INDUSLAW
THOUGHT LEADERSHIP ... APPLIED

BRIEFING NOTES
KEY LEGAL DEVELOPMENTS

CONTENTS

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1. INTRODUCTION

This time last year, few would have been optimistic that parliament would be able to push through much needed legislation to trigger sweeping changes to India's indirect taxation system and the resolution of bankruptcy and insolvency.

Undoubtedly, the highlights of legal reform in 2016 rest with the Constitutional Amendment Bill, paving the way for a unified Goods and Services Tax across the country, together with the Insolvency & Bankruptcy Code, promising to make the resolution of insolvency more efficient for creditors, encouraging the quicker recycling of capital.

At the beginning of 2016 India's legislation governing arbitration was overhauled, with a view to make dispute resolution more efficient and cost effective. Separately, the Government of India, taking feedback from the Law Commission and other stakeholders, published its amended draft bilateral investment treaty with a view to make investment protections in line with international practice.

Following the explosion of foreign investment in the e-commerce sector over the last several years, the Government published its guidelines governing investment in the sector, addressing grey areas though, leaving new nuances open for further discussion.

During the summer (which saw the passage of the Insolvency & Bankruptcy Code, amendments to the India-Mauritius Tax Treaty and the Constitutional Amendment paving the way for the Goods & Services Tax), the Department of Industrial Policy and Promotion, keeping pace with the changes, announced further clarifications with respect to the ever increasing liberalisation of the regime governing foreign direct investment.

Banking and finance regulations have also been amended, making it easier to refinance existing project debt in particular.

This publication highlights some of the key changes to India's legal framework during 2016, analysing its implications and what it means for investors, lenders, developers and other key stakeholders in the economy.

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DISCLAIMER

2. ARBITRATION & LITIGATION

2.1 THE ARBITRATION AND CONCILIATION (AMENDMENT) ACT, 2015: AN ANALYSIS

Introduction

After much clamour, the Arbitration and Conciliation Act, 1996 (the **"Arbitration Act"**) finally stands amended. The Arbitration and Conciliation (Amendment) Act, 2015 (the "**Amendment Act**"), which received the assent of the President of India on December 31, 2015 and deemed to have come into force on October 23, 2015, has proposed sweeping changes to the Arbitration Act.

Although the Arbitration Act was enacted in 1996, with the intention of providing speedy and effective resolution of disputes through arbitration or conciliation and reduce the burden on courts, in practice, the experience has turned out somewhat different to what was envisaged.

The arbitration experience in India has been subject to intense scrutiny over the years, leaving the parties to ponder whether or not to incorporate arbitration clauses. Taking note of the criticisms in the earlier arbitration regime, the Law Commission of India (the "**Law Commission**") submitted its report in August 2014 (the "**Law Commission Report**") recommending several changes to the Arbitration Act.

On 23 October, 2015, the President of India promulgated an ordinance (the "**Arbitration Ordinance**") to bring into force number of these amendments to the Arbitration Act.[1]

Since the amendments were brought through an ordinance, confusion and uncertainty prevailed and there was also no clarity on whether such amendments would be prospective or retrospective in operation.

The Amendment Act is therefore a welcome move and has been hailed for providing a much needed impetus for the future growth of the Indian arbitration regime. Despite some deviations, the Amendment Act is largely in consonance with the Law Commission Report and the Arbitration Ordinance.

However, there have been lapses in drafting the new law, and further steps could have been taken by the law makers to ensure that India does indeed become the next arbitration hub and we set out below an analysis of its provisions.

Interim Relief

Before the courts

After the judgment of the Supreme Court in *Bharat Aluminium and Co. v. Kaiser Aluminium and Co.* [2] ("**BALCO**") the Indian courts had no jurisdiction to intervene in arbitrations which were seated outside India.

Post BALCO, if the assets of a party was located in India, and there was a likelihood of the dissipation of the assets, the other party could not approach the Indian courts for interim orders.

Since interim orders made by arbitral tribunals outside India could not be enforced in India, it created major hurdles for parties who had chosen to arbitrate outside India.

This anomaly has been addressed in the Amendment Act with the insertion of Section 2(2), which makes the provision for interim relief applicable in cases where the place of arbitration is outside India, subject to an agreement to the contrary.

However, a few concerns remain. This option is *only* applicable to parties to an *international commercial arbitration* with a seat outside India. This means that the protection will not be available for two Indian parties who choose to arbitrate outside India.

The Amendment Act provides that in case the court passes an interim order, arbitration proceedings must commence within a period of 90 (ninety) days from the date of such order or within such time as prescribed by the court.

This amendment was brought in to prevent the parties from misusing this provision, by strategically obtaining *exparte or ad interim* orders and not proceeding with arbitration.

However, it should be pointed out that there is no clarity on whether the 90 (ninety) day period commences from the date of the *exparte or ad interim* order or the final order in the proceedings under Section 9.

This aspect should have been clarified. In our view, the better approach perhaps would have been to specify that the 90 (ninety) day period commences from the date of filing of the petition, in order to drive the parties to arbitration.[3]

Before an arbitration tribunal

Essentially, the amendments to Section 17 of the Arbitration Act now empowers an arbitral tribunal with the same powers as that of a court under Section 9.

In order to facilitate the parties to approach the arbitral tribunal and reduce the intervention of courts, the Amendment Act provides that once the arbitral tribunal has been constituted, the courts cannot entertain application for interim measures, unless there are circumstances which may not render the remedy of obtaining interim orders from the arbitral tribunal efficacious.

The Amendment Act also clarifies that such interim measures granted by the arbitral tribunal would have the same effect as that of a civil court order under the Civil Procedure Code, 1908 (the "**CPC**").

This is a significant development as interim orders of arbitral tribunal under the earlier arbitration regime could not be statutorily enforced, virtually rendering them meaningless.

However, in a recent judgment passed by the Kerala High Court on March 16, 2016 in Writ Petition (Civil) No. 38725 of 2015, a single judge has taken the view that under the Amendment Act, the arbitral

1. Please see our article on the Arbitration Ordinance: (http://www.mondaq.com/india/x/452076/Arbitration+Dispute+Resolution/Amendments+To+Indias+Arbitration+Act+An+Analysis)

2. (2012) 9 SCC 552

3. Please see article by Mr. Promod Nair on the Arbitration Ordinance (http://barandbench.com/when-good-intentions-are-not-good-enough-the-arbitration-ordinance-in-india/)

tribunal cannot pass an order to enforce its own orders and the parties will have to approach the courts for seeking such enforcement, thereby making the enforcement of arbitral awards cumbersome. It will be interesting to see how the other courts interpret this judgment and if this stands the test of further judicial scrutiny.

Under the new regime, it should be noted that the arbitral tribunal has the power to order interim measures even after the making of the arbitral award, but before it is enforced.

However, this is inconsistent with Section 32 of the Arbitration Act, which provides that the mandate of an arbitral tribunal shall be terminated after the making of the final award. Logically, if the arbitral tribunal ceases to have jurisdiction *after* passing the final award, it is inconceivable as to how it would have the power to order interim measures after the making of the final award. This anomaly should have been rectified by appropriate amendments to Section 32.

Limited scope to refuse request

The amended Section 8 of the Arbitration Act now empowers a judicial authority to refer the parties to arbitration when there is an arbitration agreement, unless it finds *prima facie* that no valid arbitration agreement exists.

While Section 8(1) refers to *"judicial authority",* inexplicably, in Section 8(2) the word "*Court*" has been used instead of *judicial authority* which appears to be an oversight.[4]

While the scope under amended Section 11 is limited to the examination of the existence of an arbitration agreement; scope under amended Section 8 appears to be broader in as much as the judicial authority can also examine the validity of the arbitration clause.

There appears to be different standards set for examination of an arbitration agreement under Sections 8 and 11, which ought to have been avoided. The standards consistent with the proposals made in the Law Commission Report ought to have been made uniformly applicable to both provisions.

Grounds for challenge

The grounds for challenging an arbitration award have been restricted. The scope of *"public policy"* in Section 34 has been *narrowed* and the award can be set aside *only* if the arbitral award: (i) was induced or affected by fraud or corruption; or (ii) is in contravention with the fundamental policy of India; or (iii) conflicts with the most basic notions of morality or justice.

