on how government can get an efficient Indian presence in the sectors where the private sector investments are not forthcoming especially in strategic areas where developing capabilities is essential if India has to play its rightful role among the among the nations of the world.

Governance in India: The Path Ahead

The Indian economy on the eve of the Twelfth Plan is characterized by strong macro-fundamentals and good performance over the Eleventh Plan period, though clouded by some slowdown in growth in the current year with continuing concern about inflation and a sudden increase in uncertainty about the global economy. The objective of the Eleventh Plan was faster and inclusive growth and the initiatives taken in the Eleventh Plan period have resulted in substantial progress towards both objectives. Inevitably, there are some weaknesses that need to be addressed and new challenges that need to be faced. Some of the challenges themselves emanate from the economy's transition to a higher and more inclusive growth path, the structural changes that come with it and the expectations it generates. There are external challenges also arising from the fact that the global economic environment is much less favourable than it was at the start of the Eleventh Plan. These challenges call for renewed efforts on multiple fronts, learning from the experience gained, and keeping in mind global developments. We focus on the backdrop of target setting and areas of focus of the Eleventh Plan. India entered the Eleventh Plan period (2007-2012) with an impressive record of economic growth. The vision for the Eleventh Plan prominently included an improvement in governance. Over the years, the governments at the Centre and the States have launched a large number of initiatives at substantial public expense to achieve the objectives of growth with poverty alleviation and inclusiveness. Experience suggests that many of these initiatives have floundered because of poor design, insufficient accountability and also corruption at various levels. Increasingly, there is demand for effective implementation without which expanded government intervention will be infructuous. The strategy for the Eleventh Plan was therefore aimed at bringing about major improvements in governance which would make government-funded programmes in critical areas more effective and efficient. The best possible way of achieving this objective may be by involving communities in both the design and implementation of such programmes, although such involvement may vary from sector to sector. For achieving the vision of the Eleventh Plan, it is extremely important to experiment with programme design to give more flexibility to decision making at the local level. It is especially important to improve evaluation of the effectiveness of how government programmes work and to inject a commitment to change their designs in the light of the experience gained. Evaluation must be based on proper benchmarks and be scientifically designed to generate evidence-based assessment of different aspects of programme design. Along with greater transparency and feedback from community participation, this is particularly important in the case of programmes delivering services directly to the poor. Accountability and transparency are critical elements of good governance. The Right to Information Act (RTI) enacted in 2005 empowers people to get information and constitutes a big step towards transparency and accountability.

MoU in India

Notwithstanding the spectacular performance of CPSEs in several areas, there has been a sense of disillusionment with some aspects of CPSE performance such as low profitability and lack of competitiveness. The extensive regulation of CPSEs by government had stifled the initiative and growth of public sector. The Economic Administration Reforms Commission (Chairman: L. K. Jha) had dwelt on issue of autonomy and accountability. The Commission had recommended a careful re-consideration of extant concepts and instrumentalities relating to the accountability of public enterprises with a view to ensuring (a) that they do not erode the autonomy of public enterprises and thus hampers the very objectives and purposes for which these enterprises have been set up and given corporate shape and for which they are to be accountable; and (b) accountability has to be secured in the wider sense of answerability for the performance of tasks and achievements of results (EARC-II/Report No. 4, p. 22). The adoption of MoU system in India could be seen as an attempt to operationalize this very vital recommendation.

Memorandum of Understanding: In Retrospect

The concept of Memorandum of Understanding (MoU) has been designed to provide flexibility and autonomy to Central Public Sector Enterprises (CPSEs) such that it facilitates them in pursuing the objectives and purposes, for which the enterprises have been set up. Accountability has to be understood in a wider sense by associating it with answerability for the performance of the tasks and the achievement of targets negotiated mutually between the Government and the CPSE. The rationale for MoU could be derived from principal/agent theory. The principal (administrative ministry on behalf of real owners- the people) can only observe outcomes and cannot measure accurately the efforts expended by the agent (CPSE managers). Also the Principal can only, to a limited extent, distinguish the effects of influences from other factors, which affect the performance (Laffont and Tirole 1993). Therefore extensive intervention by administrators, who might not be too knowledgeable about the nature of problems confronting the enterprises, not only impacts productivity and profitability but also makes it impossible to fix accountability for non-achievement of targets.

A negotiated incentive contract (MoU), hence, is viewed as a device to reveal information and motivate managers to exert effort. Proponents argue that the contract can translate multiple objectives into targets which can be measured by specified criteria and could be given weights to reflect priorities. Moreover, targets can be set to take into account circumstances where CPSE managers have less control over their firms than their counterparts in the private sector. For example, performance might be judged against the firm's past trends, rather than against an industry standard, to take account of situations where the firm's performance is sub-standard because of government imposed constraints (such as prohibitions on layoffs, price controls, etc.).

By specifying targets and evaluating results ex post, the MoU is seen by its advocates as a way to encourage governments to reduce ex ante controls, giving managers more freedom and motivation to improve operating efficiency.

Hence, it is strongly felt that Performance Contracts will improve performance only if they elicit both the Government's and the Firms' commitment. Since Government is both a signatory and the enforcer of the contract, it is especially important that its commitment remains credible. Political determinants may preclude the design of incentive contracts and impede CPSEs in producing the sort of productivity gains being achieved by the private firms. These findings suggest that effort in designing a framework of MoU on consistent basis can produce good results.

The Memorandum of Understanding (MoU) System in India was introduced in the year 1986, after the recommendations of the Arjun Sengupta Committee Report (1984). Twenty six years after its inception, the MoU system has evolved and is being strengthened, through regular reviews, to become a management tool that helps in performance evaluation as well as performance enhancement of CPSEs in the country.

In the backdrop of the dynamic external environment, "world- wide competition" and globalization, it is critical that the MoU system is strengthened such that it facilitates the CPSEs in becoming economically viable through efficient management and control. Hence, the MoU system aims at offering autonomy to CPSEs and is designed such that it can aid in the assessment of the extent to which mutually agreed objectives (Mandal, 2012) are achieved. This section of the report traces the evolution of the MoU system through various committee reports and highlights the major observations, along with the actions taken thereafter. This would act as an indicator of the developments that have happened in the MoU system in India and, through the study of extant literature, would also highlight the areas of concern raised after each study.

The various committees formed over the years are:

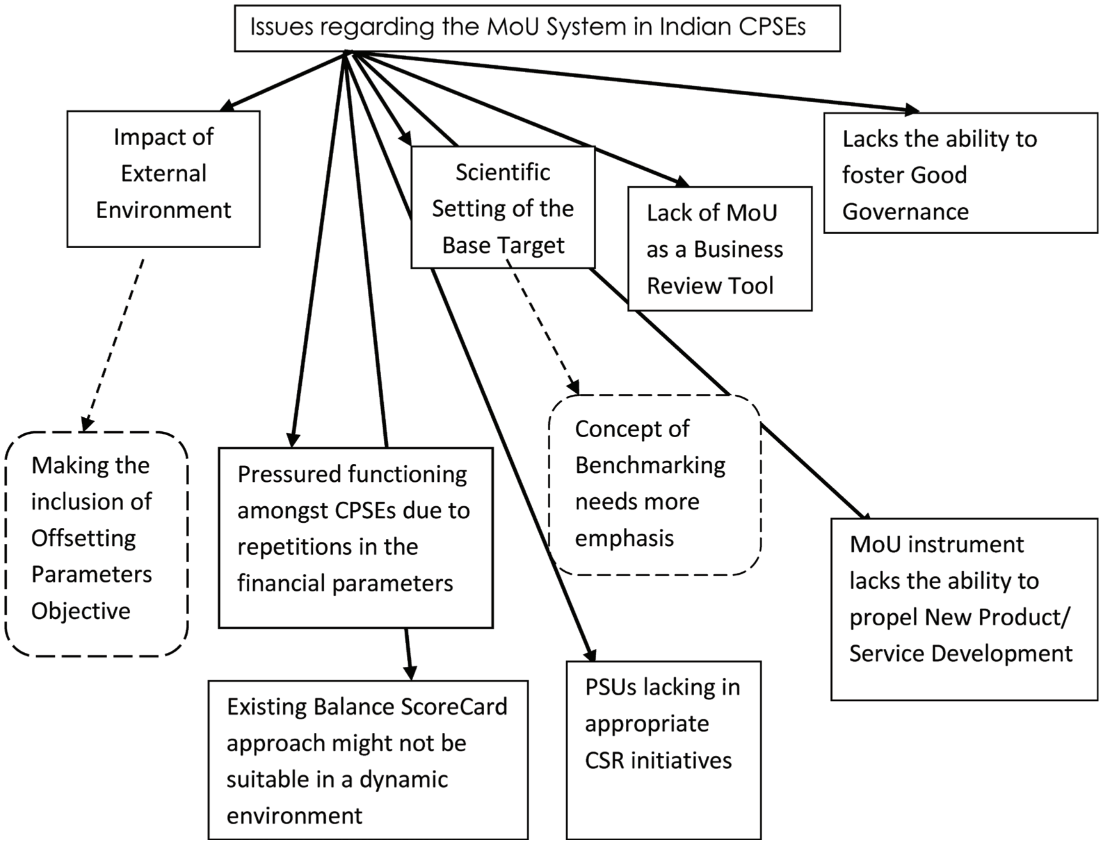
1. Arjun Sengupta Committee Report (1984)
2. National Council of Applied Economic Research (2004)
3. Report of the Working Group (2008)
4. S.K. Roongta Committee Report (2011)
5. Mankad Committee and Task Force (2012)

Concerns Regarding Memorandum of Understanding (MoU)

Thematic analysis has been applied, in this study, as a qualitative research method and the emergent issues/ challenges with the current MoU system have been clearly identified. Each issue is highlighted in the concrete box while sub-issues have been highlighted in dotted boxes. The Initial Thematic Web is presented in Figure below

Figure clearly brings out the several challenges which the MoU system in India, currently faces. These issues and challenges have also been highlighted by various committee reports and extant literature.

- Dark Lines Connect Broad Themes (Issues)
- Dotted lines connect Sub-Themes (Issues)



Conclusion:

It has been established through the discussion that from the year of its inception - 1986 till today (2013), the Memorandum of Understanding system in India has been consistently moving towards improvement to eventually become a management tool. The tool not only measures the performance of CPSEs on financial parameters but also on strategic, non- financial parameters. However, the existing literature, nationally as well as internationally, highlights the areas of improvement in the MoU framework and the present study group, attempts to fill the identified gaps through scientific research.

As corporate governance practices need to be understood as a significant part of the broader CPSE reform and renewal programme rather than as a separate stand-alone exercise, the study group recommends that the MoU System for CPSEs needs to inject the following good governance practices to enhance the autonomy as well as efficiency of the CPSEs:

a. Professionalizing the CPSE Boards by including managers from the private sector in the CPSE Boards as independent directors;

b. Rolling out leadership development programmes which would be compulsory for the Board members; and

c. Increasing transparency of the CPSEs by making internal controls and audit strong, as well as carrying out supplementary audits on a timely basis.

Study Note - 9

SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS

This Study Note includes

9.1 CORPORATE SOCIAL RESPONSIBILITY [Section 135]

(1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

(2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

(3) The Corporate Social Responsibility Committee shall,—

(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and

(c) monitor the Corporate Social Responsibility Policy of the company from time to time.

(4) The Board of every company referred to in sub-section (1) shall,—

(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and

(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation.— For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198.

SCHEDULE VII

Activities which may be included by companies in their Corporate Social Responsibility Policies Activities relating to:—

(i) eradicating extreme hunger and poverty;

(ii) promotion of education;

(iii) promoting gender equality and empowering women;

(iv) reducing child mortlity and improving maternal health;

(v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;

(vi) ensuring environmental sustainability;

(vii) employment enhancing vocational skills;

(viii) social business projects;

(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and

(x) such other matters as may be prescribed.

Summary at Glance

- Company having
  - Net Worth ≥ ₹500 Crores, or
  - Turnover ≥ ₹1,000 Crores, or
  - Net Profit ≥ ₹5 Crores

  Constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting at least 3 directors, out of which at least one director shall be an independent director;
- CSR Committee shall make CSR policy which shall indicate the activities to be undertaken, recommend the amount of expenditure to be incurred and monitor the CSR policy;
- The Board shall approved CSR policy and disclose contents of such policy in its report;
- Company should spend atleast 2% of average net profit of the company made during the three immediately preceding financial years as per the policy;
- If fails to spend such amount, the board shall, in its report specify the reason for not spending the amount.

General Circular No. 21/2014

Clarifications with respect to representations received in the Ministry on Corporate Social Responsibility (herein after referred as ('CSR') are as under:-

(i) The statutory provision and provisions of CSR Rules, 2014, is to ensure that while activities undertaken in pursuance of the CSR policy must be relatable to Schedule VII of the Companies Act 2013, the entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the amended Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities as illustratively mentioned in the Annexure.

(ii) It is further clarified that CSR activities should be undertaken by the companies in project/ programme mode [as referred in Rule 4 (1) of Companies CSR Rules, 2014]. One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. would not be qualified as part of CSR expenditure.

(iii) Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) would not count as CSR expenditure under the Companies Act.

(iv) Salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.

(v) "Any financial year" referred under Sub-Section (1) of Section 135 of the Act read with Rule 3(2) of Companies CSR Rule, 2014, implies 'any of the three preceding financial years'.

(vi) Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

(vii) 'Registered Trust' (as referred in Rule 4(2) of the Companies CSR Rules, 2014) would include Trusts registered under Income Tax Act 1956, for those States where registration of Trust is not mandatory.

(viii) Contribution to Corpus of a Trust/ society/ section 8 companies etc. will qualify as CSR expenditure as long as (a) the Trust/ society/ section 8 companies etc. is created exclusively for undertaking CSR activities or (b) where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act.

