SQUIRE PATTON BOGGS

Indian Market Regulatory Update

The International Monetary Fund (IMF) pegs India's growth at 7.6% in the year ended March 31, 2016 and estimates a growth of 7.4% for 2016 and 2017. As per IMF's estimates in April 2016, there is a gradual increase in the global weight of fast growing countries such as India and China which play a role in boosting global growth. It is estimated that growth of the Indian economy will continue to be driven by private consumption, which has benefited from lower energy prices and higher real incomes. With the revival of sentiment and pickup in industrial activity, a recovery of private investment is expected to further strengthen growth. (Source: World Economic Outlook Update for April 2016.)

This update provides a brief overview of the key legal and regulatory developments in India from May 1, 2016 to October 31, 2016.

Key Legal and Regulatory Developments

Foreign Direct Investment

The foreign direct investment policy (FDI Policy) is the primary regulation governing foreign direct investment (FDI), in India and is reviewed and amended by the Indian government annually. The government has introduced several amendments to the FDI Policy through the annual Consolidated Foreign Direct Investment Policy Circular, 2016 issued on June 7, 2016 ("2016 FDI Policy"), and a subsequent press note issued on June 24, 2016 (Press Note). The amendments introduced by the 2016 FDI Policy and the Press Note allow increased levels of foreign investment in a number of business sectors such as broadcasting, airports and pharmaceuticals, and further simplify various sector-specific conditions as highlighted below.

Sector	Previous Position	Change	Key Considerations
Food Products	Investment in the sector lacked clarity.	FDI up to 100% under government approval route is permitted for trading (such as in e-commerce of food products manufactured or produced in India).	The liberalization will enable global retail chains to set up "food only" retail stores in India, or otherwise permit Indian 'food only' retail stores to access foreign funds. This is a significant relaxation of FDI in retail trading policy of the country.
Defence	FDI was permitted up to 49% under automatic route, and above through approval route on case to case basis wherever it was likely to result in access to modern and "state-of-art" technology in India.	FDI up to 100% is permitted (up to 49% under automatic route, beyond which with government approval), however, without the condition of "state-of-art" technology. Government can now grant approval in cases resulting in access to modern technology in India or "for other reasons".	The absence of a clear definition of "state-of-art" technology had resulted in uncertainty amongst prospective investors. This change could lead to a level playing field among domestic manufacturers and global original equipment manufacturers. However, fresh foreign investment within the approved limits in companies not seeking industrial license that may result in change in ownership pattern or secondary transfer to non-resident will require prior government approval.

Sector	Previous Position	Change	Key Considerations
Broadcasting Carriage Services & Cable Networks	FDI in broadcasting carriage services was permitted up to 49% under automatic route, beyond which government approval was required. FDI in cable networks was permitted up to 49% under automatic route, beyond which government approval was required.	FDI up to 100% under automatic route is permitted in broadcast carriage services, viz. teleports, direct to home, cable networks, mobile TV and headend in the sky broadcasting services. FDI up to 100% under automatic route is also permitted in cable networks.	Fresh foreign investment beyond 49% in companies not seeking license/ permission from sectoral ministry that may result in change in ownership pattern or secondary transfer to non-resident will require prior government approval. The guidelines for obtaining license for providing DTH Broadcasting Services prohibit cross-media holdings of greater than 20% in DTH and cable network companies. In the absence of relaxation of such holdings, the impact of the change in the FDI policy could be limited.
Pharmaceuticals	No brownfield investment was permitted without government approval.	FDI in brownfield pharmaceutical projects up to 74% is permitted under automatic route. Investment beyond this threshold would require government approval.	This is a significant move that will benefit financial investors and promote joint ventures in India's pharmaceutical industry. However, the much debated non-compete restrictions will continue to apply to all foreign investments (except where approved as a special circumstance). Position on asset transfers being covered under automatic route (so long as the FDI investor has less than 74% in the entity acquiring such assets) remains unclear. The government imposed certain conditions (including fixing the production levels of essential medicines, research and development expenses, etc.) which will apply to all brownfield investments.
Civil Aviation	FDI under automatic route was permitted up to 100% in greenfield projects and up to 74% in brownfield projects (beyond which government approval was required). FDI was limited to 49% in scheduled air transport service/domestic scheduled passenger airlines.	FDI up to 100% is permitted under automatic route in brownfield airport projects. FDI up to 49% in scheduled air transport service/domestic scheduled passenger airline and regional air transport services is permitted under automatic route, beyond which with government approval.	This is a significant move, however, the limitation on foreign airlines to invest only up to 49% in Indian companies operating scheduled and non-scheduled air transport services, subject to conditions laid down in the extant FDI Policy, continues.