In order to counter the judgment of the Supreme Court in *ONGC Limited v. Western Geco International Limited,*[5] (which expanded the scope of *"public policy"* to include the *Wednesbury principle* of reasonableness which would necessarily entail a review on merits of the arbitral award), the Law Commission submitted its Supplementary Report in February 2015, which recommendations have been accepted and incorporated through insertion of Section 2A.

In terms of this amended provision, an award *cannot* be set aside merely on the ground of erroneous application of the law or by re-appreciation of evidence. However, interestingly, the test of *"patent illegality appearing on the face of the award"* has not been made applicable to international commercial arbitrations. This provision may be subjected to challenge by Indian parties, who may contend that different standards ought not to be set for international commercial arbitrations. The test of *"patent illegality"* could perhaps have been deleted all together to avoid this anomaly.

No automatic stay

Prior to the Amendment Act, the mere filing of a challenge petition to the arbitral award would result in an automatic stay of the arbitral award. Inevitably, the courts would take several years to decide the petition, making the process of arbitration time consuming and ineffective.

In a welcome move, the Amendment Act provides that there shall be no automatic stay of the arbitral award and a separate application will have to be filed seeking stay of the arbitral award. The court is now required to record reasons for the grant of a stay order and the provisions of the CPC for the grant of stay of a money decree have been made applicable, meaning that the losing party will necessarily be required to either deposit some part or the entire sum awarded in the arbitral award, or furnish security, as the court deems fit.

Time bound proceedings

The Amendment Act provides for faster timelines to make the arbitration process more effective. A proviso to Section 24 has been added, requiring the arbitral tribunal to hold oral hearings for evidence and oral argument on a day-to-day basis and not grant any adjournments unless sufficient cause is made out.

The arbitral tribunal has also been vested with the power to impose heavy costs for adjournments without sufficient cause. Every arbitral award must be made within 12 (twelve) months from the date the arbitrators receives a written notice of appointment and the parties may mutually decide to extend the time limit by not more than 6 (six) months.

If the award is not made within 18 (eighteen) months, the mandate of the arbitrators will terminate unless the court extends the period upon an application filed by any of the parties. However, it should be noted there is no time period fixed for approaching the court seeking extension of time which may again contribute to delays.

Further, while extending the time for making the award, if the court finds that the delay was attributable to the arbitral tribunal, it may order a reduction in the arbitrator's fee by an amount not exceeding 5% (five percent) for each month of such delay.

The court while extending the time limit, also has the right to change the arbitrators as it may deem fit. An application to the court (as stated above) would be endeavoured to be disposed of by the court within 60 (sixty) days from the date that the opposite party receives the notice.

4. Supra Note 3

5. (2014) 9 SCC 263

A challenge to an arbitral award should be disposed expeditiously and in any event within a period of 1 (one) year from the date on which notice is served upon the other party. Section 11 will now have to be decided within a period of 60 (sixty) days from the date of service of notice to the opposite party.

In an arbitration regime that was plagued with delays and costs, this is a positive development. However, the parties would be forced to go court to seek extensions of time to complete the arbitration, which is an undesirable situation in a court system burdened with a huge pendency of cases.

Interestingly, it would appear that even the arbitration institutions will be required to make an application for an extension of time, if the award is not rendered within the specified period. It is indeed an undesirable situation to have parties (including the arbitration institutions with their own set of rules) to be forced to come to court, seeking an extension of time to complete the arbitration proceedings.[6]

Finally, it should be noted that the proposed time line of 12 (twelve) months to pass the arbitral award is very ambitious, even by international standards. There are some complex disputes, the resolution of which may not be possible within this time frame. Even the Law Commission Report had recommended a time period of 24 (twenty four) months to complete the arbitration proceedings. Such ambitious time lines may act as a deterrent for foreign parties to choose India as the seat of arbitration, particularly in complex disputes. Providing ambitious timelines may actually backfire and go contrary to the very purpose of introducing these amendments.

Fast track procedure

The Amendment Act introduces Section 29B, which gives an option to the parties to agree on a fast track mechanism under which the award will have to be made within a period of 6 (six) months from the date the arbitrators receive a written notice of appointment.

In such circumstances, the dispute would be decided on written pleadings, documents and submissions filed by the parties without any oral hearing. Oral hearings can be held only if all the parties request or the arbitral tribunal considers it necessary for clarifying certain issues. However, it should be noted that there may not be too many occasions where the parties to an on-going dispute agree on anything, let alone agree on a fast track procedure.

New cost regime

The Amendment Act introduces Section 31A, giving wide powers to the arbitral tribunal to award costs and the expansive regime to award costs based on rational and realistic criteria, as recommended in the Law Commission Report, has been accepted.

The arbitral tribunal can therefore decide whether costs are payable, the amount of costs to be paid and when they need to be paid. The provision further provides that generally the unsuccessful party will be ordered to pay costs to the successful party.

These costs may include fees and expenses of the arbitrators, the courts and witnesses, legal fees and expenses, administrative costs of the institution and any other costs incurred in relation to the arbitral or court proceedings and the arbitral award.

The conduct of the parties is also a determining factor in awarding costs, including the refusal of a party to unreasonably refuse a reasonable offer of settlement made by the other party.

Disclosure requirements of the arbitrator

The Amendment Act has borrowed the disclosure requirements from the IBA Guidelines on Conflict of Interest in International Arbitration. The Fifth and Seventh Schedule has been inserted which provides a guide in determining circumstances for ineligibility of the arbitrator.

Cap on arbitrator fees

A Fourth Schedule to the Arbitration Act has been introduced which sets out the model fees in case of arbitrations (other than international commercial arbitrations and in cases where parties have agreed to the rules of an arbitral institution), with a view to ensure that the arbitration process does not become very expensive.

Section 11A (2) has been introduced which details the procedure for Central Government to amend the Fourth Schedule. However, since the High Court of each State is required to frame rules after taking into consideration the rates mentioned in the Fourth Schedule, this may lead to a disharmonised fee regime[7] across the country.

Shortcomings

In our view, the Amendment Act has several shortcomings, which we discuss below.

Failure to clarify whether Indian parties can choose foreign law

The Amendment Act also does not clarify whether Indian parties can choose foreign law to resolve disputes through arbitration. While some argue that this is possible since the choice of the party to determine the choice of law must be recognised; the more conservative argument has been that Indian parties cannot agree to resolve disputes choosing a foreign law, as that would mean contracting out of Indian Law, and therefore opposed to public policy.[8]

In this context, it should be noted that the Bombay High Court in the case of *Addhar Mercantile Private Limited v. Shree Jagdamba Agrico Exports Private Limited*[9] while dealing with this issue, relied on observations of the Supreme Court in *TDM Infrastructure Private Limited v. UE Development India Private Limited*[10] and held that since

6. Supra Note 3

7. Supra Note 3

8. Please see our article: http://www.mondaq.com/india/x/433430/Arbitration+Dispute+Resolution/Whether+Indian+Parties+Can+Choose+Foreign+Law+To+Settle+Disputes

9. Arbitration Application No. 197 of 2014 along with Arbitration Petition No. 910 of 2013

10. (2008) 14 SCC 271

both the parties are Indian, they cannot derogate from Indian Law and the choice of two Indian parties to choose foreign law in a foreign seated arbitration was not recognised.

However, the Madhya Pradesh High Court in *Sasan Power Limited v. North American Coal Corporation Limited*[11] has taken a contrary view. This issue is currently pending adjudication by the Supreme Court.

Emergency arbitrators

The Law Commission Report had recommended the addition of an *"emergency arbitrator"* to the definition of *"arbitral tribunal"* under Section 2(d) of the Arbitration Act.

The concept of an *"emergency arbitrator"* has been recognised by most international arbitration rules and has gained popularity for its effectiveness. The recommendations made by the Law Commission Report in this regard have not been accepted and this is a significant omission that is likely to impact arbitrations in India.

Seat or place?

Though the Law Commission Report suggested using the expressions *"seat"* and *"venue"* instead of *"place"* of arbitration (keeping it consistent with international usage) to denote the legal home of the arbitration, the proposal has not been accepted.

No time limit for enforcement of award

While a time limit has been fixed for challenging a domestic arbitral award, no such time limit is prescribed for the enforcement of foreign arbitral awards, despite the recommendations in the Law Commission Report.

We cannot see any rationale for this omission, considering the amendments have been made to make India more arbitration friendly.

Confidentiality

The Amendment Act does not address the issue of confidentiality in arbitrations.

