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Passage to India
Lessons for Foreign Investors

1. How Is the Indian Legal System Different From Other Jurisdictions?

India is a common law country and derives most of its modern legal and judicial framework from the British system. India has a written constitution that follows the Westminster system, with some federal features.

There is a uniform system of justice dispensation, with the Supreme Court at the center and High Courts in the states, as well as numerous other subordinate and specialized courts. In the strict sense, the Indian judicial system does not operate on wholly federal lines, as may be seen in the US. It does not have a dual system of courts and the judiciary is one integrated whole. There are no federal courts to decide federal questions exclusively.

As for dispute resolution, while the judiciary is professional and independent, delays are endemic – timelines of 10 years or more in obtaining a final judgment are not uncommon. Further, compared to jurisdictions such as England, Indian courts have much less experience in adjudicating complex commercial disputes.

2. How Does India Fare in "Ease of Doing Business"?

In the World Bank's 2016 "Ease of Doing Business" index, India placed 130th out of 189 countries. It ranks 157th on ease of paying taxes and falls almost to the bottom of the list on ease of enforcing contracts.

Despite these challenges, India offer significant growth opportunities. It is the 10th largest in the world by nominal Gross Domestic Product (GDP) and third largest by purchasing power GDP parity, with an annual growth rate of GDP above 5% in 2013-14. Additionally, it has strong fundamentals like a stable Westminsterstyle parliamentary democracy, cost-competitiveness and abundant supply of well-qualified and well-trained human resources across functional areas that make it a preferred destination for investment, both as a source of manufacturing and delivery of services and also as a market for the consumption of the goods and services.

The International Monetary Fund estimates a India's GDP 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 plays a role in boosting global growth. It is estimated that the growth of 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. Available at http://www.imf.org/external/pubs/ft/weo/2016/01/)

3. What Are the Precautions When Investing in India?

We recommend five tips to navigate India's business and regulatory landscape:

Understand the Regulatory Regime – India's business laws and regulations are constantly evolving. While true for all countries, changes are more frequent and unexpected in emerging economies than in developed ones. In the realm of foreign investments, Indian laws balance competing imperatives, such as the need to:

- Attract foreign capital, while ensuring that local businesses continue to thrive
- Facilitate the transfer of foreign technology and know-how while protecting legitimate business and property rights
- Create jobs while recognizing the demands of labor unions
- Promote industrial growth while supporting the agrarian economy and the rights of small farmers

These necessary compromises often result in loosely drafted policies, press notes, circulars and clarifications, pronouncements and occasional policy reversals.

Interpret Regulations Conservatively – Faced with regulatory ambiguities, foreign investors often rely on technical interpretations that open up attractive commercial opportunities. However, even the most elegant technical solutions are vulnerable when they conflict with the regulators' underlying objectives, regardless of what the regulation in question explicitly states.

When regulations are ambiguous, foreign companies should follow conservative interpretations that do not leave them vulnerable to later decisions by authorities that could compromise their business models or investment structures. Many foreign investors that have taken creative approaches have subsequently been subject to regulatory reversals, sometimes destroying the economics of their deals.

Evaluate Joint Ventures and Targets in Forensic Detail – A number of Indian joint ventures between foreign and domestic partners have collapsed as a result of insufficient due diligence and preparation prior to the launch. Foreign companies must take great care in advance to ensure all participants agree on the details of their business plans, and determine up front the manner in which day-to-day operations, corporate governance and government relations will be conducted.

Build in Commercial Protections – Good legal documents are essential, but they are not sufficient in India. Deals must be structured so that they provide commercial protection to investors. In dealing with compliance issues, it is not enough to include compliance standards in business contracts. Companies must actively encourage the behaviors they want their partners and employees to adopt.

Resolve Disputes Offshore – Since resolving a business dispute in Indian courts can take up to a decade or more, foreign companies should make every effort to resolve conflicts through offshore arbitration or, in limited circumstances, through non-Indian courts. Even when Indian law is the basis of the contract, it is important to agree to settle disputes through arbitration seated outside India. Singapore and London have long been the venue of choice for most cross-border transactions involving India.

4. What Are the Ways to Invest or Setup a Business in India?

Investment Routes

There are two routes to investing into India that are relevant to foreign corporates and institutions:

- The foreign portfolio investor (**FPI**) regime, which facilitates portfolio investments in listed Indian securities that trade on an Indian securities exchange
- The foreign direct investment (**FDI**) regime, which applies when an investor is looking to make strategic investments in Indian entities

The foreign investment regime in India has been gradually liberalized by successive governments since the liberalization process commenced in 1991. As Indian industry has developed, so has the law relating to FDI, which now encompasses a complex maze of rules, regulations, policy statements and guidelines.