Sector	Previous Position	Change	Key Considerations
Private Security Agencies	FDI under government route was permitted up to 49%.	FDI up to 49% is permitted under the automatic route. FDI beyond 49% but up to 74% is permitted with the approval of the government.	This change would need to be incorporated in relevant Indian legislation, being the (Indian) Private Security Agencies (Regulation) Act 2005, by way of an amendment. Government should also clarify the ambiguity surrounding inclusion of companies providing cash logistics or cash management within the meaning of private security agencies.
Establishment of Branch Office, Liaison Office, Project Office or Other Place of Business in India (Other Offices)	Prior approval of the Reserve Bank of India (the financial regulator, RBI) was required for establishing "Other Offices", if the principal business of the entity was defence, telecom, private security or information technology.	The RBI's approval is no longer required in cases where government approval or license/permission from the concerned ministry/regulator has been obtained.	The text of the press release proposed to exempt prior approval from RBI, as well as need for separate security clearance. However, the Press Note grants exemption only from prior RBI approval.
Animal Husbandry	FDI up to 100% was permissible in animal husbandry provided that such activity was undertaken under "controlled conditions".	The requirement of conducting the business under "controlled conditions" is no longer applicable.	
Single Brand Retail Trading (SBRT)	This sector entailed the much debated local sourcing norms.	Local sourcing norms have been relaxed for three years for entities engaged in SBRT of products having "state-of-art" and "cutting edge" technology, and where local sourcing is not possible.	The press release mentioned a three-year relaxation on local sourcing norms and a further five-year relaxation on sourcing regime for entities undertaking SBRT of products having, "state-of-art" and "cutting edge" technology. This anomaly with the Press Note needs clarification. The terms "state-of-art", "cutting edge technology" and "where local sourcing is not possible" can be nebulous. It would be interesting to see government's approach.

Sector	Previous Position	Change	Key Considerations
Other Financial Services	100% foreign investment was permitted in non-banking finance companies, for 18 activities specified by the RBI, under the automatic route.	100% foreign investment under the automatic route is now permitted in "other financial services" as well – being activities regulated by any of the financial sector regulators, including the RBI, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, National Housing Bank.	Financial services activities which are not regulated or partly regulated by any financial sector regulator or where there is lack of clarity regarding regulatory oversight: 100% foreign investment allowed with prior government approval. Foreign investment in an activity which is specifically regulated by a law will be restricted to foreign investment levels/ limits, if any, specified in such law. Downstream investment by any entity engaged in "other financial services" will be subject to extant sectoral regulations and conditions.

Review of Sectoral Caps

The regulators have introduced a process of simplification for FDI, key outcomes of which include:

- Imposing a composite sectoral cap encompassing all types of foreign investment (direct and indirect).
- Not subjecting foreign portfolio investments that aggregate to the lower of 49% or the relevant sectoral cap, to government approval or sectoral conditions as long as such investment does not result in a change of ownership/ control in such entities.
- Specifying ownership and control of entities by Indian citizens, i.e., a company shall be considered as owned by a resident Indian citizen if more than 50% of its capital is beneficially owned (directly or indirectly) by Indian resident citizens.
- Allowing foreign investments by way of share-swaps provided the investee company is covered by a sector under the automatic route.