Arbitrability of fraud

The Law Commission Report had recommended changes to Section 16 of the Arbitration Act, to empower the arbitral tribunal to decide disputes that involve serious questions of law, complicated questions of fact or allegations of fraud, corruption or other related issues.

While the provisions of Sections 8 and 11 have been amended to the effect that the parties will be referred to arbitration *"… Notwithstanding any judgment, decree, or order of the Supreme Court…"* perhaps to overcome the conflicting judgments of the Supreme Court on whether or not questions of fraud are arbitrable; the recommended changes to Section 16 of the Arbitration Act ought to have been accepted, to make this position clear and provide more teeth to the powers of the arbitral tribunal. In this context, it should be noted that a two judge bench of the Supreme Court in *Radhakrishna v. Maestro Engineers*[12] (the "**Radhakrishna judgment**"), held that issues of fraud were not arbitrable.

However, a single judge of the Supreme Court, while deciding a petition under Section 11 of the Arbitration Act, in *Swiss Timing Ltd. v. Organising Committee*[13], held that the Radhakrishna judgment *was per incuriam* and therefore not good law.

In a situation where the parties are before an arbitral tribunal in a manner other than pursuant to Sections 8 or 11 of the Arbitration Act, and the arbitrator's jurisdiction is questioned by a party alleging that there are questions of fraud involved in the dispute, it would appear that the arbitral tribunal may be bound to follow the Radhakrishna judgment, and consequently rule that it does not have the jurisdiction to deal with those questions of fraud. In our view, the better approach would have been to amend Section 16 to be consistent with the recommendations made in the Law Commission Report.

Gazetted territories

Section 44(b) of the Arbitration Act requires that a foreign award not only be made in a reciprocating New York Convention territory, but also that the reciprocating territory be *notified* by the Central Government in Official Gazette.

With only about 50 (fifty) countries having been notified as reciprocating territories, the scope of enforcing foreign arbitral awards is significantly reduced. The Government should either notify most countries in the Official Gazette, or do away with the requirement of Section 44(b) that provides for notifying reciprocating territories in the Official Gazette.[14]

Arbitration agreement

Though the Law Commission Report recommended inserting clauses 3A and 3B to Section 7 to provide greater clarity and meaning to the definition of *"arbitration agreement"*, this has not been accepted. The Law Commission Report had further recommended adding an explanation to define *"electronic means"* which has also not been accepted.

Retrospective?

The Arbitration Amendment has created confusion as to whether the amendments will have a retrospective or prospective effect for actions currently before the courts relating to arbitration and arbitration proceedings.

11. First Appeal No. 310/2015

12. (2010) 1 SCC 72

13. (2014) 6 SCC 677

14. Supra Note 3

In this regard, it should be noted that Section 26 of the Amended Act provides that:

"Nothing contained in this Act shall apply to the arbitral proceedings commenced in accordance with the provisions of Section 21 of the principal Act, before the commencement of this Act unless the parties otherwise agree but this Act shall apply in relation to arbitral proceedings commenced on or after the date of commencement of this Act".

The Madras High Court in *New Tripur Area Development Corporation Limited v. M/s Hindustan Construction Company Limited & Ors.,* has ruled that Section 26 of the Amended Act is not applicable to post arbitral proceedings including court proceedings, since the words *"in relation to"* has been deleted.

Therefore, the court held that a separate application under the amended law had to be filed for seeking a stay on the arbitral award even in respect of arbitral awards passed prior to October 23, 2015.

However, the Calcutta High Court in *Electrosteel Casting Limited v. Reacon Engineers (India) Private Limited,* has taken a contrary view and held that the enforcement of arbitral award, borne out of arbitration proceedings commenced before October 23, 2015, would be stayed automatically upon the filing of application for setting aside the same.

This is a critical issue and needs to be decided by the Supreme Court at the earliest since the courts are unsure about which law to follow. This has resulted in inconsistencies in practice and uncertainty about the law within just a few months of the introduction of the new arbitration regime.

INDUSLAW VIEW

The Arbitration Amendment is a significant step forward in overcoming the systemic malaise of delays, high costs and ineffective resolution of disputes, which had plagued the arbitration regime in India.

Most of these amendments are welcome, since many would agree that the earlier arbitration regime had serious shortcomings, and did not result in cultivating the culture of arbitration in India.

Notwithstanding that, these amendments will also have to withstand the scrutiny of the Indian courts that have often been criticised for their interventionist approach. The recent judgments of Indian courts which have had an occasion to interpret the provisions of the Amendment Act, is an early indication that these amendments will be subject to further judicial scrutiny.

It will be interesting to see how the courts interpret the new amendments in the future. Further amendments are likely needed to iron out the flaws in the Amendment Act to make it more effective, but the new arbitration regime promises to herald a new era for dispute resolution in India. Only time will tell whether or not India becomes the next arbitration hub, as aspired.

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3. BANKING & FINANCE

3.1 REVISED GUIDELINES FOR EXTERNAL COMMERCIAL BORROWING

Introduction

The Reserve Bank of India (the "**RBI**") has recently brought in significant changes to external commercial borrowing guidelines (the "**ECB Guidelines**") with respect to companies in the infrastructure and other related sectors, pursuant to a circular dated March 30, 2016 (the "**March 2016 Circular**").[15]

A summary of the key changes brought in by the March 2016 Circular is set out below, together with our view on the implications of the changes to the ECB Guidelines.

Background

The term *'infrastructure sector'*, for the purpose of the ECB Guidelines, is defined in the Harmonised Master List of Infrastructure Sub-sectors[16] approved by the Government of India as amended from time to time.

Pursuant to circular dated September 18, 2013,[17] the term *'infrastructure sector'*, under the ECB Guidelines, includes companies engaged in the following activities:

- Energy;
- Communication;
- Transport;
- Water and sanitation;
- Mining, exploration and refining; and
- Social and commercial infrastructure.

Furthermore, the RBI, pursuant to its circular dated November 30, 2015[18] (the "**November 2015 Circular**") revised the ECB Guidelines, classifying external commercial borrowing into the following 3 (three) categories based on the tenure and the currency of the borrowings:

- Track I: Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years ("**Track I**");
- Track II: Long term foreign currency denominated ECB with minimum average maturity of 10 years ("**Track II**"); and
- Track III: Indian Rupee denominated ECB with minimum average maturity of 3/5 years ("**Track III**").

In addition to the minimum average maturity, the November 2015 Circular set out in detail the list of eligible borrowers, recognized lenders and investors, all-in-cost requirements, permitted end-uses, individual limits and other prescriptions with respect to companies covered under each track.

Key changes

The RBI has made the following changes to the ECB Guidelines.

Inclusion under Track I

The RBI has specified that:

- Non-Banking Financial Companies ("**NBFCs**");
- Infrastructure Finance Companies ("**NBFC-IFCs**");
- Non-Banking Financial Companies, Asset Finance Companies ("**NBFC-AFCs**");
- Holding Companies; and
- Core Investment Companies ("**CICs**"),

will be eligible to raise ECB under Track I of the framework with a minimum average maturity period of 5 (five) years, subject to 100% (one hundred percent) hedging.

Prior to the March 2016 Circular, these companies were categorized under Track II of the ECB Guidelines.

These companies will now qualify under all the three tracks to raise foreign debt.

This will allow infrastructure companies to secure debt funding for both short and long term perspectives.

Exploration, Mining and Refinery

The exploration, mining and refinery sectors which were not included in the Harmonised List of the infrastructure sector but were eligible to take external commercial borrowing under the ECB Guidelines[19] are now explicltiy deemed to qualify under the definition of the infrastructure sector. Therefore, exploration, mining and refinery activities now have explicit recourse to foreign debt funding.

Clarification on Permitted Use

Companies in the infrastructure sector are permitted to utilize external commercial borrowing proceeds raised under Track I for the end uses permitted for Track I.

NBFC-IFCs and NBFC-AFCs are permitted to raise external commercial borrowing *only* for financing infrastructure.