Annexure Referred to at para (i) of General Circular No. 21/2014 dated 18.06.2014

Sl. No.	Additional items requested to be included in Schedule VII or to be clarified as already being covered under Schedule VII of the Act	Whether covered under Schedule VII of the Act
1.	Promotion of Road Safety through CSR: (i) (a) Promotion of Education, "Education the masses and Promotion of Road Safety awareness in all facets of road usage. (b) Drivers' training, (c) Training to enforcement personnel, (d) Safety traffic engineering and awareness through print, audio and visual media" should be included. (ii) Social Business projects: "giving medical and Legal aid, treatment to road accident victims" should be included.	(i) (a) Schedule VII (ii) under "Promoting education'. (b) For drivers training etc. Schedule VII (ii) under "vocational skills". (c) It is establishment functions of government (cannot be covered). (d) Schedule VII (ii) under "promoting education". (ii) Schedule VII (i) under 'promoting health care including preventive health care'.
2.	Provisions for aids and appliances to the differently- able persons - 'Request for inclusion	Schedule VII (i) under 'promoting health care including preventive health care.'
3.	The company contemplates of setting up ARTIIC (Applied Research Training and Innovation Centre) at Nasik. Centre will cover the following aspects as CSR initiatives for the benefit of the predominately rural farming community: (a) Capacity building for farmers covering best sustainable farm management practices. (b) Training Agriculture Labour on skill development. (c) Doing our own research on the field for individual crops to find out the most cost optimum and Agri–ecological sustainable farm practices. (Applied research) with a focus on water management. (d) To do Product Life Cycle analysis from the soil conservation point of view.	Item no. (ii) of Schedule VII under the head of "promoting education" and "vocational skills" and "rural development". (a) "Vocational skill" livelihood enhancement projects. (b) "Vocational skill" (c) 'Ecological balance; 'maintaining quality of soil, air and water' (d) "Conservation of natural resource" and 'maintaining quality of soil, air and water;

4.	To make "Consumer Protection Services" eligible under CSR. (Reference received by Dr. V.G. Patel, Chairman of Consumer Education and Research Centre). (i) Providing effective consumer grievance redressal mechanism. (ii) Protecting consumer's health and safety, sustainable consumption, consumer service, support and complaint resolution. (iii) Consumer protection activities. (iv) Consumer Rights to be mandated. (v) all consumer protection programs and activities" on the same lines as Rural Development, Education etc.	Consumer education and awareness can be covered under Schedule VII (ii) "promoting education".
5.	(a) Donations to IIM [A] for conservation of buildings and renovation of classrooms would qualify as "promoting education" and hence eligible for compliance of companies with Corporate Social Responsibility. (b) Donations to IIMA for conservation of buildings and renovation of classrooms would qualify as "protection of national heritage, art and culture, including restoration of buildings and sites of historical importance" and hence eligible for compliance of companies with CSR.	Conservation and renovation of school buildings and classrooms relates to CSR activities under Schedule VII as "promoting education".
6.	Non Academic Technopark TBI not located within an academic Institution but approved and supported by Department of Science and technology.	Schedule VII (ii) under "promoting education", if approved by Department of Science and Technology.
7.	Disaster Relief	Disaster relief can cover wide range of activities that can be appropriately shown under various items listed in Schedule VII. For example, (i) Medical aid can be covered under 'promoting health care including preventive health care.' (ii) food supply can be covered unde eradicating hunger, poverty and malnutrition. (iii) supply of clean water can be covered under 'sanitation and making available safe drinking water'.

8.	Trauma care around highways in case of road accidents.	Under 'health care'.
9.	Clarity on "rural development projects"	Any project meant for the development of rural India will be covered under this.
10.	Supplementing of Govt. schemes like mid-day meal by corporate through additional nutrition would qualify under Schedule VII.	Yes. Under Schedule VII, item no. (i) under 'poverty and malnutrition'.
11.	Research and Studies in the areas specified in Schedule VII.	Yes, under the respective areas of items defined in Schedule VII. Otherwise under 'promoting education'.
12.	Capacity building of government officials and elected representatives – both in the area of PPPs and urban infrastructure.	No.
13.	Sustainable urban development and urban public transport systems	Not covered.
14.	Enabling access to, or improving the delivery of, public health systems be considered under the head "preventive healthcare" or "measures for reducing inequalities faced by socially & economically backward groups"?	Can be covered under both the heads of "healthcare" or "measures for reducing inequalities faced by socially & economically backward groups", depending on the context.
15.	Likewise, could slum re-development or EWS housing be covered under "measures for reducing inequalities faced by socially & economically backward groups"?	Yes.
16.	Renewable energy projects	Under 'Environmental sustainability, ecological balance and conservation of natural resources',
17.	(i) are the initiatives mentioned in Schedule VII exhaustive? (ii) Incase a company wants to undertake initiatives for the beneficiaries mentioned in Schedule VII, but the activity is not included in Schedule VII, then will it count (as per 2 (c) (ii) of the Final Rules, they will count)?	(i) & (ii) Schedule VII is to be liberally interpreted so as to capture the essence of subjects enumerated in the schedule.
18.	US-India Physicians Exchange Program – broadly speaking, this would be program that provides for the professional exchange of physicians between India and the United States.	No.

9.2 THE COMPANIES (CORPORATE SOCIAL RESPONSIBILITY POLICY) RULES, 2014

In exercise of the powers conferred under section 135 and sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the Companies (Corporate Social Responsibility Policy) Rules, 2014 vide **G.S.R. 129(E) dated** 27th February, 2014 which is come into force on or from the 1st day of April, 2014 as under: -

1. Short title and commencement

(1) These rules may be called the Companies (Corporate Social Responsibility Policy) Rules, 2014.

(2) They shall come into force on the 1st day of April, 2014.

2. Definitions.-

(1) In these rules, unless the context otherwise requires, -

(a) "Act" means the Companies Act, 2013;

(b) "Annexure" means the Annexure appended to these rules;

(c) "Corporate Social Responsibility (CSR)" means and includes but is not limited to :-

(i) Projects or programs relating to activities specified in Schedule VII to the Act; or

(ii) Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

(d) "CSR Committee" means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act.

(e) "CSR Policy" relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company;

(f) "Net profit" means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely :-

(i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

(ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, shall not be required to be re-calculated in accordance with the provisions of the Act:

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of subsection (1) of section 381 read with section 198 of the Act.

(2) Words and expressions used and not defined in these rules but defined in the Act shall have the same meanings respectively assigned to them in the Act.

3. Corporate Social Responsibility

(1) Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules:

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

(2) Every company which ceases to be a company covered under sub-section (1) of section 135 of the Act for three consecutive financial years shall not be required to ~

(a) constitute a CSR Committee; and

(b) comply with the provisions contained in sub-section (2) to (5) of the said section,

till such time it meets the criteria specified in sub-section (1) of section 135.

4. CSR Activities.-

(1) The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

(2) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise:

Provided that—

(i) if such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established *track* record of three years in undertaking similar programs or projects;

(ii) the company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

(3) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

(4) Subject to provisions of sub-section (5) of section 135 of the Act, the CSR projects or programs' or activities undertaken in India only shall amount to CSR Expenditure.

(5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act. *892 GI/w-v.*

(6) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure including expenditure on administrative overheads shall not exceed five percent, of total CSR expenditure of the company in one financial year.

(7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

5. CSR Committees.-

(1) The companies mentioned in the rule 3 shall constitute CSR Committee as under.-

(i) an unlisted public company or a private company covered under sub-section (1) of section 135 which is not required to appoint an independent director pursuant to sub-section (4) of section 149 of the Act, shall have its CSR Committee without such director;

(ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

(iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 3 80 of the Act and another person shall be nominated by the foreign company.

(2) The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

6. CSR Policy.-

(1) The CSR Policy of the company shall, inter-alia, include the following, namely :-

(a) a list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

(b) monitoring process of such projects or programs:

Provided that the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company.

Provided further that the Board of Directors shall ensure that activities included by a company in its Corporate Social Responsibility Policy are related to the activities included in Schedule VII of the Act.

(2) The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

7. CSR Expenditure.-

CSR expenditure shall include all expenditure including contribution to corpus, for projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.

8. CSR Reporting.-

(1) The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure.

(2) In case of a foreign company, the balance sheet filed under sub-clause (b) of sub-section (1) of section 381 shall contain an Annexure regarding report on CSR.

9. Display of CSR activities on its website. -

The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company's website, if any, as per the particulars specified in the Annexure.

9.3 CORPORATE SOCIAL RESPONSIBILITY – PERSPECTIVES AND BEST PRACTICES

Table of Contents

Case Study I

Name: ACC Limited

Thematic Areas: Education, Health, Environment, Livelihood and Waste Management

Case Study:

In 2007 several CSR initiatives were taken to meet the requirements of various stakeholder groups.

Community development

We commenced a fresh round of Community Needs Assessment studies by external agencies for those living in the vicinity of all our plants across India.

An important partnership was forged with Development Alternatives, a reputed NGO, to help launch a Sustainable Community Development programme for those living near our Wadi Plant in Karnataka.

The time-bound plan spread over 3 years targets the building of local institutional and human capacities, creation of local enterprise-based livelihoods, healthier habitats with adequate community physical infrastructure, household services and village institution building.

HIV/AIDS Programme

ACC's effort to participate in the national effort against HIV/AIDS included the establishment of a treatment center at Wadi, and partnership with Christian Medical College, Vellore both of which address the challenges in the two states where this virus is most prevalent. The Wadi Anti Retroviral Treatment Center for HIV/AIDS commenced regular operations in March last year.

It has a complement of trained medical and para-medical staff and caters exclusively to the general public. We became the first corporate in the country to have established a standalone center of this kind. It is also the first outside the Government sector to be included in the list of NACO's approved ART Centers in the country.

Knowledge Development

The prestigious Sumant Moolgaokar Technical Institute at Kymore was opened with a new educational curriculum to complement the education provided at ITI's.

Similarly the focus of the Regional Training Center in Jamul, Chattisgarh was redirected to offer professional technical courses of relevance to manufacturing sectors such as cement.

A state-of-the-art Learning Center, ACC Academy, was opened at our Thane complex. We began work on partnering with the government and industry to upgrade the 7 ITI's located near our plants.

Sustainable Construction

We are partnering with Holcim Foundation for Sustainable Construction to promote the concept of sustainable construction in India.

We signed an understanding with Development Alternatives to create a Center of Excellence to pursue solutions for sustainable housing and rural infrastructure, by providing innovation support, capacity building and outreach services to the construction industry and to enable the creation of livelihood opportunities and provide support to small rural entrepreneurs in rural habitat and infrastructure.

Other initiatives Sustainable Development

Other significant achievements included promotion of nation-wide services in Waste Management, and the commissioning of a Wind Farm in Tamil Nadu.

Planning and measuring effectiveness

A CSR Business plan and roadmap has been made listing yearly targets, priority areas and tasks from 2008 till 2011. We adopted 2 good participative practices last year. The first is a model that helps matches areas which are of concern to various stakeholder groups with their impact on the company.

The second is a scorecard that attempts a qualitative assessment of the impact and efficacy of individual community development schemes. We have tested this process successfully and will henceforth use it to measure the effectiveness of all major schemes.

Case Study II

Name: Ambuja Cements Limited

Thematic Areas: Poverty Reduction, Reducing Child Mortality, HIV/AIDS, Education and Environment

Case Study:

Ambuja Cements Ltd. established a foundation, called the Ambuja Cement Foundation in 1993. With its cement plants being situated in the rural areas, the Company realised the need to address the needs of the rural people. These people formed direct or indirect stakeholders of the Company and therefore were important for the Company's sustainability.

Consequently, the ACF's focus has been on integrated rural development programmes. The Foundation works with the mission to "energies, involve and enable communities to realize their potential".

It upholds as its guiding light the parent company's core values and alongside pays due attention to international trends in social development, expressed through guidelines like the Millennium Developmental Goals. Poverty alleviation, achieving universal primary education, reducing child mortality, improving maternal health, combating HIV/AIDS and ensuring environmental sustainability are all integral to the work of the Company and its Foundation.

The Foundation in each location begins by working at the micro level/in a small way with the villages impacted by the Company's operations and gradually over time as partnerships develop expands its area and scope of work. The Foundation at present reaches out to over 1.2 million people in about 670 villages spread across ten states in India.

The large chunk of work of the Foundation is carried out by a team of well-trained and experienced professionals. The range of work of the Foundation is expansive/ diverse and though there are common programmes run across locations, regional variations due to local needs exist.

Provision of preventive and curative health services including reproductive and child health, promotion of education and generation of alternate sources of livelihood coupled with capacity building are some of the key areas of intervention of the Foundation.

Natural Resource Management (NRM) by far forms the largest part of the community initiatives of the Company. NRM includes activities centered on conservation and management of water, land, energy and livestock. Water being the prime mover in rural life and an essential factor for overall rural development, presets their work in the area of water re-source management.

In all its endeavors, ACF has since inception made it a mandatory practice to include people's participation in its activities. Those who are stakeholders in the social setting are consciously and regularly included in programmes that are principally meant for them.

They engage with their communities at all levels. Programmes are decided based on the needs expressed by the people during Participatory Rural Appraisals (PRAs). Implementation is carried out with the participation of the people - whether direct or indirect, financial or non-financial. This helps in developing a sense of belonging to the programmes and makes the programmes sustainable.

Natural Resource Management, especially water management, forms a significant part of their work in the rural sector. Water management and conservation is a very broad area of intervention.

The diverse geographical, climatic, topographical and cultural variations across the states have made it necessary for them to make suitable modifications in their water projects to cater to the particular requirements and problems of different regions. Substantial water resource management activities are conducted in 4 states –Gujarat, Rajasthan, Maharashtra and Himachal Pradesh.

Each of these states faced specific water- related problems which they have tried to address through their scientifically grounded, economically viable and socially acceptable techniques. A brief description of the water projects in these states follows.

Salinity Ingress Reduction

In the state of Gujarat the rural communities are situated along the coastal belt in Junagadh and Amreli Districts. Due to over-utilisation and over-exploitation of ground water over years, these areas faced a serious salinity ingress problem. The rivers in this area were seasonal and the ponds that were fed by these rivers also dried up by the time winter arrived making the water problem even worse.

To tackle these problems, ACF adopted innovative techniques like interlinking of water bodies, tidal regulators and rivers through link water channels. This technique proved to be effective in collecting the run-offs of the rivers and consequently increased the quantity of water being saved and stored.

Ground water was recharged and the salinity levels of the underground water declined to improve the quality of water. The mined out pits of the Company have been converted into water reservoirs creating a store of 11.04 MCM of water for the use of the people.

Parts of Rajasthan being desert areas have for centuries had chronic water scarcity. The rainfall in the state is scanty and often uncertain. Rivers are seasonal and traditional ponds have over the years become silted and hold lesser and lesser quantities of water with each passing year.

The ground water is characterised by high fluoride and other salts contents that are known to be hazardous to health. ACF is situated in the Jaitaran block of Pali and Mundwa block of Nagaur District in this State.

The water problems here were addressed in 2 ways – by revival of old water reservoirs and construction of new structures to collect water. Traditional ponds were deepened and de-silted so that they would hold water for upto10–12 months in the year as opposed to only 3–4 months.

Dykes were constructed in the rivers that directly impacted the ground water level and at the same time the river banks were de-silted. These immediately raised the water level by an average of 14 feet.

Agricultural productivity increased. As in Gujarat, Roof Rain Water Harvesting (RRWHS) structures were constructed in Rajasthan too. These structures helped households collect monsoon water and store it for use through the year.

In the hilly state of Himachal Pradesh, the local people depend heavily on the forests for their livelihood. The terrain makes storage of water and conservation of the top soil is-sues of serious consideration. NRM in the State is aimed at enabling the people to manage their own resources and de-rive a fair share from them. Water shed development covered 9000 Ha in the last 4 years.