Investment by Foreign Venture Capital Investors (FVCIs)

FVCIs that are registered with the Securities and Exchange Board of India are now permitted to make investments in certain sectors without requiring any approval from the RBI. FVCIs can invest in unlisted companies in the form of equity, equity-linked instruments or debt instruments in specific sectors, which include biotechnology, IT, nanotechnology, production of bio-fuels, infrastructure and a few others.

An FVCI can invest in equity, equity-linked instruments or debt instruments of a "startup" irrespective of the sector in which such startup is engaged. A "startup" is defined as a private limited company, registered partnership firm or a limited liability partnership (LLP) which is not older than five years, and with an annual turnover not exceeding INR 25 crores in any preceding financial year, and is working in areas driven by technology or intellectual property as specified, towards innovation, development, deployment or commercialization of new products/ processes.

In addition, there will be no restriction on transfer of any security/ instrument held by an FVCI to any person resident outside of India.

Deferred Consideration in Cross-border Share Purchase Transactions Allowed

The RBI has amended the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 to permit, under the automatic approval route, deferment of purchase consideration in share purchase transactions involving foreign investment. Under the earlier regime, in a transaction where a non-resident purchased shares of an Indian company from a resident, there was a requirement that the entire agreed consideration be paid upfront at the time of the share transfer. Therefore, hold-backs, e.g., on account of post-closing adjustments or indemnity payments, were not permitted in such transactions unless the prior approval of the RBI was obtained. With this amendment, a non-resident is now permitted to hold-back a part of the agreed consideration (typically under an escrow mechanism) or require the resident to return the consideration received by it (on account of indemnity payments), subject to the following conditions:

- At least 75% of the agreed consideration must be paid up front, i.e., up to 25% of the agreed consideration can be held back. In this case, the balance consideration (after adjustments) must be paid within 18 months from the date of the share purchase agreement.
- If the total consideration is paid up front, up to 25% of the consideration can be returned to the non-resident by the resident on account of indemnity payments within 18 months from the date of payment of consideration.

In both of the above circumstances, the total consideration received by the resident from the non-resident, upon the expiry of the 18-month period mentioned above, must be equal to or more than the statutory floor price determined in accordance with the RBI's pricing guidelines.

Prior approval of the RBI continues to be required for payment of deferred consideration, which deviates from the above conditions.

While the amendment will facilitate acquisitions in India by permitting better risk allocation between cross-border buyers and sellers, a few issues should be carefully considered during negotiations.

- The 18-month period in relation to a hold-back is to be reckoned from the "signing" or "execution" date of the share purchase agreement, not from the "closing" date (the actual date on which the seller transfers the shares to the buyer in return for the consideration). It is not uncommon for the time gap between execution and closing to exceed six months, depending on the complexity of the transaction and the need for regulatory approvals. Consequently, the longer the gap between execution and closing of the transaction, the shorter the actual period of hold-back will be. A non-resident will be able to avail the full 18-month hold-back period only in transactions that are executed and closed simultaneously.
- As indicated above, the RBI has reiterated (in the amendment) that the total consideration paid by a non-resident to a resident must be equal to or more than the consideration determined in accordance with RBI's pricing guidelines. Therefore, the price commercially agreed to between the parties is subject to the statutory floor price prescribed by the RBI, which needs to be paid by a non-resident to a resident. As a result, there may arise a situation where the hold-back amount will need to be paid by the non-resident to comply with the pricing guidelines of the RBI, even if such buyer is contractually permitted to retain the amount (for example, on account of indemnity payments). How this issue will be dealt with practically will need to be seen as transactions start to close subsequent to the new amendment.