The list of permitted uses for companies in the infrastructure sector are as follows:

import of capital goods including payment towards import of services, technical know-how and license fees, provided they are part of these capital goods;

15. RBI/2015-16/349 A.P. (DIR Series) Circular No.56 dated March 30, 2016: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/APDIR563092BC2342FA494ABB58D5044F0D9FA6.PDF

16. See Notification F. No. 13/06/2009-INF dated March 27, 2012

17. RBI/2013-14/270 A.P. (DIR Series) Circular No. 48 dated March 30, 2016: https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/APR48180913F.pdf

18. RBI/2015-16/255 A.P. (DIR Series) Circular No. 32 dated November 30, 2015: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/A320084163A24434DB5905EEB3F3296EBEC.PDF

19. RBI/2013-14/270 A.P. (DIR Series) Circular No. 48 dated September 18, 2013: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/APR48180913F.pdf

- local sourcing of capital goods;
- new projects;
- modernisation or expansion of existing units;
- overseas direct investment in joint ventures or wholly owned subsidiaries;
- acquisition of shares in public sector undertakings at any stage of disinvestment under the disinvestment programme of the Government of India;
- refinancing of existing trade credit raised for import of capital goods;
- payment of capital goods already shipped or imported but unpaid; and
- refinancing of existing external commercial borrowing provided the residual maturity is not reduced.

It is further clarified that Holding Companies and CICs shall use ECB proceeds only for on-lending to infrastructure Special Purpose Vehicles (SPVs).

The individual limits on borrowing under the automatic route for the aforesaid companies shall be the same as for companies in the infrastructure sector (currently USD 750 million).

Compliance Requirements

Companies which have been added under Track I should have a board approved risk management policy and the designated AD Category-I Bank shall verify that the 100% (one hundred per cent) hedging requirement is complied with during the term of the external commercial borrowing and report the position to the RBI through ECB 2 returns.

REVISIONS TO THE ECB GUIDELINES

Refinancing

Designated AD Category-I banks may now, under powers delegated to them, allow refinancing of ECBs raised under the previous ECB Guidelines, provided that:

the refinancing is at a *lower* all-in-cost; and

the borrower is eligible to raise ECB under the extant ECB Guidelines and the residual maturity of the loan is not reduced (i.e. it is either maintained or elongated).

Non Convertible Debentures

It has further been clarified that the ECB Guidelines are not applicable to investment in non-convertible debentures in India made by Registered Foreign Portfolio Investors.

Minimum Average Maturity

The minimum average maturity of Foreign Currency Convertible Bonds ("**FCCBs**") or Foreign Currency Exchangeable Bonds ("**FCEBs**") is 5 (five) years irrespective of the amount of borrowing.

Further, any call or put option for FCCBs shall not be exercisable prior to 5 (five) years.

NBFCs

Only NBFCs which are regulated by the RBI are permitted to raise ECB. Further, under Track III, NBFCs may raise ECBs for on-lending for any activities including infrastructure as permitted by the concerned regulatory department of the RBI.

Delegated Powers

The provisions regarding delegation of powers to designated AD Category-I banks is not applicable to FCCBs or FCEBs.

Reference to *Loans*

In relation to the forms of ECB, the term Bank loans shall be read as loans as foreign equity holders or institutions other than banks, also provide ECB as recognized lenders.

INDUSLAW VIEW

The March 2016 Circular allows infrastructure companies to access foreign debt with a *shorter* term. Further, it *broadens* the option for project companies to seek funding from *varied* sources.

The March 2016 Circular generally aims to complement the government's focus on the infrastructure sector, by making it easier for Indian corporates to access foreign debt. With the recent re-allocation of coal blocks, the clarification on exploration and mining activities will come as a welcome change, expressly allowing bidders to use external commercial borrowing to fund their activities.

While hedging is fundamentally important, the cost of it erodes the advantage of lower interest rates commonly seen in the international market and it remains to be seen whether *all* in costs will be substantially different to the local market.

Generally, the policy changes making ECB more attractive are to be welcomed, but it remains to be seen whether foreign lenders will be more willing to lend to Indian corporates before deeper structural issues relating to the enforcement of security and the bankruptcy process are addressed.

With non-performing loans on domestic bank balance sheets of increasing concern, foreign commercial lenders will expect to see deeper structural reforms and a reduction in the risk of projects becoming stalled, before committing debt to the Indian projects market.

Authors: Ran Chakrabarti, Prashant Kumar and Saumya Ramakrishnan

3.2 SPECIAL MEASURES TO INCENTIVISE ELECTRONIC PAYMENTS

In November, The Reserve Bank of India (the "**RBI**") has issued a circular to address the special circumstances that have emerged after the demonetization drive (the "**Circular**"). [20]

The Circular seeks to partially modify the RBI Master Circular on Issuance and Operation of Pre-paid Payment Instruments in India (the "**Master Circular**")[21] by enhancing the issuance limits for semi-closed Pre-Paid Payment Instruments ("**PPIs**") and make special dispensation for small merchants.

A summary of the key changes brought in by the Circular is set out below, together with our view on the proposed changes.

Background

The primary law governing PPIs in India is the Payments and Settlements Act, 2007 (the "**Act**"). Section 18 and Section 10(2) of the Act empowers the RBI to make such regulations as may be required, from time to time, to regulate payments systems in India. In exercise of the same, the RBI has laid down guidelines for the issuance and operation of PPIs. PPIs are those which facilitate the purchase of goods and services against the value stored on such instruments. The value stored on such instruments represents the value paid for by the holder, by cash, by debit to a bank account, or by credit card.

The RBI has broadly classified PPIs into three categories:

- **Closed System Payment Instruments**

  These are payment instruments issued by an entity to enable the purchase of goods and services from it. These instruments do not permit cash redemption or withdrawal. A closed system PPI can be used only for payment of goods and services provided by the issuer. As these instruments do not facilitate payments and settlement for third party services, operation and issue, they do not fall within the ambit of payment systems. Hence, RBI approval is not required for issuing them.

- **Semi-Closed System Payment Instruments**

  These are payment instruments which can be used for purchase of goods and services, including financial services at a group of clearly identified merchant locations which have a specific contract with the issuer to accept the payment instruments. These instruments do not permit cash redemption or withdrawal by its holder. PPIs for amounts upto INR 10000 (ten thousand rupees) can be issued under this category by a PPI issuer by accepting minimum details of the customer. PPIs for amount upto INR 50000 (Indian Rupees fifty thousand) can be created in PPIs by accepting any '*officially valid document*' which is compliant with anti-money laundering rules. The two kinds of semi-closed PPIs, stated above can be issued only in electronic form. PPIs for amount upto INR 100000 (Indian Rupees One Lakh) can be created by following the full *Know Your Client* norms in place and can be reloaded.

- **Open System Payment Instruments**

  These are payment instruments which can be used for the purchase of goods and services, including financial services such as fund transfers, they also permit cash withdrawal. However, cash withdrawal from an open system prepaid instrument is permitted only upto a limit of INR 1000 (Indian Rupees One Thousand) per day subject to the same conditions as applicable hitherto to debit cards.

KEY CHANGES

Pursuant to the Circular, the RBI has made the following changes to the 'Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India.'

- **Enhancement in issuance limits for PPIs**

  The RBI has specified that:

  - the limit of semi-closed PPIs that can be issued by accepting minimum details of the customer, as set out in the Master Circular has now been enhanced from INR 10000 (Indian Rupees Ten Thousand) to INR 20000 (Indian Rupees Twenty Thousand);
  - the limit of semi-closed PPIs that can be issued by accepting minimum details of the customer, as set out in the Master Circular has now been enhanced from INR 10000 (Indian Rupees Ten Thousand) to INR 20000 (Indian Rupees Twenty Thousand);
  - the total value of reloads during any given month to such PPIs shall also not exceed INR 20000 (Indian Rupees Twenty Thousand); and
  - all other extant instructions in this regard shall remain unchanged.

- **Special dispensation for merchants**

  Under the existing PPI guidelines, merchants are defined as establishments who accept PPIs issued by a PPI issuer against the sale of goods and services. As a special dispensation for small merchants, PPI issuers can now issue PPIs to such merchants subject to the following:

  - merchants shall give a self-declaration in respect of their merchant status and details of their own bank account, which shall be kept on record by the issuer;
  - PPIs can be issued to such willing merchants only after due verification and validation of their bank account details;
  - inflows of funds or credit to such PPIs shall emanate only from sale transactions of the merchant;

20. RBI/2016-17/150, dated November 22, 2016: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10734&Mode=0

21. RBI/2014-2015/105, dated July 1, 2014: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=8993& Mode=0

- while there is no minimum balance requirement, the maximum value in these PPIs shall not exceed INR 20000 (Indian Rupees Twenty Thousand) at any point of time;
- funds transfer from such PPIs are permitted only to the merchant's own linked bank account and upto an amount of INR 50000 (Indian Rupees Fifty Thousand) per month, without any limit per transaction; and
- PPI issuers shall clearly identify such PPIs in their systems for the purpose of maintenance of escrow, reporting and management information system requirements.