Attempts have been made to simplify the regime to encourage FDI and foster competition in the Indian market. Foreign investment, while still controlled, is actively encouraged by the Indian government.

Regulators

The key Indian regulatory authorities in the context of FDI are:

- The Foreign Investment and Promotion Board (**FIPB**), which formulates foreign investment policy
- The Reserve Bank of India (**RBI**), India's central bank with primary responsibility for implementing and enforcing foreign exchange regulations and government policy

Form of Investments

FDI is permitted through the following forms of investments:

- Financial collaborations
- Joint ventures and technical collaborations
- Capital markets via Euro issues (Foreign Currency Convertible Bonds (FCCBs)/Equity Shares under the Global Depository Mechanism)
- Private placements or preferential allotments

Process for Foreign Direct Investment

FDI is freely allowed in all sectors including the service sector in India, with certain restrictions in a few sectors where the existing and notified sectoral policy does not permit FDI beyond a ceiling. FDI for most cases can be brought through Automatic Route under the powers delegated to the RBI and for the remaining case as elaborated below through the government approval.

Automatic Route

Investment under the Automatic Route is available to new ventures and also to existing companies proposing to inject foreign equity. Investors investing under the Automatic Route do not require any approval from any of the authorities. FDI in the public sector would also qualify under the Automatic Route. The investors are only required to notify the relevant Regional Office of RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of the issuance of shares to foreign investors.

Approval Route

Government Approval through FIPB for FDI is essential for the following cases:

1. Proposals which require industrial license
2. FDI being more than 24% in the equity capital of the units manufacturing items reserved for the small scale industries
3. Proposals falling outside the notified sectoral policy in which FDI is not permitted

Government Approvals are accorded on the recommendation of the FIPB. Application for all FDI cases should be submitted to the FIPB. No fee is payable.

Entry Options

Foreign investors planning to set up business in India have two options, either to set up a separate corporate entity in India, i.e., incorporating an Indian company or through an unincorporated entity, for instance, a branch office of the foreign entity.

Incorporation of an Indian company can be possible under the provisions of the Indian Companies Act 2013. The foreign investors can invest in such Indian company up to 100% of capital depending upon sectoral guidelines prescribed by the Government of India.

Under the second option, a foreign company is allowed to operate in India, subject to conditions and activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office of Other Place of Business) Regulations, 2000, through setting up either of the following: liaison office/representative office, project office, or branch office.

Tax

From a tax perspective, incorporating an Indian company has advantages to operating through an unincorporated entity:

- Resident Indian companies are taxed at 32.445% (for net income between INR 10-100 million) and 34% (if net income exceeds INR 100 million).
- Foreign/non-resident companies are taxed at the rate of 42.024% (for net income between INR 10–100 million) and 43.26% (if net income exceeds INR 100 million).
- While residents are taxed on their worldwide income, non-residents are only taxed on income arising from sources in India.

Governing Law

Broadly speaking, Indian law recognizes the freedom of parties in an international contract to choose both the governing law, the forum (arbitration/courts) and the jurisdiction for settling disputes. However, the FIPB often requires as a condition of its approval that agreements involving FDI are governed by Indian law. Litigation in India is an onerous and time-consuming process. Arbitration is, therefore, a popular dispute resolution option.

Points to Note

Limits: Under current rules, foreign investment up to 100% is permitted in almost all industry sectors. There remain only a handful of industry sectors in which no FDI/FPI or limited FDI/FPI is permitted – these tend to be "sensitive" sectors, either for security reasons, such as defense or telecommunications, or for political reasons, such as agriculture, retail, real estate, banking and insurance. In addition, the government has been simplifying procedural aspects such as the approval process in respect of FDI.

Approval Timeline: For investments going through the "approval route", the FIPB approval process typically takes six to eight weeks; however, barring exceptional circumstances, is relatively straightforward.

Entry options: Large-scale business activity with FDI is usually conducted through a company incorporated in India. The company can be a wholly-owned subsidiary of the foreign investor in sectors where 100% FDI is permitted or, where limits apply or for strategic reasons, a joint venture with an Indian counterparty. Incorporating a company in India is a fairly straightforward process (although occasionally time-consuming). The investment in the company can be through the holding of shares and/or equity linked instruments.