India-Mauritius Double Taxation Avoidance Agreement Amendment

India and Mauritius signed a protocol (the Protocol) amending the India-Mauritius Double Taxation Avoidance Agreement (India-Mauritius DTAA). This radically changes the tax liability on capital gains arising from alienation of shares of an Indian resident company by a Mauritian tax resident. Under the erstwhile regime, such gains were taxable in the country of residence, i.e., Mauritius, resulting in zero taxation. Now the Protocol imposes taxes on such gains at the source, i.e., at the level of the Indian resident company at the applicable domestic tax rate. This amendment effectively takes away the capital gains exemptions that were available investing through the Mauritius route. The Protocol has been made effective on investments made on or after April 1, 2017. Therefore, investments made prior to March 31, 2017 and related exits/share transfers will remain unaffected by this change. For a detailed analysis, please refer to our client alert from October.

Corporate Law and Financing

Clarification on Rupee Denominated Offshore Bonds

The Ministry of Corporate Affairs has clarified that issuance of rupee denominated offshore bonds will not be governed by the requirements of private placement or public offer under the [Indian] Companies Act, 2013. Also, the securities regulator in India, Securities and Exchange Board of India (SEBI), has issued a notification to clarify that the SEBI (Foreign Portfolio Investors) Regulations, 2013, will not apply to such offshore bonds. Cumulatively, these clarifications have eliminated the confusion with regard to the regulations applicable to rupee denominated offshore bonds and clearly establish the jurisdiction of the RBI in this matter, under its Master Direction on External Commercial Borrowings issued in January 2016.

Extension and Conversion of External Commercial Borrowings (ECBs)

Banks were allowed to approve requests from borrowers for changes in repayment schedules on certain conditions, so long as these were made during the tenure of the ECB (i.e., prior to maturity). The RBI has now allowed banks to approve the extension of matured but unpaid ECBs, subject to the following conditions:

- No additional cost is incurred
- Lender's consent is available
- Reporting requirements are complied with

The approval also extends to allowing conversion of "matured-but-unpaid" ECBs into equity, subject to the above conditions. This will provide greater flexibility to the borrowers and lenders to structure appropriate arrangements in case of failure to repay upon maturity of the ECB.

Reforms in Debt Recovery and Enforcement of Security Interest Proceedings

The Indian Parliament has amended the [Indian] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the [Indian] Recovery of Debts due to Banks and Financial Institutions Act, 1993. These amendments are aimed at reducing the time taken in debt recovery proceedings by reforming procedures followed by tribunals established for this purpose. These amendments include provisions on electronic filings and record keeping for all debt recovery tribunals. Additionally, these amendments provide greater powers to secured creditors to enforce their collateral interest and take over the management of defaulting corporate debtors.

Insolvency and Bankruptcy Code, 2016

Notice of the Insolvency and Bankruptcy Code, 2016 (the Code) was published in the [Indian] official gazette on May 28, 2016. The Code overhauls laws governing insolvency in India and is a major initiative of the government towards improving the ease of doing business in the country. The Code applies to companies, partnerships, limited liability partnerships and individuals. The Code replaces the existing insolvency framework which was confusing and fraught with substantial delays. Insolvency proceedings against a corporate debtor commence with a resolution process that seeks to resolve the insolvency of a debtor as a going concern by formulating a resolution plan. If this process fails to achieve a resolution, the debtor is subjected to liquidation proceedings to settle pending claims against it within a specific time frame. The process of corporate insolvency is subject to the overarching supervision of the National Company Law Tribunal (NCLT). Further, the Code envisions the establishment of an Insolvency and Bankruptcy Board which is mandated with the task of training and regulating the functioning of insolvency professionals who will have an important role in administering the insolvency proceedings along with the NCLT.

National Company Law Tribunal Notified

Corporate litigation in India has substantially been reformed with the constitution of the NCLT and the National Company Law Appellate Tribunal (NCLAT) with benches across major cities. The NCLT has jurisdiction over matters that were earlier dealt with by the Company Law Board and the High Courts, in addition to the functions assigned to it under the Code (as discussed above). This includes court approved mergers, winding-up, reduction of share capital, oppression of minority shareholders and mismanagement of companies, among others. The NCLAT will decide on appeals of the NCLT's decisions.

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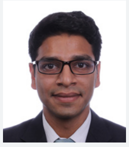

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