INDUSLAW VIEW

The intention of the RBI in increasing the limits for PPIs is to provide some relief in the present demonetization scenario. The Circular allows the issue of PPIs to holders of PPIs by a PPI issuer upto a value of INR 20000 (Indian Rupees Twenty Thousand) per month against the earlier limit of INR 10000 (Indian Rupees Ten Thousand) per month by accepting minimum details of the customer.

Further, with a view to providing relief to small merchants in the current demonetisation scenario, the Circular has made certain exceptions for these merchants. Earlier, the Master Circular referred to the fact that merchants were only permitted to accept PPIs. However, the Circular now expressly makes a reference to, issue of PPIs to these merchants by the PPI issuers, being permitted. Small merchants can avail the facility of these PPIs by following minimum disclosure requirements (self-declaration and bank account details). Inflows of credit to such PPIs shall emanate only from sale transactions of the merchant. This Circular can be seen as strategic measure by the RBI to allow cashless transactions for the benefit of the small merchants while simultaneously ensuring transparency in relation to receipt and payment of monies by such merchants.

In addition to the foregoing, the Circular also seeks to relax the earlier limit of, INR 5000 (Indian Rupees Five Thousand) per transaction subject to a cap of INR 25000 (Indian Rupees Twenty Five Thousand) per month, as prescribed under the Domestic Money Transfer Guidelines[22] for fund transfer from semi-closed PPIs to the linked bank account of the PPI holder. Small merchants can now transfer upto INR 50000 (Indian Rupees Fifty Thousand) per month, with no limit on the amount that can be transferred in a single transaction, to their linked bank account from the PPIs held by them.

This move by the RBI will help ease the challenges being faced by local shopkeepers and vendors as a result of the demonetization by easing compliance requirements and at the same time allowing the RBI to keep track of the funds being channeled through such systems.

It is pertinent to note that while the Circular refers to 'small merchants' and seeks to facilitate cashless transactions or their benefit, the term 'small merchant/s' has not been defined in the Circular. Till such time that the RBI provides clarity in this regard, it may be difficult to act upon the instructions issued by the RBI in order to avail of the benefits contemplated therein.

Authors: Suneeth Katarki, Priyank Nanavaty and Shweta Adhikari

22. RBI/2011-12/213, dated October 5, 2011: https://rbi.org.in/scripts/NotificationUser.aspx?Id=6750&Mode=0

4. COMPETITION LAW

4.1 REVISED THRESHOLDS FOR COMBINATION REGULATIONS

Introduction

The Ministry of Corporate Affairs, Government of India (the "**MCA**") has recently brought in significant changes to the merger control thresholds through three notifications. A summary of the notifications is given below.

Exemption of 'Group'

The Competition Act, 2002 (the "**Act**") provides that any person or enterprise, which proposes to enter into a Combination (as defined under Section 5 of the Act) is required to give a notice under Section 6 of the Act to the Competition Commission of India(the "**CCI**") disclosing the details of the proposed Combination in accordance with the Competition Commission of India *(Procedure in regard to the transaction of business relating to combinations)* Regulations, 2011.

The MCA had pursuant to its notification S. O. 481 (E) dated March 4, 2011 exempted a *'Group*' exercising less than 50% (fifty percent) of the voting rights in other enterprises from the provisions of Section 5 of the Act for a period of 5 (five) years (until till March 3, 2016).

Extension

The MCA has pursuant to its notification number S.O. 673(E) dated March 4, 2016 extended the exemption of such '*Group*' for a further period of 5 (five) years from the date of the notification (until March 3, 2021).

Revision of Target Based Thresholds

The MCA had, pursuant to its notification number S.O. 482 (E) dated March 4, 2011, exempted transactions where enterprises whose control, shares and voting rights or assets were being acquired had an asset value of not more than INR 2500 million (Indian Rupees two thousand five hundred million) or a turnover of not more than INR 7500 million (Rupees seven thousand five hundred million) from the provisions of Section 5 of the Act for a period of 5 years (until March 3, 2016).

The MCA has, pursuant to its notification number S.O. 674(E) dated March 4, 2016, revised the target based thresholds and extended the validity of the said exemption for notification of transactions to the CCI seeking its approval under Section 5 of the Act.

Now an enterprise whose control, shares, voting rights or assets are being acquired, is exempt from filing a notification with the CCI if it has assets of value not more than INR 3500 million (Indian Rupees three thousand five hundred million) or turnover of not more than INR 10000 million (Indian Rupees ten thousand million). This exemption is also valid for a period of 5 years from the date of notification (until March 3, 2021).

New Thresholds for Notification under Section 5

Section 5 of the Act sets out specific assets and turnover thresholds limits so as to determine whether or not any:

- acquisition of control, shares, voting rights or assets by an acquirer; or
- acquisition of control of an enterprise by a person who directly or indirectly controls another enterprise engaged in production, distribution or trading of similar, identical or substitutable goods or services; or
- any merger or amalgamation,

Subsequently, the MCA had, pursuant to its notification number S.O. 480 (E) dated March 4, 2011 enhanced the value of assets and turnover as laid down under Section 5 of the Act by 50% (fifty percent) (the "**2011 Notification**").

INDUSLAW VIEW

The extension of the exemptions in respect of the target level thresholds and *'Groups*', and the increase in the statutory thresholds for the purpose of determining a *'combination*', are a welcome move given the present business environment, inflation and other factors.

There remains some confusion as to whether the 100% increase in the statutory thresholds is based on the figures as specified in the Act, or as specified under the earlier 2011 Notification.

The industry view, based on informal discussion and reasonable assumption, is that the 100% increase qualifies as a "**combination**" within meaning of Section 5 of the Act itself.

The MCA has now, pursuant to its notification number S.O. 675(E) dated March 4, 2016, enhanced the value of assets and turnover as laid down under Section 5 of the Act by 100% (one hundred percent).

should be applied to the original Section 5 thresholds as: (a) the wording of the 2016 Notification makes a reference only to Section 5 of the Act and not the 2011 Notification; and (b) the 2011 Notification was not an amendment to the Act and therefore a reference to Section 5 of the Act cannot be construed to include the increase in the thresholds prescribed by the 2011 Notification.

A formal clarification would be helpful in imparting greater clarity to this notification.

Authors: Avimukt Dar, Anubha Sital, Devya Sharma and Shreya Suri

5. CORPORATE & COMMERCIAL

5.1 GUIDELINES FOR FDI IN E-COMMERCE

Introduction

A court petition filed by the Footwear Manufacturers & Retailers Association before the Delhi High Court last year, alleged violation by e-commerce players of the regime governing foreign direct investments in India (the "**FDI Policy**") and the subsequent order of the Delhi High Court directing investigation into the matter has spooked foreign investors and industry players in this sector in general.

To bolster the confidence of foreign investors and industry players, the Department of Industrial Policy & Promotion (the "**DIPP**") released Press Note 3 dated March 29, 2016 (the "**Press Note**")[23] which lays down regulatory boundaries of the FDI Policy in the e-commerce sector with immediate effect.

Prior to the Press Note, under the FDI Policy, e-commerce activities were defined as *"the activity of buying and selling by a company through the e-commerce platform*" and 100% foreign direct investment was allowed subject to specified conditions in *business to business e-commerce* ("**B2B**").

As regards e-commerce in *business to customer* e-commerce ("**B2C**"), the Press Note reiterates and clarifies the following specific exceptions and conditions of FDI Policy.

Selling goods manufactured in India

An Indian manufacturer being the investee company and the owner of the brand is permitted to sell its own products in any manner (that is, through wholesale or retail (including through e-commerce platforms)).

Such Indian manufacturer should be the owner of the Indian brand and should manufacture in India, in terms of value, at least 70% of its products in house, and source, at most 30% from the Indian manufacturers.

Single Brand Retail

Subject to the provisions of the FDI Policy, foreign direct investment in single brand retail trade is permitted up to 49% under the automatic route and beyond 49% under the government route and a single brand retail trading entity operating through a brick and mortar store is also permitted to undertake retail trading through e-commerce subject to conditions imposed under the FDI Policy.