As a result of decreased soil erosion and increased moisture, the agricultural production has gone up. The water and soil conservation programme along with forestation have shown good results. Farmers are able to grow more than one crop a year. Their cropping pattern has diversified and consequently their incomes have increased. Wastelands have been developed as pasture lands, which have benefited villagers owning cattle. The milk yield of the cattle has also seen an improvement as a result of this.

ACF is active in Rajura, Korpana and Jivati blocks of Chandrapur District in Maharashtra. The focus in this State has been improving access and availability of potable water. For this, old ponds were renovated and brought into use one again. Streams and rivers were de-silted. Wherever possible check dams were built, bore wells dug and storage structures constructed. To address soil erosion, large tracts were collected under bunding and gully plugging. A fall out of these activities was that the availability of water for agricultural and household uses improved and a positive impact on agricultural productivity was noted.

Detailing specific project: Salinity Ingress Mitigation

The water resource management work has been going on for the longest duration in Kodinar, Junagadh District, Gujarat. The scope of work being done here is extensive. As a result of numerous factors, salinity ingress is a serious problem in this location. With the increase in the population, demands on existent water resources have increased and therefore there has been an over-exploitation of these resources.

With the fragmentation of the joint family system, each of the nuclear family unit involved in agriculture is increasing the number of wells and extensively using pumps to meet their increasing water demands.

Water intensive crops have been artificially introduced in the area, sharply increasing the demand on water for agricultural purposes. Mismanagement and misuse of water along with recurrent droughts have further worsened the situation.

The cumulative impact of all these occurrences has been that the villagers have been facing water shortage along with salinity ingress in this area.

Taking into consideration the scale of the problem, multiple interventions were planned and implemented by ACF and the rural people. This multi-pronged approach included the following:

Interlinking of rivers and canals

They initiated an innovative intervention technique of inter- linking local rivers and canals. This was done in a relatively limited geograpical area where the distance between the rivers and /or canals wasn't too large.

A large amount of water in Kodnar gets wasted because it gets drained into the sea.

This water was diverted into nearby water bodies through channels. In interlinking, excess water from one source flows into the next, almost completely eliminating water wastage.

Water conservation structures like check dams have been made at appropriate places along the rivers and streams in-creasing recharge of the entire area. Villagers provided crucial information for this project. Having inhabited the area for generations, they were able to help locate the potential sinks and the shortest routes to these, which were essential for identifying watershed dynamics.

There have been direct benefits of this project. The crops in the region have diversified because of increased availability of water; and there is now a sustained water table. Farmers are now also growing crops and vegetables which are less water intensive.

The household income of the farming families has resultantly increased. We have been successful in changing the farming practices of the cultivators. The crop yields have also in-creased.

Pond deepening and interlinking

In 1999–2000 an interlinking project was undertaken that involved five adjacent villages. The village ponds in these villages were identified and deepened to increase their capacity and interlinking canals were constructed between villages.

During monsoons, the stream overflowed and the excess water got collected in these ponds. After the water level passed a stipulated height in one pond, it automatically got diverted to the next interlinked pond, thereby preventing wastage of water.

The total storage capacity of 0.42 million cubic meters benefited 339 wells and 1161 hectares of parched land thereby benefiting 316 farmers of the region. A lot of water that used to flow into the sea in the past has now been diverted into the downstream ponds which were previously starved of water. An analysis of the impact of this project showed a drastic reduction in the salinity in the area and farmers are now able to cultivate three crops in a year, as against one earlier. Due to the reduction in the salinity, now farmers also require 30–60 percent less seeds for sowing as compared to earlier, while yield in Kg/Ha increase by an average of 55 percent for the 5 major crops being grown in this area.

Utilising mined out pits

ACL uses open cast mines to obtain limestone and marl that are essential for cement production. Owing to the mining, large pits measuring between 12 to 15 meters in depth are created. Generally these pits are reclaimed by filling, afforestation, pastureland development.

Tidal regulator

Tidal regulators were constructed by the Government to act as a barrier between the agricultural land and salinity. The regulators reverse the natural flow of water from the sea to the land. To further augment the benefits of the regulators, ACF excavated link canals from the tidal regulators to the villages.

This has given the villagers numerous benefits of the project. In just one village Panch Pipalwa 67 farmers covering an area of 234Ha benefited, with all their wells being recharged. There is now multi-cropping in the area and agriculture yields are higher by at least 30 percent and the salinity in drinking water wells has reduced.

Roof Rain Water Harvesting Structures

The droughts and water salinity in Kodinar area created a serious drinking water crisis for many years. Villagers were forced to either walk unreasonable distances to collect water or had to depend on the uncertain tanker water provided by the local authorities.

In almost all cases without exception, the women and girls in the families had to shoulder the responsibility of collecting water. This meant a large chunk of daytime was spent on this activity and very often young girls had to drop out of school to help out in this chore.

ACF has promoted a simple and cost effective means to deal with the problem. Roof Rain Water Harvesting Structures (RRWHS) have been built in homes. RRWHS are simple structures that collect fresh rain water during the monsoons and store it in underground tanks for use throughout the year.

In addition to the RRWHS, ACF has also renovated wells to provide drinking water to the villagers. The renovation of wells has greatly improved the quality of the water in these wells. In conclusion.

Their work in water management and salinity mitigation in Gujarat has become a model for them. They have applied some of the water management techniques to other locations and found them to be just as effective.

Their projects have been appreciated by their people and governmental and non-governmental organisations. They would be very keen in sharing their experiences and learning with other organisations working in the same field.

Case Study III

Name: Apollo Tyres Limited

Thematic Areas: Health

HIV-AIDS Programme in Apollo Tyres Ltd.

Background

Apollo started its fight against HIV-AIDS in a project called Healthy Highways. The project was in partnership with DFID and started in Sanjay Gandhi Transport Nagar in the year 2000.

Today Apollo has a comprehensive programme on HIV-AIDS focusing on its employees, customers and supply chain.

The programme focus is on building awareness and prevention aspect of the epidemic. The approach is to forge strategic tie-ups with organisations, which bring the technical skills and capacity building aspects in to the partnership.

Apollo Tyres Health Care Centers

Apollo Tyres Health Care Centers are targeted interventions for truckers. The location for clinics is identified on the HIV prevalence, density of trucking and mobile population and the current level of work being done by other organisations in the area. Currently, the company has 7 clinics running in North, West & South of India. All clinics are strategically located in transport nagars. Attached to HIV-AIDS, however the focus of the services provided is on HIV-AIDS.

The main components of the programme are:

(a) Behaviour Change Communication (BCC)

The communication is directed at increasing awareness regarding the basics of HIV/AIDS. The communication adresses the modes of transmission, myths regarding HIV, connection between sexually transmitted diseases and HIV through one-to-one and one-to-group interactions.

(b) Peer Educators

Building an effective peer educator network is the most important link of the entire program. The peer educators become imperative given the geographical spread of the transportnagars and the mobile nature of the population.

(c) Condom Promotion

Condom promotion takes place through free distribution as well as social marketing of condoms. These condoms are available at various outlets and strategic points within the transport nagars.

Also the outreach workers and the peer educators emph sise and educate the target audience on the correct usage and disposal of condoms.

Sexually Transmitted Diseases and Infection Identification and Treatment

The outreach workers and the peer educators are trained in the identification of sexually transmitted diseases and infections. There is a strong referral system in place and patients are by guided by the outreach workers and peer educators to the clinic.

The clinics provide treatment for sexually transmitted diseases and infections only. In case the doctor or the counselors are not satisfied they refer the patient for voluntary testing at the government hospitals. The pre and post test counseling is available at all Apollo Tyres Health Care Centers.

Workplace Programme

In June 2006 a workplace sensitisation programme was rolled out in partnership with International Labour Organisation. The programme targets 7500 employees across all locations of the company.

The programme started with a half day sensitisation of the top management of Apollo. A steering committee was formed post the sensitisation of the top management. About 26 ambassadors were identified and trained as master trainers in a two day workshop and simultaneously a survey to gauge the existing knowledge in the company was undertaken.

So far over 5000 employees have been covered under the programme. The next level of this programme is targeting contract workers.

Integration with Supply Chain

Extension of the HIV programme into the supply chain was a natural progression for ATL. Under this Apollo has taken the prevention and awareness programme across its supply chain.

The model is similar to the employee engagement pro-gramme wherein a peer educator network is trained by Apollo's master trainers. The objective is to create a chain which has a multiplier effect in carrying the message on prevention forward.

Monitoring, Reporting & Evaluation

- The reporting system is standardised and a common format is available with all clinics to file a monthly report. The reports capture all details of BCC, STI and counseling at the centers. The reports provide both quantitative and qualitative aspect
- A monthly report is filed by the master trainers for the wor place programme as per ILO's format
- A monthly report is received from supply chain partners and also by Apollo
- A six monthly detailed report is filed to steering committee on the entire committee

A study on an annual basis is undertaken to gauge the impact of the programme across the target segments. The first one has been conducted in December 2007

Case Study IV

Name: Bharat Petroleum

Thematic Areas: Health, Education, Infrastructure, Income Generation, Vocational Guidance, Livelihood & Environment Conservation

Case Study:

Community Development at village 'Ramthenga', Jajpur Dist, Orissa

Community participation

(i) To help the village become socially conscious

(ii) To improve the general health of the villagers

(iii) To improve community participation

(iv) To help them become self-reliant.

This village is dominated by the tribal population – 'Santhal Tribe'. Their socioeconomic status was highly impoverished. Most of the villagers worked in the neighboring mines. Due to prolonged and non-conducive working environment, they had developed severe respiratory / skin infections.

The children did not attend any school and the nutrition status of the children was very poor. There was also a severe problem of alcohol abuse amongst the men. The women were suppressed and worked in the farm as well as in the mines. Lack of availability of water was also one of the main concerns of the villagers. There were bore wells but they were non- functional.

Major interventions were required in the area of:

- Health
- Education
- Awareness about health/ sanitation/ hazards of working in the mines
- Precautions to prevent respiratory illness
- Making water available

Having understood the need of the community, BPCL constituted a team to implement the work in the community. The main participants in the project were :

- Villagers
- NGO partner – Research Analysis Consultants
- BPCL LPG Team based in Bhuvaneshwar and Khurda headed by TM Khurda
- BPCL HR Team at Kolkata headed by HR Chief and CSR co-ordinator
- BPCL Corporate CSR Team headed by GM (Admin)

Strategy & Execution

A plethora of activities were undertaken in the village. How-ever, depending upon the need at that particular time, the activities were phased out. The activity matrix developed was very strategically planned and executed.

Phase 1

A visit was made to the village by BPCL Kurda Team. There was lot of inhibition among the villagers to discuss and participate. However with repeated visits the villagers began to open up.

Since there was a need to execute the project very professionally, the BPCL Khurda Team identified an NGO with its main office in Bhuvaneshwar. The NGO had extensive experience of having worked in the mentioned areas and implemented community development projects.

The NGO did a need assessment of the village with complete village participation. Assistance for providing health services and primary education emerged as one of the main needs.

Also what emerged from the need assessment was to enable the formation of Self Help Groups. The general participation level among the villagers was very high.

Phase 2

BPCL supported the project through NGO RAC by:

Providing the services of a doctor (from neighboring area)

The Homeopathic Doctor would check the patients for free thrice in a week. Since the medicines were sweet there was less resistance among the villagers and children to eat the same. Moreover for the problems that they were more succumbing to, like respiratory illness, skin infections, homeopathic medicines were much more effective.

Initiating a Balwadi (pre-primary) for children within the village

This put the children into the habit of attending school especially when their parents would go to work in the mine. The teacher for the village was identified from within the village. She was subsequently trained about innovative methods in teaching and needs of pre primary children. She was also the main force in convincing the parents to put the children in main school after their pre primary.

Phase 3

Once the basic trust level amongst the villagers was attained, then:

Awareness was created about precautions for working in the mines

Awareness was created amongst the villagers about the precautions they need to take while working in the mines nearby. The modes of communication were through street plays, skits during village festivals, drawing competitions for children.

The homeopathic doctor played a vital role in creating this awareness. A lot of awareness was also created about alcohol abuse.

Deepening of village pond and encouraged fishery

There was a pond in the village, which had to be cleaned. With support from RAC the villagers engaged in cleaning the pond and also dredging the same. With the help of Central Institute of Fresh Acqua Culture, Bhuvaneshwar, the villagers were trained of fishery management. It was a community pond, and the fishes caught were shared by the villagers this activity was more favored by villagers during monsoon, when there is ample of water in pond.

Need for formation of Self Help Groups (SHG's)

The fishery management activity established the need for the formation of Self Help Groups – A group which would be trained in activities that can generate income. Meetings were held in the village for formation of Self Help Groups.

Repair and maintenance of Bore wells

Availability of water was an area of concern for the villagers. There were bore wells in the village, but they were non-functional. With the help of volunteers from the village, the bore wells were repaired and the villagers were also trained to maintain the same. Now there is ample water to sustain throughout the year.

Phase 4

The first batch of SHG was formed comprising of mainly women.

Formation of 1st SHG in the village

The group comprised mainly of women. They had mutually agreed to learn stitching and appliqué work (a form of embroidery famous in Easter India). BPCL supported by way of providing teacher from the nearby village and also 4 sewing machines. Initially the women used to learn stitching work etc in the spare time they got after working in the mines.

Subsequently when the first batch finished the course, simultaneously a course was conducted on marketing the stitched products. A group of women were trained to market the stitched products in the local haats (local bazaar). The course included:

- Communication skills
- Perceiving the market requirements
- Quality of stitched products
- Pricing the clothes stitched
- Co-ordination within SHG
- Roles and responsibilities

The group slowly began to generate income through stitching and that made a breakthrough in the village.

The women from the SHG were able to, though in very small way, substitute the family income which came mainly from mining and agriculture. More and more women began to learn stitching and discontinued the mining job.

Promoting Mushroom Cultivation

The NGO assisted the villagers through the SHG to initiate mushroom cultivation. The SHG would purchase mushroom sponge at INR 17 a packet from 'Orissa Institute of Agriculture and Technology' Bhuvaneshwar.

Each packet of sponge would generate approximately 1.5 kg of mushroom. This mushroom when sold generates INR 80 from the INR 17 per packet.

The villagers who had very poor health, especially the children were encouraged to include mushroom in their diet and the extra ones were sold in the local market. This activity also generated income for the SHG.

Phase 5

There were 2 well-functioning SHG's in the village. The success of the women's group SHG was instrumental in the formation of the 2nd group, which was a mixed group of men and women.

The good work done by SHG's in this village was duly recognised by the Block Development Officer (BDO), who in turn has rewarded them with the "BEST SHG AWARD" in the District. As an incentive they were given a sum of ₹ 2 lakhs. With this, the SHG has bought a stone-cutting machine, which is in turn fetching the SHG INR 15,000 to 20,000 per month.