Price: The purchase or sale price of any transaction in Indian securities between a resident Indian and a foreign investor is regulated by prescribed pricing guidelines which limit flexibility. For example, the price of any shares sold in a listed company has to be above the minimum price calculated in accordance with a formula linked to the market value of the shares over a prescribed period preceding the sale. A different methodology applies for the sale of shares in an unlisted company.

Tax Structuring: A large number of investments into India are routed through Singapore, Mauritius or Cyprus to take advantage of benefits under the double tax treaties that exist between India and those countries. There is concern at the attempts by the Indian tax authorities to question the validity of those benefits.

For companies and businesses entering India there are important tax considerations. These include:

- What amounts to have an establishment or taxable presence in India
- Transfer pricing
- Withholding tax
- Tax concessions in the Special Economic Zones (SEZs)
- Treaties on avoidance of double taxation if a foreign individual is travelling frequently to India on work within a financial year, when tax liability arise

6. What Are the Key Focus Areas in Due Diligence?

As warranties and indemnities are difficult to enforce in India and "earn-out" mechanisms fall foul of existing foreign exchange controls, it is advisable to do a thorough due diligence and pay special attention to the following issues:

Corporate Governance – Many Indian companies are run by a "promoter," the person who is in charge of founding, organizing, and/or selling the company. Frequently, the promoter may own a large percentage of the company and the board may not be independent. In such companies, internal controls and financial reporting processes may at times be susceptible to override and may not meet typical US corporate governance requirements.

Due diligence needs to focus on both the company and its owner or promoter, and it is frequently advisable to include a Foreign Corrupt Practices Act (FCPA) component if government contracts are involved.

In India, due diligence of the owners and promoters of the company's businesses are as important as due diligence of the company itself. It is critical to perform an "integrity" check on owners, promoters, and related parties. This due diligence needs to examine individual credit histories, market reputations and credentials, their holdings and interests in other entities, evidence of fraudulent business dealings, political connections, and involvement in civil and criminal proceedings.

Regulatory Compliance – As the Indian economy undergoes further liberalization, uncertainty relating to the evolving regulatory environment is expected to continue. Regulatory issues on FDI policies, foreign exchange regulations, securities and corporate law, and direct and indirect tax laws need to be given special attention, as these laws tend to result in significant liability issues. Lastly, due diligence needs to examine whether the target is complying with local labor and environmental regulations.

Accounting – Companies must take steps to ensure prudent measures are established at the outset of a partnership. Acquirers should appoint their own independent accountants and auditors to maintain and verify the accuracy of the venture's accounts and ensure that they comply with the law and internationally recognized accounting standards. All activities undertaken in a venture – including bank transactions and receivables – must be subject to proper accounting controls.

Related-Party Transactions – It is not uncommon for target companies to be one among many holdings owned by the family or promoter. In that situation, there are frequently a substantial number of intercompany/related-party transactions that involve both customers and suppliers. These transactions may not be arm's length, may not be formalized, and in certain instances, may not even relate to the core activities or operations of the business. Aggressive tax management may also result in transactions being booked off the records of the target's operating company and liabilities may be held on the books of associated entities. Acquirers therefore need to be extremely cautious not to assume liabilities that are not related to the business being acquired. Similarly, due diligence may reveal that the target has lent funds to owners or related entities that have been deployed for nonbusiness purposes.

7. What Are the Risks When Resolving Disputes With an Indian Nexus?

The biggest risk is that disputes with an Indian nexus end up before the Indian courts, notwithstanding a foreign (offshore) dispute resolution clause.

On arbitration, whilst India is a signatory to the New York Convention, offshore arbitration (i.e., where the "seat" of arbitration is outside India) can become the subject of the exercise of "long arm" jurisdiction of the Indian courts.

One fiercely debated aspect of this "long arm" jurisdiction centers on whether the Indian court has power to review foreign arbitral awards under the Indian Arbitration and Conciliation Act 1996 (Arbitration Act). Relying on the Supreme Court decisions of 2002 (Bhatia International) and 2008 (Venture Global Engineering), it has been argued that the Indian court did have jurisdiction to review offshore arbitration awards under Part I of the Arbitration Act. As a result, foreign companies entering into contracts either under Indian law or with Indian parties risked being dragged before the Indian courts, despite their contracts containing an offshore arbitration agreement.

In 2012, a five judge Constitutional Bench of the Supreme Court in *Bharat Aluminium Co v Kaiser Aluminium Technical Services Inc* (Balco) overruled Bhatia International and Venture Global, holding that Part I of the Arbitration Act is applicable only to arbitration proceedings which take place inside India (not to foreign seated arbitrations). By this ruling, the Supreme Court made it clear that the Indian courts do not have the power to annul foreign arbitral awards.