The Market Place Model

In an attempt to validate and clarify that the *market place* model of e-commerce is permissible under the FDI Policy and the conditions to be adhered to by entities operating under such models, the Press Note provides the following.

Definition

The marketplace model means the provision of an information technology platform by an e-commerce entity on a digital and electronic network to facilitate sales between buyers and sellers.

The Press Note confirms that 100 (one hundred) per cent foreign direct investment through the automatic route is expressly permitted in e-commerce companies operating under the marketplace model subject to the conditions stipulated in the Press Note which are elaborated below.

Restrictions

An e-commerce entity engaged in marketplace model is prohibited from:

- having ownership of any inventory;
- permitting more than 25% of the sales through one vendor or their group companies;
- directly or indirectly influencing the price of goods or services, and is required to maintain a level playing field.

The marketplace entity can provide support services such as warehousing, logistics, call centre services, order fulfilment, payment collection and other services to sellers. However, the Press Note expressly provides that any warranty or guarantee for goods or services and post sales responsibility, including delivery of goods and customer satisfaction shall vest with sellers.

B2B

B2B shall be governed by the guidelines on cash and carry wholesale trading under the FDI Policy.

B2C

The sale of goods or services through an e-commerce platform will be under automatic route subject to other conditions in FDI Policy and applicable law.

INDUSLAW VIEW

The Press Note provides for much awaited clarity, among other issues, on the terms e- commerce and the marketplace model by providing definitions in this regard and it should reduce the scope for litigation which might otherwise impact innovation.

It has also spelt out clearly that 100% foreign direct investment under the automatic route is permitted in a marketplace entity (which at no point shall have ownership of the inventory).

As a result, e-commerce companies providing a marketplace and a B2B *inventory-based* model will have to restructure their business.

23. http://dipp.nic.in/English/acts_rules/Press_Notes/pn3_2016.pdf

However, the restriction on marketplace entities providing that not more than 25% of their sales on their platform can be from one vendor or its group entities will definitely impact the business model of some players.

Marketplaces that have a few number of vendors or one or two dominant vendors (including its subsidiaries or group entities) will be particularly hit by this condition. These entities will therefore require more vendors to satisfy the requirement.

The restriction may become a practical obstruction as the mechanism for computing and monitoring the threshold has not been provided for in the Press Note. Assuming that this has to be computed for a particular cycle, satisfying the requirement could pose some practical but not insurmountable hurdles.

Separately, it is interesting to note that the Press Note allows marketplace entities to provide support services such as warehousing, logistics, call centre, order fulfilment, payment collection and other ancillary services to sellers whilst specifying that post sales, delivery of goods to customers will be the responsibility of sellers.

It appears that the regulator is trying to convey that while there is no restriction on marketplace entities providing these ancillary services, the primary responsibility should lie with the seller as if it had outsourced the function to any other third party.

To this extent, marketplace entities will need to ensure that the end responsibility with respect to the delivery of goods and post sales services lie with the vendors and that the contractual obligations are in line with the essence of the Press Note.

Further, the definition of an "**E-commerce entity**" which provides that it is a company or an office or agency owned and controlled by a non-resident, creates an anomaly with the FDI principles.

It seems to suggest that FDI up to 49% *without* control being exercised is permitted in e-commerce companies which could not have been the intention. A clarification or a change in wording in this regard would be helpful.

It is not clear why e-commerce services are now included in this definition. Services generally were always under the automatic route under the FDI Policy and this is also clarified in the Press Note.

Therefore adding services within the ambit of this Press Note seems to us to serve no meaningful purpose but only obfuscates and raises several questions about online services currently being provided by a host of entities.

It may have been preferable to leave out e-commerce services from the ambit of this Press Note apart from clarifying that the e-commerce entity may provide support services.

Finally, the Press Note states that the marketplace entity will not directly or indirectly influence the price of the goods or services and shall maintain a level playing field. This poses multiple problems and raises further questions:

- Given the fact that anti-competitive practices are regulated under competition law, the intent of bringing this within the DIPP's realm is debatable. Influencing price is not necessarily bad. One must remember that consumers benefit from a reduction in price. Having said that, there is substantial jurisprudence in competition law around what is permissible and what is not. Dealing with the issue in one sentence, in our view, is not appropriate. This should have been left to the competition regulator.
- What does level playing field mean? This is highly subjective and can become a matter of clever drafting and structuring. Further, certain kinds of vendors or territories may need special support and help. Marketplaces, as they evolve, will go deeper into items that are not mainstream and require significant marketing and support. This clarification might come in the way of such activities.
- Purely *Indian* marketplaces with no FDI are exempt from this requirement. Unfair practices are harmful, irrespective of the person or entity propagating them. Does this give an unfair advantage to an Indian marketplace with no FDI?
- The FDI Policy in general covers sectors, capitalisation and other high-level issues. This Press Note goes into detail and regulates business models. How will this be regulated? Who will examine and determine whether there is a violation? What is the consequence of this violation? How can foreign investors ensure that companies comply with these requirements? Will small violations or infractions make the company non-compliant?
- What is *"an inventory of services"*? Will aggregators or facilitators of services be governed by this restriction? It would be very odd, for example, if there is no uniformity in the taxi service rates, fees for beauty related services or for plumbing services offered on a services marketplace.

Authors: Srinivas Katta, Aakash Dasgupta and Ankita Gupta

5.2 THE INSOLVENCY & BANKRUPTCY CODE 2016

Introduction

The Insolvency and Bankruptcy Code, 2016 (the "**Code**") passed by the *Lok Sabha* on 5th May 2016[24] seeks to provide a framework for time-bound settlement of insolvency by formulating a survival mechanism or by ensuring speedy liquidation by a formal insolvency resolution process ("**IRP**").

According to World Bank data, the average amount of time required to resolve insolvency is just over 4 years in India.

The proposed law aims to increase confidence for creditors in the Indian market.

The present regime

The Code will amend the existing laws governing bankruptcy and liquidation in India which *inter alia* include the Companies Act, 2013, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Sick Industrial Companies Act, 1985 and the Recovery of Debt Due to Banks and Financial Institutions Act, 1993.

Further, the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 shall stand repealed.

The new regime

The new regime sets up a new institutional framework to administer and rationalize the process.

The Board

The Code provides for the setting up of an Insolvency and Bankruptcy Board of India (the "**Board**")[25] with 10 members including representatives from the Reserve Bank of India and the Central Government to regulate insolvency procedures in India.

The Board will have the power to oversee the functioning of insolvency professionals ("**IPs**")[26] who are defined to be a specialized class of professionals appointed to deal and manage the IRPs, their agencies and information utilities (which are agencies collating information from companies with the intention to identify those with insolvency risk).

Adjudicating Authorities

The Debt Recovery Tribunals ("**DRTs**")[27] will adjudicate the IRPs of individuals and partnership firms. Any person aggrieved by the order of DRT may appeal to the Debt Recovery Appellate Tribunal.

The National Company Law Tribunal (the "**NCLT**")[28] will have jurisdiction over the IRPs for companies and Limited Liability Partnerships. Any person aggrieved by the order of the NCLT may appeal within 30 days.

An appeal from the order of the respective appellate tribunals may be filed before the Supreme Court of India.

The insolvency resolution process

The Code provides for separate IRPs for individuals and companies. The resolution process can be initiated by either debtors, or creditors.

Individuals

In case of individuals, the Code provides for two different methods for solving disputes, namely:

- a fresh start; and
- IRP.

Under the fresh start process, an individual will be eligible for a debt waiver of up to INR 35000 on fulfilling certain conditions.

In case of IRP, the parties will engage in negotiations under the supervision of the IP to make a plan for repayment of debts.

Such plans will require an approval of 75% of the creditors.

Bankruptcy can be initiated only after the failure of the IRP.

An individual held to be bankrupt would be disqualified from holding public office.

Companies

In case of companies or limited liability partnerships, the Code prescribes a limit of 180 days from the date of admission of the application (extendable to a period of 90 days with approval of 75% of the creditors) within which the IRP should be completed.

A resolution applicant may submit a plan to the IP containing the necessary details. The resolution plan will be approved only if 75% of the creditors have voted in favor of the plan. Once approved the IP shall submit the resolution plan to the adjudicating authority.

If such adjudicating authority is satisfied, it shall by order approve the plan, which shall then be binding or it may reject the plan.