Where working in the mines the villagers use to earn a meager amount of INR 50 per day, and were employed hardly for 10 to 12 days in a month, now the members of the SHG earn INR 2000 per month, through the various activities of the SHG.

Phase 6

A new group of 20 villagers has been formed in the village, wherein they have been enrolled in an income generation programme – ' Agro Based'. They have been given 2000 banana plantations. The plantations are being grown on 2 hectares of a common land.

The offshoots of the plantations would be given to another 20 families free of cost. Once the fruit comes, a market linkage for the same has already been created. Through this activity the results are that each house hold is getting an additional income of INR 7,000 to 8,000 in the first year.

Another group of 20 villagers are being supported in poultry. In the first year itself all the group members will benefit. How-ever from the second year offspring of the nurtured animals will be freely distributed to other needy villagers and the process will continue.

Phase 7

Already necessary approvals have been obtained to support another set of 20 and 20 families by way of papaya cultivation under agro-based initiatives and goatry under non-farm sector.

This way the entire village will have been roped into diverse activities and each family is can earn extra income for the sustenance of the entire family.

The education of pre-primary students, which was initiated and supported by BPCL, has been withdrawn. The pre-primary education has now been taken over under central Government ICDS scheme.

This way the Corporations fund were more channelised to-wards health support, formation of SHG's and developing in-come generation programmes.

Evaluation of Success/Results

The impact of the whole programme has been overwhelming. In another two years, BPCL would be in a position to with-draw all the financial support being extended to this village, and extend its support to some other deserving village.

- Where the entire village was mainly into mining work, now there are hardly a couple of families
- There are two registered SHG's functioning very well with good co-ordination

- BPCL initiated pre-primary school and mid-day meal scheme, which has now been withdrawn and through the NGO made village, children receive the same benefit from central Governments ICDS scheme
- The State health workers are involved in creating awareness about health and hygiene issues in the village
- All the bore wells of the village are functional and there is no scarcity of water even during summers
- The pond, which was a breeding ground for mosquitoes, is now being utilised for fishery
- The SHG group members are earning a steady income of INR 2000 per month
- The members of the banana plantations and poultry are earning an additional income of INR 7,000 to 8,000 per annum
- The work done by SHG's in this village has been recognised by the Block Development Officer (BDO), who in turn has rewarded them with the "BEST SHG AWARD" in the District.

The entire project has created goodwill for the company in the hearts of villagers in and around Ramthenga. More so the success from this project has given us the confidence about project replication in other regions.

Case Study V

Name: Coca-Cola India Inc

Thematic Areas: Health, Environment, Education, Livelihood

Case Study:

According to Atul Singh, President & CEO, Coca-Cola India, "We at Coca-Cola are committed to refresh the lives of communities on an everyday, all-day basis. As part of the same strategy, sustainable water management remains our top priority. We will continue to find innovative solutions in all areas of water management through our integrated 4 R strategy. Starting in 2000, over the last 7 years, we have taken the lead in improving water use efficiency by nearly 30 percent in our operations across India."

They identify partners primarily on the basis of the need of a specific project, understand their experience and expertise in specific fields; their ability to deal/engage with the community; their working relationships with other stakeholders such as the government at state/local or district level; their commitment to make the project sustainable; manage crisis as and when they arise etc.

They form a group comprising of experts from (within the system) departments such as Technical, Public Affairs & Communications, Regional bottling units and the implementing agency; visit the project sites; interact with the community frequently; understand the progress and impact of the project.

So far, the Company's water initiatives have improved the lives of more than 140,000 Indians and made millions more aware of the crucial importance of water conservation.

The Company's aim is to return whatever water it has been drawing from the ground by 2009 through water conservation projects.

To this effect, they have taken the lead in improving water use efficiency by nearly 30 percent in our operations across India and have returned 85 percent of the total water that we have returned approximately 85 percent of the water that they have drawn from the ground"

Their key activities include:

(a) **Rain Water Harvesting**

Working alongside local NGOs and communities, Coca Cola India has been installing rooftop rainwater harvesting projects at all of its bottling plants in India besides other communities and has also has been installing checkdams, recharge shafts etc in rural areas.

In Delhi alone, the existing RWH structures have the potential to harvest over 100 million liters of rain water.

Other key water sustainability projects that have run alon side the rainwater harvesting programmes are the construction of check dams.

(b) **Check dams**

In Andhra Pradesh, in partnership with the Hyderabad Urban Development Agency, local village committees and NGOs, Coca-Cola India has helped 16,000 villagers of Saroor Nayar restore existing "check dam" water catchment areas.

The project involved removing silt, recreating the pond and making the check dam with strengthened stone in order to stop the decline in groundwater levels.

In Bangalore, Karnataka, the Company recently dedicated a Check Dam at Kurubarakarena Halli.

With a capacity to harvest 1080 Kilo liters (1080000 litres) of rain water per annum, this Check Dam with a catchment area of 2 Sq Km will benefit 3000 people in the villages around. The system helps in recharging (improving water levels) of 30 bore wells around the check dam area.

(c) **Recharge Shafts**

Also in Rajasthan, in its many arid open areas, the Company has undertaken the construction of more than 100 Recharge Shafts where rainwater collects but does not percolate into the ground due to the nature of the soil.

Today, nearly 15,000 villagers are reaping the benefits of a steady or increasing water table without having the need to further deepen their existing bore wells.

The result of the water programmes is an increase in the amount of ground water available to local residents. Studies of the Rajasthan State Ground Water Board, for example, show the 2005 Kaladera ground water level was 21.85 meters below the ground, up from 22.23 meters in 2004.

(d) **Restoring Old Water Bodies**

In Rajasthan, one of the driest states of India, Coca-Cola has aided the restoration of a series of ancient and historic "Bawari", or step well, water catchment systems.

The 400-year-old Sarai Bawari and Kala Hanuman ki Bawari, both located on the Delhi-Jaipur Highway in Jaipur, have both been completed and residents in the nearby communities are now able to draw drinking water from them.

The restoration project of Kale Hanuman ki Bawari witnessed active community involvement in the selection of the project site, design, source of supply for labor and material, implementation and creation of awareness for the project.

The actual restoration work included the removal of silt, rubble and algae, repairs to the infrastructure in the traditional "Jaipuri" style, and re-opening of the facility for use.

Today, thousands of gallons of water flow into the step wells from underground pores or streams, and the storage and recharge capacity has reached more than 8m liters of water. More than 3,000 villagers near each of the Bawari now have a sustained source of clean water. In addition, both step wells are now fully restored heritage sites and tourist attractions.

Facilitating Water Access

In its aim to provide access to clean drinking for the under-privileged in and around Chennai and in northern parts of Tamil Nadu covering the districts of Thiruvannamalai, Vellore, Kanchipuram and Chengelpet, the Company has launched Elixir of Life, which is a convergence of the vision of the 2 partners – Rotary International and Coca-Cola India, and is an extension of the Rotary's 'Schools into Smiles' project that envisages betterment of the quality of lives of students.

Elixir of Life is enhancing the quality of life of students in these schools as unsafe water is the root cause for most of the health hazards and fatal diseases affecting young children, and in particular those from the underprivileged sections in the country.

These children are more susceptible to the water-borne diseases and the project is helping to realise one of their distant dreams by making clean drinking water available to them.

The unique aspects of the Elixir of Life project include a pioneering initiative to maintain the system for the next 3 years. In addition to this, a comprehensive maintenance and servicing protocol has been prepared for ensuring the ongoing success of this project.

This includes fortnightly inspection, cleaning of raw and treated water tanks, rinsing and flushing of micron filters, apart from emergency breakdown and repair service.

When Rotary celebrated the 100th year during 2004–05, RI District 3230 planned to execute a landmark project to commemorate the centenary year. The team surveyed 1,200 schools in five northern districts of Tamil Nadu and selected the 100 worst schools.

Thereafter, these schools were adopted through different Rotary Clubs which reconstructed the schools and added new class rooms, compound walls, good toilet/water facilities, be-sides providing noon meal kitchens, desks and benches.

The Schools into Smiles project is being continued this year by adding more schools but, at the same time, in order to improve the existing schools which have already been renovated, the Elixir of Life project has been launched with the support of Coca-Cola India so that every child gets access to potable water.

As of now the project has been completed in 20 Schools impacting the lives of around 10,000 children.

Creating Awareness

Besides the quantitative results, Coca-Cola's water initiatives in India have ushered in a new wave of water consciousness. Millions of Indians are being made aware of the importance of water management through the Company's marketing activities and other different fora in partnership with key institutions across the country.

Seminars/Workshops; Jal Yatra; Jaldhara Karavan; Jal Bima Abhiyan; Jal Sanchay Abhiyan; Film on Water Conservation, Community Mobilisation Programme, India celebrations on Water Water Day and World Environment Day, key events with Assocham, CII, FICCI, Rotary etc.

Playing the Role of a Mentor

The Company would be happy to play the role of a mentor in setting up water conservation projects on which it has developed core expertise.

Case Study VI

Name: DLF Limited

Thematic Areas: Rural Development, Urban Community Development, Education and Environment

Case Study:

While DLF continues to create world class infrastructure throughout India, it has not lost sight of its responsibilities as a change agent for accelerating the pace of social and economic transformation across various segments.

Even though there has been tremendous improvement in construction technology and quality, it is distressing to note that the people who actually make all the glitzy buildings are a neglected lot and are often required to do so in inhuman conditions. The sight of construction workers and their children living in jhuggies without even the basic facilities at most of the construction sites is not uncommon.

At DLF it has been our constant endeavor to improve the living conditions of our construction workers by providing them all the basic necessities at the site itself by efficient and effective space management.

DLF seized the initiative in this respect and became a pioneer in providing all necessary facilities to its construction workers on site when it tied up with Laing O Rourke for construction projects.

As a pilot project the site selected was an area of approximately 42 acres in village Silokhera district Gurgaon where an IT Park of 10 million sq feet was to come up. The construction on this site is slated to be completed by 2010.

The total workforce currently deployed at the site consists of about 6000 people. Out of this 5500 are essentially construction labor, with 500 supervisors. Further 1500 people are with families and 3500 are single. There are a total of 4200 men, 1800 women and 2000 children.

Before commencement of the construction a suitable location was identified on site for construction of hutments to house the workforce for the entire duration of the project. Instead of constructing makeshift or temporary accommodation, a budget of INR 6 crores was sanctioned to build a mix of cemented hutments and dormitories for the workers.

The entire area was paved to ensure easy access even during the monsoons and the work of sanitation and housekeeping was outsourced to a third party namely M/s Lion Services.

All the residential accommodation is provided with electricity, water, fans, beds and linen, and separate areas have been provided for toilets and washing. In order to take care of the children of the workers mobile crèches have been made available on site through a strategic tie up with an NGO.

A subsidised canteen manned by a third party has also been made available on site to ensure hygienic and good quality food on site. Medical help is available on site along with a 24 hour ambulance to take care of emergencies.

In order to improve the skills of the workers as well as train potential workers on site a non-profit residential "Apprentice Training Centre" for imparting skills in carpentry and masonry has also been constructed.

This model is being replicated in 17 sites all over India catering to a workforce of approximately 20,000 workers. It is pro-posed to extend this model to all future sites being developed by DLF.

If all construction companies were to adopt a similar approach then the construction workers would not be forced to live in inhuman conditions on site for the duration of the time they spend in creating the infrastructure which becomes the pride of the nation.

Case Study VII

Name: Dr Reddy's Laboratories

Thematic Areas: M icrofinance, Education, Health, Environment, Livelihood and Social Entrepreneurship

Case Study:

Dr. Reddy's purpose is to help people lead healthier lives. This, combined with a clear commitment to their values and ethical practices, forms the foundation of sustainability or CSR.

Being a pharmaceutical company they are deeply sensitive to the needs of accessibility and affordability of medicines in developing and developed countries. They define their strategy and determine their impact.

In an era when increasing demands are being made on healthcare services, generic medicines provide a major benefit to society by ensuring patient access to quality, safe and effective medicines while reducing the cost of healthcare.

Generic medicines cost a fraction of the original products, which is good news for patients and means greater access for more people.

Their active pharmaceutical ingredients (API) and generics businesses focus on affordability by providing lower cost alternatives. They are addressing access needs by investing in innovation with emphasis on New Chemical Entity (NCE) Re-search and Differentiated Product Development that address unmet and poorly met medical needs.

Their product development effort with example of innovation in making medicines affordable and accessible. In addition, the triple bottom line approach enables us to deliver sustained value with equal emphasis on people, planet and profits through environmentally friendly and socially responsible operations.

Their CSR efforts encompass sustainable business practices, safety, health and environment (SHE) systems, patient assistance programmes, community development, people practices and citizenship.

Dr Reddy's was one of the earliest in establishing a zero liquid discharge facility to ensure 100 percent effluent recycling. They have significant improvements in process development with growing emphasis on green chemistry. Energy saving initiatives and awareness communication on Climate Change is being accelerated in the company Programmes like Sparsh, betaCare, Sarathi, deliver assistance to doctors, pharmacists and patients by improving access to medicines and patient education. These efforts complement our commitment to product responsibility ad-dressing quality and safety of our products.

Dr. Reddy's Execution Excellence Model (DREEM) has spawned focus action in Lean Manufacturing ("doing more with less") in both finished dosage and active pharmaceuticals. Organisational redesign of teams has increased throughput, provided higher quality, lower cost and integration of Intellectual Property in product development.

The community development efforts are evident in places where we live and work, with specific focus on manufacturing locations, implemented by CSR teams in each facility. With a combination of approaches communities in the neighborhood are being assisted to access healthcare, improved education opportunities and sustainable livelihoods.

They encourage employee giving in association with Naandi foundation, an organisation co-founded by Dr Reddy's. 6000 employees contribute to The Power of Ten, the employee giving programme.

Employees are encouraged to volunteer by forming specific interest groups and also join volunteering programmes with Dr Reddy's Foundation.

The Foundation, setup by the company, demonstrates their Citizenship work in the area of poverty alleviation, with specific emphasis on quality in education and sustainable livelihoods.

Over 100,000 sustainable livelihoods with Livelihood Advancement Business School (LABS) programme and out-reach to over 34,000 children in government run schools through School Community Partnerships in Education (SCOPE).

Sustainability involves almost every aspect of a company. It ranges from purpose and values, marketplace and innovation, workplace safety, people practices, environment management, human rights to community contribution.

Dr Reddy's embraces the principles of sustainability to drive responsibility and to create the capacity to re-invent, sustain and thrive through changing generations of technology, managers, shareholders and society.

Dr. Reddy's is the only Indian pharmaceutical company to publish a Sustainability Report and among the few Indian companies to do so. The report is prepared according to guidelines recommended by Global Reporting Initiatives.