The Balco decision was a positive development for India's investment and business climate, as it reduced the scope of interference by the Indian courts in offshore arbitration. This has been reinforced by the decision in Shri Lal Mahal Ltd. Nonetheless, there remain at least two elements of the post-Balco arbitral regime which may have a negative impact on the certainty of the arbitral process.

Pitfall 1 – Parties to Older Arbitration Agreements Are Still Subject to the Pre-Balco Regime

Parties with arbitration agreements executed before September 6, 2012 are still subject to the pre-Balco system. This is because the judgment is phrased only to "…apply prospectively, to all arbitration agreements executed hereafter". Parties with arbitration agreements executed before September 6, 2012 therefore remain subject to the Bhatia regime.

Pitfall 2 - Interim Measures Now Not Available in Support of Foreign Arbitral Proceedings

For parties entering into new arbitral agreements, to which the Balco judgment applies, a substantial benefit of "offshore" arbitration – the ability to apply to the Indian courts for interim measures in support of such proceedings – is no longer available.

8. What Is a Good Seat for Arbitration With an Indian Party?

The seat or place of arbitration is crucial as it dictates the legal framework underlying the arbitration (in relation to, for example, the grounds on which the arbitral award may be challenged or appealed). That the seat is the "center of gravity" of arbitration has been recognized by the Indian Supreme Court in the Balco judgment. Neutral fora that are currently popular include London, Singapore, Paris, Geneva and Stockholm.

With the recent inclusion of China in the list of countries notified in the Official Gazette as a reciprocating territory for the purposes of enforcement under the regime of the New York Convention, Hong Kong is likely to emerge in the coming years as another neutral seat that parties may wish to consider when selecting a forum for India-related arbitrations.

The best option in the Indian context is usually one of:

- LCIA or ICC arbitration in London
- SIAC or ICC arbitration in Singapore
- HKIAC arbitration in Hong Kong
- ICC arbitration in Paris

Each of London, Singapore, Hong Kong and Paris has arbitration laws and courts which are broadly supportive of arbitration. They also have well=established, reputed arbitration institutions.

Other alternatives sometimes seen in the Indian context include: (i) ad hoc arbitration in London or Paris; and (ii) institutional or ad hoc arbitration in other major European arbitration centers (e.g., Geneva, Zurich and Stockholm)

Indian parties are often most comfortable with arbitration in London or Singapore, perhaps because of the similarity between the basic tenets of the Indian, English and Singapore legal systems. SIAC arbitration in Singapore is increasingly popular with Indian parties.

In our experience, Indian parties are reluctant to agree to arbitrate in the US.

9. How Are Arbitral Awards Enforced in India?

Domestic awards and foreign awards under the New York Convention and the Geneva Protocol are enforceable in India as if they were decrees of an Indian Court. Non-convention foreign awards are not enforceable in India.

10. On What Grounds Can International Arbitration Awards Be Resisted by Indian Courts?

The enforcement of a foreign arbitration award may be resisted only on certain limited grounds, which are:

- Incapacity of one of the parties
- Failure of natural justice
- The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration
- Composition of the arbitral authority or the arbitral procedure not being in accordance with the agreement
- The award not being binding on the parties, or being set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made
- The subject matter of the dispute is not capable of settlement by arbitration under the law of India
- The enforcement of the award would be contrary to the public policy of India

11. Can a Judgment of a Foreign Court Be Enforced in India?

Judgments of specified courts in certain "reciprocating countries" can be enforced directly in India by execution proceedings as if these foreign judgments are decrees of the Indian courts.

A "reciprocating country" is one which is notified by the Government of India, which is:

- UK
- Singapore
- Hong Kong
- Bangladesh
- United Arab Emirates
- Aden
- Fiji
- Malaysia
- Trinidad and Tobago
- New Zealand, the Cook Islands (including Niue) and the Trust Territories of Western Samoa
- Papua and New Guinea

Do note that the US is not notified as "reciprocating territory".

Foreign judgments of non-reciprocating countries can be enforced in India only by filing a suit based on the judgment. A foreign judgment is usually recognized by Indian courts unless it is proved that:

- It was pronounced by a court which did not have jurisdiction over the matter
- It was not given on the merits of the case
- It appeared on the face of the proceeding to be founded on an incorrect view of international law or a refusal to recognize Indian law (where applicable)
- Principles of natural justice were ignored by the foreign court
- The judgment was obtained by fraud
- The judgment sustained a claim founded on a breach of Indian law.

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