24. See the following link for the full text http://www.prsindia.org/administrator/uploads/media/Bankruptcy/Bankruptcy%20Code%20as%20passed%20by%20LS.pdf

25. See Section 188, the Code

26. See Section 199, the Code

27. Section 179, the Code

28. Section 60, the Code

Liquidation can be initiated, *inter alia* in the following cases:

- on the expiry of maximum period permitted for IRP;
- on rejection of the resolution plan by the adjudicating authority; or
- in the event a committee of creditors decide to liquidate.

If the process cannot be resolved within the 180-day period mentioned above (or as extended) the assets of the company may be sold to repay the creditors.

The Code further makes provision for a *fast track* insolvency process for companies with smaller operations. The process will have to be completed within 90 days from the insolvency commencement date unless extended for a further period of 45 days with the approval of 75% of creditors.

Liquidation

In relation to corporate entities, the Code provides for an *order of priority* for distribution of assets during liquidation, set out in Section 53 (*Distribution of assets*) of Chapter III (*Liquidation Process*) of Part II (*Insolvency Resolution and Liquidation for Corporate Persons*) of the Code.

On accepting the claims, the liquidator shall determine the value of the claims in a manner that may be specified by the Board. If the liquidator rejects any claim, the creditor may apply to the adjudicating authority within the specified time period.

The order of priority is set out below:

- insolvency resolution costs;
- workman's dues (for the preceding 24 months) ranking equally with debts owed to a secured creditor;
- wages and unpaid dues to employees other than workmen for the preceding 12 months;
- financial debts owed to unsecured creditors;
- amounts due to the Central Government and the State Government (including amounts owed to a consolidated fund) ranking equally with debts due to a secured creditor for any unpaid amount;
- remaining debts and dues;
- preference shareholders; and
- equity shareholders.

It remains unclear as to why unsecured creditors have priority over trade creditors.

It should also be noted that amounts owed to the government would be repaid *after* unsecured creditors.

It should be noted that, *inter alia*, monies owed to employees through a provident fund, pension fund or gratuity shall be excluded from distributable assets to the creditors.

Generally, it should be noted that bankruptcy applications for individuals and partnership firms will need to be filed within 3 (three) months (previously, it was 6 (six)) from the date the order sanctioning bankruptcy is passed by the adjudicating authority.

Preferential transactions and undervalued transactions

The Code provides for treatment of preferential transactions and transactions that are undervalued in nature. In case of undervalued transactions, the adjudicating authority may declare such transactions to be void and reverse the effect of such transactions.

Penalties

The Code provides penalties for offences committed by a corporate entity under corporate insolvency.

Officers of the company can be penalized for not declaring assets and property owned by it or for willfully concealing any property.

In such cases, the officer shall be penalized with imprisonment of up to 5 (five) years or with a fine of up to INR 10 (ten) million or both. However, he shall not be punished if it is proved that he had no intent to defraud.

The Code also penalizes individuals for offences including the provision of incorrect information and the punishment will vary based on the offence committed by an individual.

For the majority of the offences, the fine is specified to be up to INR 500000 or imprisonment for up to 1 year or both.

Fund

The Code provides for the creation of the Insolvency and Bankruptcy Fund with amounts contributed from the Central Government or from other sources. It is not clear however, how these funds will be utilized.

Any person who has contributed to the fund may in case of proceedings initiated in respect of such person withdraw funds (not exceeding the amount of contribution).

INDUSLAW VIEW

The Code intends to rationalize the processes and procedures for bankruptcy and insolvency and improve the recovery rates of debt and increase creditor confidence in India.

It should hopefully go some way to address the rights of lenders to enforce security in a distress situation and bring down the rate of non-performing loans.

However, it should be noted that the orders from the NCLT and the DRT could be further challenged before the respective appellate tribunals and then before the Supreme Court of India.[29]

Much work will need to be done to make the work of IPs coherent under the regulatory authority of the Board.

Arguably, the penalties for not declaring assets are not stringent enough (and we assume that those penalties will fall under the amounts owed to the government in the insolvency waterfall).

Generally, the provisions for appeals could prove to be a setback for the effective implementation for insolvency resolution.

With avenues for appeals and disputes, it remains to be seen to what extent IPs can essentially take control over distressed assets and sideline promoters of companies in default scenarios.

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5.3 KEY HIGHLIGHTS IN THE CONSOLIDATED POLICY ON FOREIGN INVESTMENT IN INDIA

Introduction

Earlier in the summer, the Department of Industrial Policy & Promotion (the "**DIPP**") released the revised consolidated policy on foreign direct investment ("**FDI**") in India (the "**FDI Policy, 2016**") which became effective on 7 June 2016 amending the existing foreign direct investment policy (the "**Old Policy**").

Under the FDI Policy, 2016, the DIPP has consolidated all its press notes released in the last year and further attempted to provide much needed clarification with respect to several issues, which caused difficulties in interpretation.

For our analysis of Press Note 9 of 2015 (relating to partly paid shares and warrants), Press Note 12 of 2015 (relating to changes to the FDI policy) and Press Note 3 of 2016 9 (relating to e-commerce) please refer to our earlier Infolex alerts.[30]

In this article, we highlight key developments in the FDI Policy, 2016 over and above the revisions suggested in the abovementioned Press Notes. It should be further noted that soon after the FDI Policy, 2016, the DIPP has issued Press Note 5 of 2016, which sought to further liberalize a few sectors listed under the FDI Policy, 2016 (the "**Press Note 5**").[31]

Key highlights of the FDI Policy, 2016 and Press Note 5

Deferred payment

The Old Policy stated that prior permission of the Reserve Bank of India (the "**RBI**") was required for the transfer of capital instruments by a non-resident acquirer, involving deferment of payment of the amount of consideration.

It should be noted that the RBI amended the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 ("**TISPROI**") by notifying the TISPROI (Seventh Amendment) Regulations, 2016 on May 20, 2016[32] (the "**TISPROI Seventh Amendment, 2016**").

Pursuant to the TISPROI Seventh Amendment, 2016, the RBI permitted deferred payment in case of transfer of shares involving non-residents subject to following conditions:

- not more than 25% of the total consideration can be paid by the buyer on a *deferred basis*;
- deferment cannot be for a period *exceeding* eighteen months from the date of the transfer agreement;

29. Sections 32, 42, 61, 62, 181, 182, 202 of the Code

30. Press Note 9 of 2015 (Review of the existing foreign direct investment policy on partly paid shares and warrants) available at http://induslaw.com/publications/pdf/alerts-2015/september-23-15.pdf?src=Website&Month=23Sept2015, Press Note 12 of 2015 (Review of foreign direct investment policy on various sectors) available at http://induslaw.com/publications/pdf/alerts-2015/november-2015-final.pdf?src=30Nov2015, Press Note 3 of 2016 (Guidelines for foreign direct investment on e-commerce) available at http://induslaw.com/publications/pdf/alerts-2016/april-2016.pdf?src=Webiste&CTA=ReadMore

31. Press Note 5 of 2016 (Review of foreign direct investment policy on various sectors) available at http://dipp.nic.in/English/acts_rules/Press_Notes/pn5_2016.pdf

32. No. FEMA. 368/2016-RB

- an escrow arrangement can be executed for this purpose for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months from the date of the transfer agreement;
- if the total consideration is paid by the buyer to the seller, the seller may furnish an indemnity for an amount not more than 25% of the total consideration for a period not exceeding 18 months from the date of the payment of the full consideration; and
- total consideration finally paid for the shares must be compliant with the applicable pricing guidelines.

It is important to note that the TISPROI Seventh Amendment, 2016 does not mandate (but allows creation of) escrows to park the money to be paid as deferred payment in the 18-month period.

However, the intention of placing a cap of 25% on the amount that can be paid towards indemnity and a restriction that such indemnity cannot be provided for more than 18 months, is not clear.

This will mean that standard purchase transactions that include uncapped indemnity clauses (or otherwise, capped at anything more than 25% of the total consideration) shall require RBI approval.

In our view, this will act as a disincentive for foreign investors since their ability to be covered for risks in relation to such purchases is restricted only to 25% of the total purchase consideration.

It is probably fair to assume that the regulator intended that in case of an indemnity amount exceeding the 25% threshold, RBI approval will be required at the time of actually making such payments and not at the time of entering into share transfer contracts (though this would put the risk on the buyer).