Case Study VIII

Name: Infosys Technologies Limited

Thematic Areas: Education, Health, Environment, Livelihood

Case Study:

Infosys was founded in 1981 with the view that sustainability and the success of the organisation would depend on how much wealth they create for their customers, employees and the society in which they operate.

They have been responsible for creating multiple frameworks involving corporate governance, education, infrastructure, and inclusive growth. They believe that corporations must reach out to the society if they want longevity.

It is this belief that drives their commitment to be fair and transparent to their stakeholders, to help people and communities enhance their living conditions, and to improve the quality of education and healthcare through various community development programmes.

Their CSR activities are carried out at 4 different levels – at the Infosys group level, through the Infosys Foundation, through the Internal Board of Directors and by the Infosys Employees at an individual or team level.

Infosys as an organisation runs global initiatives to develop human capital by creating sustainable frameworks with educational institutes for training students and faculty. At the Infosys Foundation level, Mrs. Sudha Murty, Trustee and Chairperson, manages a team of dedicated members to reach out to the underprivileged and enrich their lives.

At the Board level, the members lead by example, by participating in the advisory councils of NGOs and civil bodies, donating their time, money and effort to various causes. At the employee level, there are location-wise CSR teams to cater to local requirements.

The 5 major CSR themes at Infosys include education, healthcare, art and culture, rural upliftment and inclusive growth. They identify partners and beneficiaries based on their goals, credibility, performance and alignment to Infosys vision and values.

They are the first Indian company to emphasise strong Corporate Governance practices and they have expanded their practices significantly beyond the norms.

They complied with the US GAAP accounting requirements and were first to incorporate a number of innovative disclosures in financial reporting including human resources valuation, brand valuation, value added statement and EVA reports.

They are very committed to supplementing Government efforts in branding India in global forums. As a strategic partner of the World Economic Forum (WEF) they lead discussions on social and economic issues.

They help the forum shape its agenda by actively participating in the "Forum of Young Global Leader" and the "Global Growth Companies" programmes. They are prime sponsors at several flagship events like Gartner Summit, Sapphire, Oracle Open World, and World Wide Webs Consortium's W3C Conference.

They have recently initiated the Infosys Young Indians (INFYi), the first corporate chapter of Confederation of Indian Industry (CII) which will strive to provide a platform for social entrepreneurs by undertaking activities in the areas of economy, education, environment, and healthcare and youth affairs. They also participate actively in pro bono engagements.

Their mission to go beyond business translates into every Infoscion and the Internal Board Of Directors (IBOD) the sense of being responsible corporate citizens.

The IBOD serves as member of advisory council / founder trustee in various Government and non-profit organisations to establish views or codes on corporate governance, global warming, education and training, social welfare, healthcare, infrastructure management and rural upliftment.

They have always been the forerunners in providing asistance when disaster strikes – be it the Tsunami, the Gujarat earthquake or Katrina.

As responsible corporate citizens, they not only rushed funds but their employees personally helped the relief operations undertaken by Infosys Foundation and other NGOs.

They have been recognised in fora where CSR is also one of the parameters to measure a company's success:

- Citizen Award – 2001
- Helen Keller Award – 2006, 2007
- NASSCOM – India Today award for gender inclusivity – 2007
- Ranked the "Business world most respected Company" in a survey
- Named the "Most Admired Company" for the sixth consecutive survey by Asia Wall Street Journal

They touched the lives of 150,000 beneficiaries during 2007 and the will continue to conduct business responsibly and ethically in the years to come.

Case Study IX

Name: JSW Steel

Thematics: Women Empowerment

Case Study:

Data Halli – Building and Running a Rural BPO for Women The JSW Group of Companies has interests in core manufacturing, energy and infrastructure areas. In almost all areas, the manufacturing facility/ operation is in remote locations, far from the cities.

The primary source of income in these areas is farming. As new manufacturing facilities are built in these areas, the skill sets of the population around the facilities do not always meet the requirements of the operations. Providing meaningful employment to the local population is thus seen as a challenge.

In order to provide a sustainable and alternate livelihood to the population around the facilities, JSW Foundation, which manages the CSR activities of the JSW Group, embarked upon a novel approach of building a BPO at these remote lo-cations? This gave an alternative employment avenue to the rural men and women, thus empowering them socially and economically.

The idea was spearheaded by Mrs. Sangita Jindal, Chairperson of JSW Foundation. The first BPO at Toranagallu was inaugurated on 15th August 2006. The BPO focuses on non-voice activities and is located adjacent to the JSW Steel Ltd.'s Toranagallu facilities, near Bellary, Karnataka. Starting with a mere 40 men and women, the BPO now employs about 200 women.

The concept of a rural BPO sounds unique and challenging, primarily because BPOs are typically associated with cities. This unique Innovation turns this concept on its head and has demonstrated that the stigma associated with BPOs can be challenged and proven otherwise. Considering the location and activities carried out at the BPOs, the name Data Halli was selected. Halli, in Kannada, means village.

Focusing on womenfolk in the rural areas, where education levels are also lower than in the cities, the rural BPO provides an avenue for these womenfolk to work outside their conventional livelihood and enrich their lives, with the aim of empowering women socially and economically.

JSoft Solutions Ltd., the IT & ITES Company in the JSW Group, currently runs a non-voice BPO at Toranagallu, next to the JSW Steel Ltd.'s Integrated Steel Plant at the same location. The BPO focuses on data entry activities for multiple clients and employs about 200 women.

Plans are afoot to open more such BPOs across the country.

Most women come with little or no exposure to computers. A computer skill is therefore not mandatory. The eligibility criteria are simple - should be 18 years or above and should have passed the SSLC examination.

Upon joining the BPO, the women are given training for a period of 3 to 6 months, depending on their grasping ability, on basic typing, English reading etc. - skills that enable them to be productive, earn a decent living and deliver value at the BPO. In addition, professional training, specific to the projects on hand, is provided for up to 2 months.

Most women come from the near-by villages, from up to a radius of about 60 km. Buses are provided for pick-up and drop from the village to the work spot. In order to take the skills development to the doorsteps, the requisite software is also installed at the village schools where JSW Foundation runs Computer-aided Learning Centers (CALCs).

These are supervised by the BPO women from the same village. Potential candidates therefore do not need to travel to the BPO to develop the requisite skills.

The rural BPO has had a positive impact on many persons. As the nature of the initiative suggests, this impact has been significant on the employees of the BPO. Some of the impact areas are:

- Transformed simple village girls into matured, positive, confident and economically independent professionals who hold a respectable place in their homes and are looked upon as examples of transformation in the villages
- Encouraged villages girls to continue their education up to 10th or 12th Standard, an impossible task prior to the BPO
- Has given them the courage to postpone their marriages which would have otherwise made them wives and mothers at the young ages of 14 or 15
- Teaching of English and Personality Development has boosted their self-confidence and has made them socially known figures in their society as they are now affiliated with a large entity, namely, the JSW Group
- Sowed the seeds of leadership in these ladies by giving them job responsibilities of Supervisors, Trainers, etc., through which they lead their respective teams which has in turn helped in showing them a career path
- Equal employment opportunity is given to quite a few physically challenged ladies who have carved their own identity
- Providing a springboard to look for better work opportunities in the vicinity

Along the way, there have been many challenges – social barriers, resistance from the men folk at home, training, technology, quality of work, transportation, shift working, etc.

Some of the challenges faced were:

Internal Challenges

Skepticism about viability of the Concept

Overcome by focused efforts to streamline the processes, at-tack the issues on hand and hire managerial talent with BPO experience. All this led to a turn-around in the operations and show-casing of the BPO for everyone to see the success.

Lack of infrastructure (IT, space, people, etc.) to handle the daily stream of potential candidates

Overcome by taking the skills development to the villages via the CALCs, thus building a resource pipeline.

External Challenges

Lower Quality and Throughput

Overcome by providing adequate training, dummy projects and hand-holding. With the implementation of a batch tracking software, Individual performance and throughput is also monitored and tracked

Hesitation by the village folk to send their women folk away from their villages

Overcome by arranging for transport up to the villages and making the BPO an all-women

Case Study X

Name: Reliance Industries Limited

Thematic Areas: Microfinance, Education, Environment, Health, Livelihood, Community Development, Child Welfare and Infrastructure Development

Case Study:

Vision: What is good for India is good for Reliance

Reliance Industries Limited has embraced sustainability as a core business strategy and regards sustainability as a foundation for lasting economic success. After all, sustainability is about meeting the needs of the present generation without di-luting the ability of the future generation to meet their needs.

Their commitment to sustainability is backed by active initiatives on the ground, together with a detailed reporting system with third party external assurance certification. Further, they actively engage with their stakeholders (along with their partners who are associated with their various CSR projects) to take their feedback and monitor the progress of the work.

Their maiden Corporate Sustainability Report (2004-05) re-port was the first Corporate Sustainability Report from the Indian Oil & Gas sector. Further, this report obtained “in-accordance” 2002-guidelines status from the Global Re-porting Initiative (GRI) - the official collaborating centre of the United Nations Environment Program (UNEP).

Pursuing their goal of continual improvement in their reporting, the report for FY 2005-06 has an enhanced scope based upon the feedback received for its maiden CSR. Further, it focuses on “issues” and “stakeholders” and includes numerous case studies from different locations and divisions. This report is the only “GRI Checked A+ level” rating report from India.

Their belief, “What is good for India is good for Reliance”, drives their effort in positively impacting the life of more than one billion Indians.

They will use sustainability to drive process innovation, new product development, improving manufacturing efficiencies and reducing material and energy consumptions.

They manufacture products that have made a positive impact on millions of people in the country, i.e. fuels for transportation, plastic bags to fiber optics, synthetic fabrics to name a few. Continuing this strategy is their plan to provide a cleaner fuel to millions of households by way of natural gas.

On the health front, they have the distinction of being the founder member of the India Business Alliance of the World Economic Forum. They have resolved to share the responsibility of combating diseases such as Tuberculosis (TB) and HIV/AIDS.

To achieve this, they have collaborated with a large number of agencies working on these issues to create some rather unique Public-Private Partnerships (PPP).

In addition to setting up hospitals at some of their manufacturing locations, they offer medical services at all their manufacturing facilities and offices.

These includes free outdoor medical services for nearby communities, outreach mobile medical services, family planning camps, blood donation drives, antenatal check-ups, vaccination centers, pulse polio camps, school health check-ups, diagnostic multidisciplinary camps, eye camps and other out-reach programmes.

On December 28, 2006, over 40,000 villagers and other stakeholders located near their Dahej Manufacturing Division, Gujarat State, got a unique 'Gift of Life' from this manufacturing facility. In a unique public-private partnership initiative, Dahej Manufacturing Division in partnership with the State Government of Gujarat adopted the existing Public Health Centre (PHC). This is the only nearest public health centre located in this vicinity. The other nearest one is at least 45 to 50 kms away, located at district Bharuch.

Aligned with the goals and vision of the management, several educational initiatives have been proposed/ established as leaps into the future. These ventures aim at building confidence, capacity, global mindsets and communication skills among young people. Their growth will shape and give direction to the growth of our country.

Reliance Rural Development Trust has undertaken a unique corporate initiative to create infrastructure facilities in rural areas. The projects undertaken in rural areas are construction of roads, anganwadis (kindergarten school), panchayat offices and community halls. These are some basic development priorities of rural areas.

In order to give focused attention to the needs of surrounding rural communities, Baroda Manufacturing Division, Gujarat State, initiated a collective action programme by setting up a voluntary society SVADES with the co-operation of all the neighboring industries in Vadodara.

SVADES is a collective endeavor that binds industry and rural community together towards socioeconomic development in the rural areas surrounding the industry. SVADES works in 40 villages covering a population of nearly 200,000.

At Reliance a clean environment for sustainable development is of prime concern. At all their manufacturing sites lush greenery has been developed utilising treated effluents.

Some of their leading Other Community Initiatives

Road at Dwarka, guest house for devotees, electronic security services and maintenance at Dwarka; Gardening of air-port waste land; Gaushala (Cow shed); Cultural promotion programmes for all races; Road safety and emergency services on state highways; Greening and lighting of road di- viders; Sheets and Pipes for Jaipur Foot and Prosthesis with Bhagawan Mahaveer Viklang Sahayata Samiti, Jaipur; Community meals / providing potable water; Empowering women through formation of Mahila Mandals organising vocational training courses for women.

Further, Dhirubhai Ambani Foundation (DAF) - founded under the Patronage of Shri Dhirubhai Ambani (registered under the Bombay Public Trust Act in August 1995) - has been working in partnership with RIL in most of its social initiatives. Smt. Nita Mukesh Ambani leads the CSR initiative at DAF and RIL.

The overall objective of the Foundation is to make philanthropic interventions for the welfare of Indian Society and pro-mote sustainable development of its people through initiatives in the fields of: Health, Hygiene and Sanitation, Education.

Community Revitalisation, Promotion of Social and Economic welfare of and upliftment of the People; Conservation of Natural Resources, Environmental and Ecological Protection; Rural Development and Assistance to other organisations with similar objectives.

The DAF joined hands with the management of Sir Hurkisondas Nurrotumdas Hospital and Research Centre in December 1997 with the commitment to restore the hospital to its erstwhile glory. Consequently the hospital services were restructured and state-of-the-art healthcare technology, conforming to international standards was set up.

Project Drishti, launched, in 2003, in association with the National Association for the Blind (NAB - a non-profit institution serving the blind in India for over five decades) – is a nation-wide corneal grafting drive to bring light in the lives of visually challenged from the underprivileged segment of the society - has illuminated lives of over 5,000 Indians – all free of cost.

This project is the largest (corneal grafting surgery) project undertaken by any corporate entity in the country. Presently, this project has conducted corneal grafting surgeries in over 16 cities in India and efforts are on to spread to far-flung mofussil areas of the country.

Dhirubhai Ambani International School, Mumbai, provides international educational opportunities in the context of the emerging educational needs of students.

The school prepares students for the Indian Certificate of Secondary Education (ICSE), Cambridge University's International General Certificate of Secondary Education (IGCSE) and the International Baccalaureate Diploma (IB) examinations.

Faculty members with rich experience in national and international curricula, educate, mentor and guide the children through these developmentally critical years of growth.

Case Study XI

Name: Tata Steel Limited

Thematic Areas: Microfinance, Education, Environment, Health, Livelihood and Relief during calamities

Case Study:

Vision: To improve the quality of life of the employees and the communities we serve

Tata Steel Ltd, established in 1907, is India's first and fully-integrated steel plant located in Jamshedpur, having employee strength of over 42,000.

As a conscious Corporate Citizen, Tata Steel Ltd is committed to improving the quality of life of its employees and also of the citizens residing in and around the Steel Works in Jamshedpur and the various out locations scattered in different states in the country as well as abroad.

These dual interventions in workplace and community have a far reaching impact. This responsible corporate citizenship is reinforced by the organisation by being a signatory to Global Compact and accepting and practicing the "Ten Principles" in total as well as being a Member of Global Business Coalition on HIV/AIDS.

HIV/AIDS is a disease that threatens to affect communities all over the world and especially the young and productive industrial workforce.

Tata Steel Ltd's involvement vis-à-vis preventing HIV/AIDS dates back to early 1990s when the organisation realised that the disease had acquired epidemic proportions and accepted that its control or prevention was not the sole responsibility of the government.

It decided to respond to the situation by taking appropriate initiatives to safeguard health of the community and prevent spread of the disease.

Tata Steel Ltd., fully mindful of its role, promptly mobilised its resources and evolved a policy on control of HIV/AIDS. The policy is revisited every couple of years with inputs from HIV+ people, and the need of the stakeholders. It also formulated a strategy of creating mass awareness and educating the society to prevent and combat the menace of HIV/AIDS.

In 1994, the management of Tata Steel Ltd evolved a Corporate Sector Model to prevent STD/HIV/AIDS and constituted a Core Group – AIDS and Nodal Centre – AIDS to focus on this disease and formulate strategies for its control and prevention.

The members of Core Group – AIDS comprise experts from various divisions of the company e.g., Community Development & Social Welfare Department, Centre for Family Initiatives, Personnel, Tata Steel Rural Development Society, Tribal Cultural Society, Public Health & Medical Division as well as invitees from local governmental and private organisations. Convener Core Group – AIDS, a technical person, was assigned full time by the Company to run the HIV/AIDS initiatives.

The members conduct AIDS Awareness Programmes especially for women and youth, using various IEC (Information-Education-Communication) media and forum, not only among the citizens in and around the Steel City, but also for those re-siding in (700) villages around its out-locations.

Feedback from the target group acts as input to further improve the programmes. Each year International Candlelight Memorial and World AIDS Day are observed to express solidarity with those affected by HIV/AIDS.

Testimony to Tata Steel Ltd's commitment to prevent and check HIV/AIDS disease is amply provided by the adoption of practice of non-discrimination between HIV infected employees and other employees. The Company firmly believes that by continuously informing and educating various levels of society, adequate awareness can be built in the community, which in turn would take appropriate preventive measures against the disease.

There is no pre-employment screening for HIV status. Confidentiality of HIV+ employees is maintained with continuation of their employment. They are re-located to assignments that are best suited to their physical ability and continue till they are medically fit to work.

Workplace programmes are conducted regularly with the help of HR Personnel for both the permanent employees as well as the contract labor which also helps sensitise em ployees and reduces stigma and discrimination. Approximately 250 AIDS Awareness Programmes are conducted every year in the workplace.

Comprehensive counseling, treatment and care including the Preventing Parent To Child Transmission Plus programme is provided through all health centers of Tata Steel such as:

Tata Main Hospital, an 850-bed modern specialty hospital and has an Out-patients Department in all specialties and provides "treatment without discrimination" to all positive people. All HIV+ employees or their dependents are provided with HAART free of cost by the Company

12 Out-patients clinics in Jamshedpur Township attached to Tata Main Hospital

21 Maternal & Child Health clinics of Tata Steel Family Initiatives Foundation and

4 Clinics of Tata Steel's Community Development & Social Welfare

Jamshedpur Blood Bank encourages voluntary blood donation which ensures availability of "safe blood."

A "Single window" health delivery concept, Sneh Kendra, was started to provide care and support to those affected by STI/HIV/AIDS. All cases detected HIV+ and their family members are finally referred here by above-mentioned agencies for on-going support. The family members of these patients regularly come for counseling, group support and life skills training.

They are also benefiting from programmes on vocational training, economic support for education of children, formation of Self Help Group for economic rehabilitation and sus-tainability.

To increase the reach of the programmes Peer leaders are identified in the community and trained. Internal and external experts are invited to conduct training and workshops for capacity building of knowledge and skills of all stakeholders in health and community-based care and support services on a regular basis.

Tata Steel Ltd believes in networking with like-minded agencies e.g. National AIDS Control Organisation (NACO), UN-AIDS, Global Business Coalition on HIV/AIDS (Tata Steel received an award for its HIV/AIDS initiatives in the community in 2003), ILO, CII-Indian Business Trust, WHO, JSACS, Transport Corporation of India Foundation (TCIF), PFI, The David & Lucile Packard Foundation to share resources.

To help the district health services Core Group – AIDS introduced computer-based Health Information Management System (HIMS) in Jamshedpur. Each month statistics on new HIV+ cases from local Health Institutions is collated in the Civil Surgeon's office.

Tata Steel Ltd is a recipient of Global Business Coalition on HIV/AIDS Award 2003 for its initiatives on HIV/ AIDS in the community.

9.4 WHOLE LIFE COSTING - ASSESSMENT OF SOCIO-ECONOMIC IMPACT OF STRATEGIC AND OPERATIONAL DECISIONS OF BUSINESS

Introduction

Value for money is a concept that is frequently considered when an individual or an organisation is seeking to make a purchase or investment. When acquiring a new car, for example, we may consider the costs of ownership (fuel economy, insurance, maintenance, availability of replacement parts, etc.) when deciding between options. Implicitly then, we consider the long-term costs of ownership in the decision making process.

Furthermore, it could be argued that the larger the capital cost of a product, the more important it is to consider these long-term costs. Buildings are a prime example of high cost purchases, yet consideration of long-term costs is not given the attention it deserves. The past 30 years have seen many attempts to encourage a holistic approach to what is in effect 'whole life' cost analysis, but with limited success, particularly in the United Kingdom.

One such technique that is currently emerging in the industry is whole life-cycle costing (WLCC).

Whole life-cycle costing is a relatively new concept to the construction industry, albeit based upon the foundations of analytical techniques that have been in existence for some time. It is in essence an evolution of lifecycle costing (LCC) techniques that are now commonly used in many areas of procurement. Like LCC, the primary purpose of WLCC is to aid capital investment decision making by providing forecasts of the long-term costs of construction and ownership of a building or structure. However, unlike LCC it is also a dynamic approach, and can provide up-to-date forecasts on cost and performance throughout the life of the building. Some of the ideas behind the justification for WLCC are synonymous with key issues in today's construction industry:

- Meeting clients' expectations Clients (especially in the public sector) now require buildings that are efficient during and after construction. WLCC techniques can demonstrate real cost savings in design solutions
- Sustainability Achieving sustainable design solutions relies on the consideration of long-term operational costs and performance of building components
- Monitoring performance of constructed assets For example, are PFI/PPP (Private Finance Initiative/ Public–Private Partnerships) projects really cost effective? Only by considering the whole life-cycle costs can this be assessed. Using WLCC also supports benchmarking and key performance indicators.
- Monitoring cost effectiveness of constructed assets
- Lean Construction: By considering long-term cost and physical performance , waste is minimized both during construction and through the life of the building.

Whole life-cycle costing: a brief history

Prior to the 1970s, most clients, developers and professionals involved in building procurement made capital investment decisions solely on the basis of capital cost. Outside the construction industry, it was appreciated in some quarters that making decisions solely on capital cost could be folly. They believed that by possibly spending more in capital cost, the long term would realise substantial cost savings when compared with a cheaper alternative.

This school of thought was known as 'terotechnology', and it was in effect the beginnings of whole life-cycle cost theory. Within the construction industry, nevertheless, terotechnology was largely ignored. Some of the reasons behind this included an ignorance of the importance of whole life-cycle costs, lack of available data and data collection mechanisms, and the fact that those providing the capital generally had no interest in the subsequent operational costs of the building. In the early 1970s, the term 'cost-in-use' began to cost effective? Only by considering the whole life-cycle costs can this be assessed. Using WLCC also supports benchmarking and key performance indicators

- *Monitoring cost effectiveness of constructed assets* WLCC provides the means by which to constantly review this and base future capital investment on this information
- *Lean construction* By considering long-term cost and physical performance, waste is minimised both during construction and through the life of the building.

The aim of this chapter therefore is to provide a general overview of the fundamental ideas and principles behind WLCC and to demonstrate how it can be of benefit to the construction industry practitioner. The chapter initially examines the history of LCC and its various definitions, moving on to show how WLCC has evolved from LCC as a new and innovative cost analysis tool. The failings of previous LCC methodologies are examined by definition of the innovative aspects of WLCC. appear in the industry and the literature. Cost-in-use refers to the expenditure related to the operation of an asset. Although not related specifically to the construction industry, it was recognised that the underlying principles of costing use could apply to buildings and critical structures. What cost-in-use failed to consider, though, was the necessity for accurate future cost forecasting. It became clear then that some kind of technique was required to facilitate this.

It was not until the mid to late 1970s that LCC emerged as a solution to this problem. LCC fostered a wide-ranging approach to cost appraisal, encompassing all perceivable costs from construction through to eventual disposal –

'the whole life'. Using a variety of forecasting techniques, the analyst was able to demonstrate how increased capital cost could be offset by long-term cost savings. LCC sounded good in theory, but the practical implementation within the construction industry did not reflect this. In terms of the enlargement of life-cycle costing theory, the major factor which frustrated its development was lack of good quality cost-in-use and performance data. This proved to be the principal dissatisfaction felt by those who showed some willingness to employ life-cycle costing techniques.

In 1971, the Royal Institution of Chartered Surveyors established the Building Maintenance Cost Information Service (BMCIS) as a method of collecting operational and running cost data. Its main aim was to adopt a single classification system, which could then be disseminated among subscribers in a common demeanour. Although the BMCIS went some way to addressing the implementation problems of life-cycle costing, it did not address the need for a coherent framework and structure in which to deal most effectively with this information.

In 1977, the then UK Department of Industry published *Life-cycle costing in the management of assets* which presented one of the earliest definitions of LCC:

'A concept which brings together a number of techniques – engineering, accounting, mathematical and statistical – to take account of all significant net expenditures arising during the ownership of an asset. Life-cycle costing is concerned with quantifying options to ascertain the optimum choice of asset configuration. It enables the total life-cycle cost and the trade-off between cost elements, during the asset life phases to be studied and for their optimum selection use and replacement.' Since 1977, LCC has become widely reported on, with a diversity of models and techniques existing. In 1983, two eminent researchers in LCC, Roger Flanagan and George Norman, developed a framework for collecting data, which could then be used to build up the life-cycle cost of a project. By 1992, LCC was a familiar concept to building economists throughout the world, and as such became a recognised standard in the UK under British Standard BS 3843 (1992):

'The costs associated with acquiring, using, caring for and disposing of physical assets, including feasibility studies, research and development, design, production, maintenance, replacement and disposal; as well as all the support, training and operations costs generated by the acquisition, use, maintenance, and replacement of permanent physical assets.'

In 2000, this definition was revised and incorporated into ISO 156868 Part 1 – Service Life Planning which cites LCC as (ISO 2000):

'A technique which enables comparative cost assessments to be made over a specified period of time, taking into account all relevant economic factors both in terms of initial capital costs and future operational costs.'

The BS/ISO definition, although authoritative, is a daunting and perhaps vague definition given the plethora of cost items that could be included within each cost category. Principally, the authors believe this to be one of the reasons why LCC is still rarely used to the extent that it was initiated for, although others argue that the lack of quality data is the principal reason.

Additionally, the plethora of cost models and definitions associated with LCC has been significant in creating an 'air of confusion' over the subject. Ambiguity and inconsistency were identified in Newton (1991), where consideration of the problem of model classification and the inability to compare models on a like-for-like basis are discussed. Furthermore, the individual perception of the life-cycle model raises many concerns. This is validated in Smith (1999), which highlights how LCC has for some time become an important issue in the overall cost picture, but has not featured in the decision making process to the same extent. This lends weight to the argument in Kirkham *et al*.

(1999) that in some respects LCC has remained an academic rather than a practical tool, and that presently the financial burden of implementing an LCC approach outweighs the advocated benefits.

By way of example, consider the application of LCC in other sectors. It has been widely used in the procurement of United States and Australian defence contracts for some time now (Australian National Audit Office 1998; US Department of Defense 1997, 2001). The sheer cost involved in these kinds of projects emphasises the need for LCC; that is, the possibility that significant capital outlay needs to be justified by the longer-term benefits. In some respects, research has shown that LCC has only been applied to projects that have a very high capital cost. In a significant amount of cases, it has been found that ignoring the likely future costs in the conception stage can lead to a significantly more costly endeavour in the future (Smith 1999).

Towards the late 1990s, the concepts of 'whole life costing' (WLC) and 'whole life-cycle costing' (WLCC) emerged. The terms whole life costing and whole life-cycle costing are interchangeable. WLCC is a new term that appears to have been adopted by many building economists involved in the preparation of forecasts for the long-term cost assessments of capital projects.

There has been debate amongst academics and practitioners as to whether a difference really does exist between WLCC and LCC. The key emphasis in most of the definitions lies in the implication that LCC is only concerned with the economic life of the building, in other words the period of commercial interest. It could be argued that WLCC forms the attempt by academia and practitioners to overcome some of the problems of LCC. Moreover, it takes into account the costs of running and operating a building over its entire life span – 'the whole life' – as opposed to over a specified period of time, which is a feature of LCC models. Notwithstanding, some have argued that WLCC is simply synonymous with LCC. Others have specified that a difference exists (Bourke & Davis 1999). In this book, the contention is that the concepts are indeed different and to justify this assumption an online survey was conducted (Boussabaine & Kirkham 2000). The authors sought to assess the opinions of academics and practitioners involved in LCC/WLCC, and to establish if the majority of individuals thought that there was real difference between the concepts. This survey forms part of the backbone of the definition of whole life-cycle costing taken in this book.

Defining whole life-cycle costing

The online survey revealed a broad spectrum of opinion about the difference (if any) between WLCC and LCC. The following are random examples of the responses:

'The term. . . is whole life costing (WLC) and if you believe the old life-cycle costing (LCC) also included all capital and revenue costs for the whole business case/project and not merely elements, e.g. cladding, ceilings etc. then LCC and WLC are. . . the same thing.'

'By rights they should mean the same thing, with the "whole" being superfluous. When one considers a "life-cycle", its wholeness is implied. However, it [may be] possible that when some refer to LCC, they may be referring to the consideration of only costs incurred up to the point when the asset is no longer economically viable and ignoring the issues that relate to asset disposal – which is considered to be part of WLCC.'

'If LCC is anything like life-cycle assessment, its completeness is a continuum. . . In practice, LCAs suffer dramatically from incompleteness, because environmental impacts have to be traced many transactions upstream. This is not a problem for LCC . . . I can't imagine what the problem would be regarding a small amount of information about the scope of LCC. Australian and New Zealand standards I have seen on LCC do not define WLCC. [Why] would the additional term be required?'

'I believe that WLC is simply the modern [equivalent] of LCC. Cost-in-use remains something different. There may be a shift in emphasis to suggest that WLC is not a one-off calculation, but may also be reviewed during the life of the building.'

'As I understand it, WLCC goes slightly beyond that to include costs beyond working life – in the case of a building project therefore demolition costs for example would be included . . .'

'In practice, we refer to WLC as the total operating costs of the building, including energy/utilities costs and facilities management elements that relate to the building, such as maintenance and cleaning. LCC refers to replacement building components within the building such as windows, fan coil units, etc. Over and above this are facilities management costs, such as security and catering.'

'Theoretically speaking, there is no difference between LCC and WLCC. Each sector adopts a different term. For example, the manufacturing and military [sectors] use LCC, whilst the construction industry may use WLCC and . . . oil, gas and prime contracting [companies] use through life cost (TLC). However, in the concept of the Private Finance Initiative (PFI), LCC means life-cycle replacement cost which is a part of WLC.'

It would be fair to speculate, after consideration of the points above, whether we really know what WLCC represents. In the absence of any internationally recognised standard on WLCC, it remains a subjective opinion based upon experience, field of work/study and economic standpoint. Of greatest importance is that not one of the respondents in the survey defined WLCC in similar terms; some though pointed out that LCC and WLCC were two of the same thing. In the absence of any national/international standard, who is to say that the above views are at worst incorrect or at least misguided? Although several institutions within the UK are currently working on WLCC-related projects, how can a wider understanding amongst practitioners and academics be initiated, when the research community as a whole is still confused about terms? Naturally it follows that an urgent need exists to define WLCC.

It is the authors' belief that a tangible difference exists between WLCC and LCC. We see WLCC as an evolution of LCC and not a re-invention of the wheel in terms of its association to LCC. Many have rightly noted that a fundamental problem with LCC is the aspect of uncertainty, the risk that is inherent in future forecasting. Some have gone so far as to say that LCC is based on 'guesswork' and 'speculation'. True, we will never be able to state with a very high degree of certainty how a building will perform economically in terms of operation, maintenance and such like. However, it is possible to quantify that risk, to enable stakeholders and decision makers to base capital investment proposals on a basis by which they are aware of the uncertainty in the forecasts. We are also concerned about the fact that the elemental deterioration of building components and the characteristics of the building itself are not integrated into the WLCC decision making process.

In consideration of the results of the survey, and based upon the previous research activities of the various institutions in the UK and elsewhere, the authors advocate the following definition as that of WLCC:

'Whole life-cycle costing (WLCC) is a dynamic and ongoing process which enables the stochastic assessment of the performance of constructed facilities from feasibility to disposal. The WLCC assessment process takes into account the characteristics of the constructed facility, reusability, sustainability, maintainability and obsolescence as well as the capital, maintenance, operational, finance, residual and disposal costs. The result of this stochastic assessment forms the basis for a series of economic and noneconomic performance indicators relating to the various stakeholders' interests and objectives throughout the life-cycle of a project.'

The WLCC assessment components included in the above definition will serve as the guiding principles for this book. WLCC and risk assessment are but part of the overall management of the whole life-cycle of project processes that comprise the art and science of decision analysis. This book addresses the risk assessment-related aspects of decision making in the process of WLCC. The aim is to convey to the reader the fundamental principles of WLCC and risk assessment and the enveloping processes.

Risk and uncertainty in WLCC

In the previous section, attention has been drawn to the importance of dealing with risk and uncertainty in WLCC analyses. This importance is reflected in the new definition. However, this leads us to a salient point. Is there a difference between uncertainty and risk?

The authors believe there is a great difference. The terms risk and uncertainty are often used interchangeably, although a distinction can be drawn by noting that the concept of risk deals with measurable probabilities while the concept of uncertainty does not. An event contains an element of risk where a probability distribution can be defined. An event is uncertain when no probabilities can be developed concerning its occurrence. Risk refers to probabilities of errors in decisions and WLCC forecasts throughout the life-cycle of a project, or the probabilities of occurrence of events. Risk assessment deals with the likelihood and expectation of possible WLCC outcomes using probability concepts. If computed in terms of the probability of success or failure to achieve the return on investment, the risk is seen as an objective risk. It is an uncertainty when the probability cannot mathematically be indicated but there is enough knowledge to make a subjective judgement about the WLCC decisions. The more explicitly the risk is defined, the greater the possibility for the decision maker to have confidence in using the results of the WLCC analysis.

Subjectivity in WLCC

The issue of subjectivity and vagueness is also a very important facet of WLCC. Subjectiveness, vagueness and ambiguity (used interchangeably in this book) are different from randomness. Randomness deals with uncertainty (in terms of probability) concerning the occurrence or non-occurrence of anevent. Subjectivity, on the other hand, has to do with the imprecision and inexactness of events and judgements, including probability judgements.Many WLCC decision problems involve variables and relationships that are difficult, if not impossible, to measure precisely. For example, probability judgements about issues like inflation, operation costs, etc. are not always precise in WLCC and often cost analysts use subjective expressions to express their probability judgements. This applies to probability judgements as well as the costs and benefits in many WLCC decision problems. The requirement for high levels of precision may cause WLCC models to lose part of their relevance to the real world by ignoring some of the relevant decision attributes because these variables are incapable of precise measurement or because their inclusion may increase the complexity of the models. Hence, the key to successful WLCC and risk assessment is to build models that require little information – no more than the users can provide. This is a challenge, but it is a challenge that is addressed through the chapters of this book.

Summary

In this chapter we have looked at the evolution of WLCC and introduced some of the basic principles behind the technique. A working definition of WLCC is proposed, based upon the results of a survey, and we have also briefly introduced the importance of considering risk, uncertainty and subjectivity. In the following chapters we will look in closer detail at the techniques and procedures that are commonly used in WLCC modeling and how these techniques can be modified to cope with risk.

Dealing with risk and uncertainty in WLCC should be the cornerstone of the analysts' approach to WLCC decision making. The uncertainty of forecasting has always been a key problem with practitioners, so by providing information and quantifying the risk element, stakeholders should be more confident in the information that WLCC can provide.

Why has the construction industry failed to embrace WLCC?

Currently, the application of WLCC in the construction industry is still hindered significantly by the lack of standard methods and the excuse of lack of sound data upon which to arrive at accurate decisions. As a result, the output from WLCC models is looked on as unreliable. A government report issued by the

Building Research Establishment (Clift & Bourke 1998) on whole life costing identified several factors that presently act as barriers to applying WLCC:

WHOLE LIFE-CYCLE COSTING RISK MANAGEMENT

Introduction

Contemporary developments in the construction industry since the mid 1990s have highlighted the benefits that the whole life-cycle cost approach to investment appraisal can bring to the construction industry. Several reports, including those of Latham (1994) and Egan (1998), have strongly advocated the need to consider the long-term cost of design decisions. Guidance from other agencies has also stressed directly the need for design to encompass a WLCC approach. WLCC has been identified specifically as it gives the analyst the ability to generate tangible evidence of the sustainability of building facilities. It also allows insight into the economic efficiency and performance of the asset.

Recent guidance for projects procured using the Private Finance Initiative (PFI) route advocates the use of WLCC techniques specifically as they provide an assessment of the long-term cost effectiveness of a project. Investments in facilities are long-lived and necessarily involve uncertainty about project life, operating and maintenance costs, and many more factors that affect facilities economics. If there is substantial uncertainty concerning cost and time information, a WLCC analysis may have little value for decision makers. Therefore, it is essential to assess the degree of uncertainty associated with the WLCC results and to take that additional information into account when making decisions. Thus, risk management should form an integral part of the WLCC process. This chapter presents a framework for dealing with WLCC risk management.

Why Construction Industry fails to embrace WLCC

Currently, the application of WLCC in the construction industry is still hindered significantly by the lack of standard method and the excuse of lack of sound data upon which to arrive at accurate decisions. As a result, the output from WLCC models is looked on as unreliable. A Government report issued by thr Building Research Establishment on Whole Life Costing identified several factors that presently act as barriers to applying WLCC:

- The lack of universal methods and standard formats for calculating whole life costs
- The difficulty in integration of operating and maintenance strategies at the design phase
- The scale of the data collection exercise, data inconsistency
- The requirement for an independently maintained database on performance and cost of building components.

These barriers might be directly related to the absence of adequate knowledge of WLCC processes and mechanisms. There may also be a lack of willingness from stakeholders to set up appropriate mechanisms to solve these problems. If, for example, all building occupiers were required to submit annual running cost profiles, the risk associated with WLCC techniques could be significantly reduced (Bird 1987). In fact, White (1991) argues the case for 'performance profiles' and in particular, highlights again the requirements for a universal construction data information system. One could argue that a plethora of WLCC models does exist but the common denominator in practical application and development is lack of appropriate information or know-how to use and develop models with existing information.

It seems to be worth noting how both the academic and practical 'schools of thought' in the industry need to get their own houses in order if significant steps are to be taken in the wider applications of WLCC. Newton (1991) in his work in cost modelling procedures highlights the need for a methodological and organised framework for such research activities. The sheer complexity of many models lends little to practical application and in many cases, if not the majority, the lack of available good quality data prohibits further development. In terms of the practitioners, they need to be willing to encourage clients and building occupiers into adopting a more holistic approach to running cost control so that procedures can be put in place to aid all those requiring WLCC cost profiles.

Why risk assessment in whole life costing?

Combined with WLCC, risk assessment should form a major element in the strategic decision making process during project procurement and also in value analysis, especially in today's highly uncertain business environment. WLCC decisions are complex (the complexity level is usually determined by the scale, funding and financial environment surrounding the scheme, amongst other factors), and usually comprise an array of significant factors affecting the ultimate cost decisions. WLCC decisions generally have multiple objectives and alternatives, long-term impacts, multiple constituencies in the procurement of construction projects, generally involve multiple disciplines and numerous decision makers, and always involve various degrees of risk and uncertainty. Project cost, design and operational decision parameters are often established very early in the life of a given building project. Often, these parameters are chosen based on owner's and project team's personal experiences or on an ad hoc static economic analysis of the anticipated project costs. While these approaches are common, they do not provide a robust framework for dealing with the risks and decisions that are taken in the evaluation process. Nor do they allow for a systematic evaluation of all the parameters that are considered important in the examination of the WLCC aspects of a project. The existing methods also do not adequately quantify the true economic impacts of many quantitative and qualitative parameters.

Capital costs and future costs must be quantified, analysed and presented as part of the strategic decision making process in today's business environment. Cost analysis and value analysis techniques are used to quantify and assess the economic implications of investment in building facilities in general. These techniques have typically concentrated on utilising life-cycle and comparative cost procedures to determine either the lowest initial cost alternative or the highest investment return alternative. While these techniques do provide a basis for making project cost decisions, they most often do not account for many of the parameters which may affect the actual project value or cost\ (Plenty *et al*. 1999). The existing methods also do not use formal decision making processes and risk assessment methods in performing cost benefit analysis.

It is not surprising that the BRE report (Clift & Bourke 1998) found that clients have a lack of interest and trust in the value of whole cost exercises. This might be due to the fact that WLCC analysis that is not supplemented with risk assessment of all aspects of decision making involved in this process has little value to any decision maker. Risk assessment should be an integral part of the WLCC process. A significant effort is being invested in developing a framework for data collection but data collection on its own, without the correct methods and tools to identify important decisions in the WLCC process and associated risks, is of little value to clients or other interested parties. Clients did not know what to do with information when received and practitioners did not understand the process or the benefits of WLCC (Clift & Bourke 1998).

A framework that uses formal decision making processes and risk assessment of each aspect of the decision to be taken in performing WLCC life-cycle analysis can help owners, design teams and cost planners in making strategic decisions based on analysis results that truly reflect the inherent risks and costs related to the project. Alternative building decisions can be evaluated and compared early in the project development stage. Simply choosing an alternative as being 'better' than the others, based on the traditional approach of life-cycle costing, may not be strictly correct. The confidence of the decision maker's choice depends on the level of uncertainty in the variables and decisions considered. If the WLCC computation results were aided with probabilistic information on the potential costs and risks of the various decisions that are taken throughout the whole life-cycle process of a facility, the confidence in the process of whole life-cycle costing would probably be increased. The subsequent chapters in this book are intended to provide this.

Data requirements in whole life-cycle costing and risk assessment

Flanagan and Norman (1983) highlighted three fundamental requirements in successfully implementing a life-cycle costing methodology:

- A system by which the technologies can be used: a set of rules and procedures
- Data for the proposed project under consideration: estimates of initial and running costs of elemental life-cycles, discount rates, inflation indices, periods of occupancy, energy consumption, cleaning and the like. The data required to carry out WLCC analysis can be derived from a range of possible sources (Bennett & Ferry 1987):
    - Direct estimation from known costs and components
    - Historical data from typical applications
    - Models based on expected performance, average, etc.
    - Best guesses of the future trends in technology, market application
    - Professional skill and judgement.

All these factors have some bearing on the quality of data that is collected and how it is used in modelling and decision making processes. Whilst WLCC is now becoming widely used as a valuable tool in the design process, probably two key factors have undersized its potential impact (Flanagan *et al*. 1987; Bird 1987):

- A suspicion that life-cycle cost estimates are in some sense inaccurate or based merely on guesswork
- The absence of sufficient and appropriate cost and performance data.

Data sources

It has been highlighted how important the data and its composition are to WLCC, but where can this data be obtained? Ferry and Brandon (1991) highlighted six main outputs:

- Technical press
- Builder's price books
- Information services such as the Building Cost Information Service (BCIS)
- Government research literature such as from the National Economic Development Office (NEDO)
- University research
- Technical information services.

Flanagan and Norman (1983) defined these into four subgroups:

- Manufacturers' data
- Suppliers and contractors
- Modelling techniques
- Historical data.

The availability of data has a significant impact upon the types of modeling techniques available to the analyst. For instance, monthly data for energy costs can be used to develop time-series forecasts, annual data can be used to model probabilistic distributions, etc.

Manufacturers' data

A unique aspect of the building process is its individuality and specialist requirement. Many building materials and indeed processes are subcontracted out to individual specialists. These specialists as a rule will have detailed breakdowns of the life-cycle of the product, its material components and its performance characteristics.

This data can also be obtained from other authorities that are responsible for testing the integrity and materials for construction. The British Board of Agrément is a UK government testing body which carries out independent testing of materials used in the industry. Materials that meet a set specification and performance are issued with Agrément certificates, which give details on service lives and other critical information. The Building Research Establishment also carries out testing on materials and can be a useful source of information. Furthermore, the American Society of Civil Engineers regularly publishes papers on building material life spans for use in cost profiling (Ehlen 1997).

Forecasts from models

In the absence of any historical or suppliers' data/feedback, models can be used as a way to analyse the WLCC implications of particular design decisions or choices of materials. The concept behind modelling is to facilitate and introduce a higher degree of accuracy in the estimates made by cost analysts when drawing up life-cycle cost profiles. Some dispute the validity of model forecasts but one school of thought advocates that simulated forecasts are as good if not better than historical data due to the following reasons (Ferry & Brandon 1991).

- Historical data by definition relates to the past, whereas simulated data refers to the future. The argument is that for maintenance and servicing costs, data recorded previously would be a poor guide as in the future more sophisticated facilities management techniques and higher quality products and reliability would provide for a different cost structure.
- It is very fortunate to obtain historical data that has not been trained or recorded for other purposes. Typically, in dealing with life-cycle costs, data may be required about a particular element but data may only be available generally for a whole group of elements. Simulation could provide this data in the required format.
- It is also believed that historical data can be inaccurate if those job-sheets and other forms filled in on a 'Friday afternoon' are maintained in a slipshod manner.

These idiosyncrasies can be dealt with, however, using a variety of statistical techniques to reduce data noise, data outliers and other characteristics which are likely to incorrectly skew the results. For example, outliers might be determined using box plots; missing or erroneous data sets are corrected using local means (averages). However, a thorough knowledge of the data used in the modelling should be acquired to ensure that the techniques used are valid and not likely to introduce biases into the modelling process.

Historical data

Historical data can be obtained from a variety of sources such as the BMCIS, clients and building occupiers and in some cases the design team themselves. The value of historical data is relevant in that the values of initial capital cost and subsequent running cost can be categorised for certain groups of element in the building and this comparison can then be used to identify the elements which will benefit from a life-cycle cost approach. For instance, if a building element has a high initial capital cost and then subsequently low maintenance and running costs, a life-cycle approach would gain little use. However, elements with significant running costs could, through design change, for instance, benefit from life-cycle cost savings.

Specifying a comprehensive set of objectives and measures for each WLCC component

The authors advocate, for this purpose, the use of operational research (OR) and methods described in risk assessment and decision making in business and industry (Pilcher 1992; Koller 1999). OR methods consist of a number of well-defined scientific steps:

(1) Formulation of the problem, establishing the objectives and any constraints that may apply

(2) Building a model that represents the system under analysis

(3) Using the model in order to obtain a solution to the problem

(4) Comparing a solution obtained by means of the model with that in current use

(5) Evaluating the results and monitoring the performance of the system through changing conditions.

The above steps must be applied to every aspect of the WLCC. Therefore, the interactive steps that are involved in this process are:

Service life

The prediction of component service life is a very important aspect in WLCC assessment. One such methodology currently in use is the factor method.

The ISO/CD 15686-1 factor method for the estimation of the service life of components or assembly (facility) under specific conditions treats the service life as a deterministic value. In reality the service life has a big scatter and should be treated as a stochastic quantity. Here the authors advocate that at early stages of the project (design) this approach should be used but in conjunction with uncertainty and risk assessment for each of the involved factors. The objectives that need to be assessed include:

- Assumptions about the service life of the major facility components
- Risk of failure of components
- Quality of fabrication and production
- Assumption about the updating and maintenance management plans
- Cost constraints
- Assumptions about frequency and time intervals of maintenance and replacement.

At operation stage the requirements are different and necessitate a completely different method of assessment. The process here is concerned with the prediction of the remaining service life of the facility components and the forecasting of the rate of their deterioration and the maintenance budget required to bring the state of the facility to an operational standard. For this purpose the authors advocate the use of the Markov theory (explained in detail in Chapter 5). The objectives that need to be identified and assessed at this stage include:

- Survey condition of the existing facility components
- Assumption about the remaining service lives of components

- Updating budget requirement
- Priority of components updating – critical components
- Quality of maintenance and replacement components
- Assumption about time-lag replacement or maintenance delays
- The effect of delayed maintenance on budget and deterioration of facility
- Evaluating the economic viability with a view to disposal.

Obsolescence and end of use

Societal and business environments are characterised by rapid changes in technology and user patterns, which also result in changes in the requirements for infrastructure. Changes in use, trends in fashion (this is more likely to be in housing), and the emergence of new technologies (mainly mechanical services and IT) will have a direct effect on the life expectancy of components and facilities in general. Facilities should be designed and constructed with flexibility in mind to allow future adjustments for anticipated and/or likely changes. The objectives that should be identified and assessed include:

- Intangible costs, such as access disruption to building activities or other costs borne by other than clients, which will also be considered under this section
- Birth, growth and death of firms (business). This can be achieved by projecting the number of years that a business is viable. This will have a direct effect on the functional life expectancy of a facility. This assumption can be used for preparing a life-cycle cost analysis
- Physical obsolescence
- Economic obsolescence
- Technological obsolescence
- Functional obsolescence
- Legal and social obsolescence
- Disposal and decommissioning methods
- Demolition, retain or refurbish options
- Asset reuse or recycle of components
- Waste disposal implications
- Site and land clean-up procedures.

Capital costs

Returns on invested capital costs are essential in making decisions on investment scenarios. This requires a combination of knowledge about the investment in question, skill for analysis and elicitation of decisions from the existing information, experience and judgement. The capital cost for acquiring a facility will not be known with certainty until the facility is developed and handed over for operation. Hence, the information required for carrying out whole life-cycle cost and economic viability analysis relies on the availability of previously documented cases and speculative assumptions. The capital cost objectives that need to be assessed include:

- Land acquisition cost. The location, and land viability may have a direct effect on the whole life cost and life expectancy of a facility
- Predesign costs. The amounts of time and quality of information generated (development of the brief and facility specification) at this stage have great consequences on the quality and operation of a facility. The investors have a good opportunity to optimise the whole life cost of a facility through the selection of component and functional flexibility. Ideally, the issues relating to obsolescence should be investigated, accounted for as costs at this stage

- Design costs. The quality of design in terms of error, detailing and buildability will have a direct effect on the cost of production and operation. A high quality building might also require higher costs in use in order to maintain its high aesthetic quality in use (Ashworth & Hogg 2000)
- Development and production costs. The quality of workmanship is directly related to the level of maintenance. It is important to ensure that quality control is in place to ensure sound construction practices are used
- Fees
- Risk costs
- Financial costs, tax, interest, etc.

Operational costs

Operational costs are less certain as the time span increases due to uncertainties in energy costs, maintenance, fees, staff and regulatory changes. It is important to view operational cost estimates in their holistic state; several qualitative factors will have an important effect on the total operational costs.

The operational cost objectives that need to be assessed include:

- Factors which contribute significantly to the total operational costs
- Optimum balance between capital and operational costs
- Operational risk management systems
- Optimum asset cleaning procedures
- Optimum waste management procedures
- Optimum utilities management procedures
- Optimum staffing level
- Minimum disruption due to denial use of the asset.

Maintenance costs

The costs and priority of required maintenance, rehabilitation and replacement can be obtained from historical data but base cost estimates have to be supplemented with expert opinions in order to perform whole life-cycle analysis and risk assessment. The maintenance cost objectives that need to be assessed include (some are from Kirk & Dell'Isola 1995):

- Performance indicators for the assessment of maintenance costs
- Remaining service life of facility components
- Frequency and replacement costs
- In-house or subcontracted maintenance
- Selection of exterior and interior materials and surfaces
- Selection of light fixtures with minimum routine repair and replacement requirements
- Type of preventive maintenance programme.

Financing costs and revenues

The objective here is to deal with WLCC input parameters of discount, inflation rates, taxes, expenses, etc. Critical analysis of investments must include both initial and ongoing costs and returns over the period of the investment. This will allow stakeholders to compare different options and decide which offers the best return for the investment. Usually discount rate is used for computing the value of future revenues. This includes a large degree of risk return. For example, if the discount rate is set too high or too low then future costs may appear insignificant; this could result in high operational costs and capital costs, which will discourage investment. Also, if inflation is different from the selected rates this may lead to inappropriate investment choices. The financing cost objectives that need to be assessed include assumptions about:

- Inflation rates, interest and taxes
- Level of returns and risks
- Optimum discount rate
- Economic activity. This has a direct effect on the economic obsolescence of facilities
- Level of risk financing
- Cash inflows versus outflows
- Different rates, time periods and cash flows.

Asset characteristics

The characteristics (i.e. physical and functional) of new or existing facilities are very important aspects of WLCC computation. The research community has largely ignored this aspect of WLCC. For example, a relationship may exist between building function and mechanical services costs, a particularly important feature of modern facilities. Little research has been published with regard to the impact of building characteristics on WLCC. Experience shows that an indirect link exists through many aspects, including energy costs for example. A poorly insulated building will consume more energy, thus increasing WLCC and possible downtime costs in maintenance (Department of Industry 1977). The characteristics that should be assessed and included in the computation of WLCC include:

- Layout and location
- Functionality
- Construction technology
- Gross floor area
- Number of storeys and storey height
- Glazing area
- Occupancy (m2/person)
- Shape of the facility
- Aesthetics
- Energy-saving measures
- Quality of components
- Type and quality of public health systems
- Type and quality of superstructure building fabric
- Type and quality of internal fabric
- Type and quality of electrical and mechanical services
- Extent of site works.

Economic performance measures

The procurement of building facilities involves a variety of decision makers who decide on alternatives that generate capital and ongoing costs during a project's life. These capital costs generate value for different stakeholders and potential for returns to the project owner which should be durable over the life-cycle of the asset. Conventional investment appraisal techniques, which focus on cash flows represented by the costs and expected returns of a project discounted to a common base period, do not reflect the total value of capital expenditure choices which include intangible and no-monetary benefits as well as reduction of future costs and financial returns (Plenty *et al*. 1999). Usually these economic measures are not supported by any risk assessment analysis. Therefore, economic performance measurement in WLCC is very important for decision makers to evaluate and allocate identifiable value from capital and continuing costs to relevant stakeholders in the life-cycle of a facility. This will allow the consideration of different stakeholders' objectives in the assessment of the WLCC. The objectives that should be assessed under this heading should include:

- What type of performance indicators should be used to aid in the selection of alternatives
- The boundaries of these indicators, i.e. minimum and maximum values that the stakeholders are prepared to work to
- The best measures of performance in terms of WLCC outputs
- Mechanisms for WLCC benchmarking
- Measures for mitigating economic risks.

A framework for whole life costing risk management

WLCC risk management is one of the important issues facing building assets executives today. As spending on building assets rises, asset owners become increasingly worried about WLCC optimisation throughout the life span of facilities; consequently, they become highly vulnerable to the risk of operational costs. Usually, when decision makers are faced with an investment choice under uncertain conditions, their main concern is to avoid projects whose actual economic outcome might be less favourable than what is acceptable, resulting in the risk of missing out on potential investment opportunities.

Thus, the objective of WLCC risk management should be to assist decision makers in evaluating whole life alternatives so that investment success is maximised. Usually traditional methods are used to optimise this process. However, traditional approaches to risk management have failed miserably because of their demand for mysterious statistical data that the end user does not have (Koller 1999). The key to successful WLCC risk-process and risk modelling is to build a WLCC framework that requires from the user nothing more than they presently can provide. This can be a challenge that can be addressed through the use of a variety of techniques. That is why it is important to use a combination of risk management techniques (depending on the stage of assessment) for risk assessment in WLCC, ranging from simple deterministic approaches to uncertainty assessment (e.g. sensitivity and break even analysis methods which are easy to use and understand and require no additional methods of computation beyond the ones used in LCC analysis), to very sophisticated methods based on probabilities, artificial intelligence (AI) and a hybrid of both techniques.

There has been a great emphasis on the techniques that are used to model risks but there has been little work on the integration of the whole process of risk identification, quantification, response and management strategies. We believe strongly that these interlinked processes are essential ingredients for any successful risk framework in the life-cycle of assets. Figure 2.2 shows the interaction between these processes.

The whole life-cycle risk process for each stage of the project might be divided into five interactive steps, as shown in Fig. 2.2. This framework does not emphasise any one particular component (though identification is deemed to be the most important) of the WLCC risk management process but concentrates on the sequential and iterative linkage of the five components to make up the entire process of WLCC risk management. If WLCC risk is addressed in this fashion it should enable stakeholders to smoothly move forward and backward from one component to another by identifying and understanding the possible courses of action in the different steps. Such a framework should provide whole life risk managers with a comprehensive view of the overall WLCC risk management strategies. The framework, integrating the five iterative steps, is presented in Fig. 2.2 and explained in the following sections.

Whole life risk identification

The process starts with a qualitative stage that focuses on identification of risks related to each of the whole life-cycle processes. Risks that are unidentified and not quantified are unmanaged risks that can have a significant negative outcome on projects and organisations. If any of the unidentified risks occur at any stage of the project life-cycle, this may have serious consequences on stakeholders' financial status. Hence, perhaps the most important step in the whole life-cycle risk process is the process of risk identification. The quality of this process has a direct effect on the quality and accuracy of risk analysis, quantification, and development of risk strategy responses, and on the management of risk throughout the life span of projects. The output of risk identification will inform the second quantitative analysis process that focuses on evaluation and assessment of risks associated with each aspect of the life-cycle span of projects.

Whole life risk analysis

Several methodologies are available to deal with WLCC risk analysis. The techniques that can be used in WLCC risk assessment decision making might be summarised as deterministic, probabilistic and AI. Deterministic methods measure the impact on project outcomes of changing one uncertain key value or a combination of values at a time. In contrast, probabilistic methods are based on the assumption that no single figure can adequately represent the full range of possible outcomes of a risky investment (Fuller & Petersen 1996). Rather, a large number of alternative outcomes must be considered and each possibility must be accompanied by an associated probability from a probability distribution, followed by a statistical analysis to measure the degree of risk. Using a deterministic approach, the analyst determines the degree of risk on a subjective basis. AI methods differ from the above approaches and use historical data to model cost and uncertainty in WLCC analysis. None of these techniques can be applied to every situation. The best method depends on the relative size of the project, availability of data and resources, computational aids and skills, and user understanding of the technique being applied. We have not provided here a detailed explanation of all the risk analysis methodologies as these are adequately discussed in Chapter 5.

Whole life risk responses

Developing responses to reduce WLCC risks is the third step in the integrated WLCC risk management framework. Once the building assets and the many different risks and threats to which they are exposed are identified and quantified and the related life-cycle vulnerabilities assessed, necessary steps should be taken to ensure that the entire investment is protected from all sources of external and internal threats. Thus, the third stage is concerned with the identification of strategies that mitigate the effect of anticipated threats to the greatest extent possible. This should be based on the following universal rules: risk avoidance, risk reduction, risk absorption and risk transfer. The various risk responses that may be implemented to mitigate WLCC risks are explained in Chapters 9, 11 and 12.

Whole life risk management plan

Following the identification, quantification and development of risk responses, the related vulnerabilities of building assets need to be determined and planned for. This provides the basis on which risk management plans and decisions are made. The risk management planning process is concerned with putting in place the procedure for:

- What response actions are needed
- When these response actions are needed
- How these actions are implemented
- Who is responsible for the implementation, control and monitoring of the actual progress of risk responses and management strategies that have been developed to deal with the identified risk.