It seems unlikely that the regulator intended that contractual indemnities be limited to 25% of the purchase consideration or that indemnity claims can only be invoked within 18 months from the date of the share transfer contracts since this would be inconsistent with the prescribed statutory limitation period.

Accordingly it may be possible to take the view that share purchase contracts can continue to be entered into without any prior RBI approval providing for no indemnity limits or for indemnity limits beyond 25% and for longer time periods than 18 months but any payments beyond the stipulated amounts or time periods would require RBI approval at the time of payment. In our view however, this would put buyers at risk and RBI clarity on this should be requested.

It is interesting to note generally, the TISPROI Seventh Amendment, 2016 appears not to have been taken into account in the FDI Policy, 2016, which still provides that any deferment of payment in transfer of capital instruments involving non-residents shall require RBI approval.

Investment Vehicles

The FDI Policy, 2016, has introduced a definition of an "**Investment Vehicle**" to mean:

"an entity registered and regulated under relevant regulations framed by The Securities and Exchange Board of India ("SEBI") or any other authority designated for the purpose and shall include Real Estate Investment Trusts ("REITs") governed by the SEBI (REITs) Regulations, 2014, Infrastructure Investment Trusts ("InvIts") governed by the SEBI (InvIts) Regulations, 2014 and Alternative Investment Funds ("AIFs") governed by the SEBI (AIFs) Regulations, 2012."

While the restriction on FDI in trusts except Venture Capital Funds ("**VCFs**") continues to apply, as a consequence of introducing Investment Vehicles, an exception has been created to allow FDI in Investment Vehicles incorporated as trusts.

FDI by Investment Vehicles

The FDI Policy, 2016 permits foreign investment from person's resident outside India (other than individuals being citizens of, or any other entity registered or incorporated in Pakistan or Bangladesh) including a registered foreign portfolio investor ("**RFPI**") or non-resident Indians ("**NRIs**") in Investment Vehicles.

In addition to the InvITs, REITs and AIFs, the FDI Policy, 2016 also includes AIFs notified under Schedule 11 of TISPROI as being entitled to receive foreign investment from a person resident outside India.

Schedule 11 to TISPROI was amended by a recent amendment, *inter alia*, seeking to promote investments by AIFs, and this seems to be in furtherance of the same objective.

The FDI Policy, 2016 also clarifies that a *Real Estate Business* does not include, *inter alia*, REITs registered and regulated under the SEBI (REITs) Regulations 2014.

Calculation of FDI in an Investment Vehicle

FDI Policy, 2016 talks about computation of total foreign investment and includes investment in fully, compulsorily and mandatorily convertible preference shares and fully, compulsorily and mandatorily convertible Debentures, or units of an Investment Vehicle.

The FDI Policy, 2016 provides that downstream investment by an Investment Vehicle shall be regarded as foreign investment if either the sponsor or the manager or the investment manager is not Indian "*owned and controlled*" as defined in Regulation 14 of TISPROI as amended by the TISPROI (Second Amendment) Regulations, 2016 ("**TISPROI Second Amendment, 2016**") dated February 15, 2016.

The *proviso* states that for sponsors or managers (or investment managers organized in a form other than companies or LLPs), SEBI shall determine whether the sponsor or manager or investment manager is foreign owned and controlled.

This may cause certain hardships in the absence of an objective test to determine the residential status of a sponsor or manager or investment manager if the entity is not a company or an LLP. While there are no restrictions on the sponsor or manager or investment manager being organized in a form other than a company or an LLP, it will be administratively difficult for such entities to approach

SEBI to determine the residential status, which in turn will affect the investments made by the AIF.

This exposes such entities to subjective determination of residential status, which in turn has a bearing on the investments of the AIF. Further, if there are any changes in the constitution of the sponsor or manager or investment manager, it may again require validation of SEBI, pursuant to such change.

It is interesting to note that ownership and control of trustees (in case the Investment Vehicle is organized as a trust) is not a criterion for determining whether the downstream investment will be considered foreign investment, given that trustees may have wide powers with respect to the actions undertaken by a trust.

It is also interesting to note that a *"**sponsor**"* under the SEBI (AIFs) Regulations, 2012 has been defined as a person or persons who set up the AIF and includes a promoter in case of a company and a designated partner in case of a limited liability partnership, but the definition does not specify trustees in case of a trust.

An explanation under Annexure 5 sets out the computation of foreign investment for an AIF. It says that *"control"* of the AIF should be in the hands of "*sponsors*" and "*mangers/investment managers*", with the general exclusion of others.

In case the *"sponsors"* and *"managers/investment managers"* of the AIF are individuals, for the treatment of downstream investment by such AIF as domestic, *"sponsors"* and *"managers/investment managers"* should be resident Indian citizens.

Another explanation clarifies that the extent of foreign investment in the corpus of the Investment Vehicle will not be a factor to determine whether downstream investment of the Investment Vehicle concerned is foreign investment or not.

The FDI Policy, 2016 also states that any downstream investment by an Investment Vehicle that is reckoned as foreign investment shall have to conform to caps, conditions and restrictions applicable to that sector. Similarly, downstream investment in an LLP by an Investment Vehicle that is reckoned as foreign investment has to conform to the provisions of Schedule 9 of TISPROI as well as the Old Policy.

The Investment Vehicle receiving foreign investment shall also be required to make such report and in such format to RBI or to SEBI as may be prescribed by them from time to time

Sweat equity shares

It should be noted that the TISPROI (Fourth Amendment) Regulations, 2015[33] (the "**TISPROI Fourth Amendment, 2015**") incorporated a definition and introduced the concept and definition of "**sweat equity**" to mean such equity shares as issued by a company to its directors or employees at a discount or for consideration other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

This definition is aligned with the definition under the Companies Act, 2013 (the "**2013 Act**") and has been carried forward to the FDI Policy, 2016. Further, the guidelines with respect to issuance of employee stock options ("**ESOPs**") as enumerated in the TISPROI read with TISPROI Fourth Amendment, 2015 have also been carried forward to the FDI Policy, 2016 and have been made applicable to issuance of sweat equity shares to non-residents.

Employee stock options

The Old Policy did not contain a definition of employee stock options ("**ESOPs**"). The TISPROI Fourth Amendment, 2015 introduced the definition of employee stock options to mean the option given to directors, officers or employees of a company (together, "**Eligible Employees**") or of its holding company or joint venture or wholly owned overseas subsidiary or subsidiaries, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

It was further clarified in the TISPROI Fourth Amendment, 2015 that the issue of ESOPs under applicable law should be in compliance with the sector cap applicable to the issuing company and where foreign investment is under the approval route, such issue shall require the prior approval of the Foreign Investment Promotion Board ("**FIPB**").

Further it was stated that ESOPs could be issued to residents of Pakistan subject to prior approval of FIPB. The understanding of ESOPs as captured in the TISPROI Fourth Amendment, 2015 has now been incorporated in the FDI Policy, 2016.

It is pertinent to note here that the definition of ESOPs is not aligned with the definition under the 2013 Act in the sense that the 2013 Act does not include Eligible Employees of a joint venture entity.

It needs to be noted here that the 2013 Act did permit for ESOPs to be issued to Eligible Employees of an associate company,[34] which included joint venture entities. However, this provision pertaining to ESOPs to be issued to Eligible Employees of associate companies was removed pursuant to the Companies (Share Capital and Debentures) Amendment Rules, 2015 with effect from March 18 2015.

Further, the 2013 Act contemplates ESOPs to be given to Eligible Employees of any subsidiary and not specifically a wholly owned subsidiary as is contemplated under the TISPROI Fourth Amendment, 2015 and the FDI Policy, 2016.

One would have hoped that the FDI Policy, 2016 would attempt to remove these inconsistencies. However, this does not seem to be the case and these inconsistencies continue to remain in the FDI Policy, 2016.

33. Notification No. FEMA.344/2015 RB dated June 11, 2015

34. Section 2 (6) of the 2013 Act defines an "**Associate Company**" in relation to another company to mean a company in which that other company has a significant influence but which is not a subsidiary company of the company having such influence and includes a joint venture company. "**Significant influence**" means control of at least twenty per cent of total share capital, or of business decisions under an agreement.

Venture Capital Funds

The definition of a VCF has been revised in the FDI Policy, 2016 to state that a "**VCF**" means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model and shall include an angel fund as defined under Chapter III-A of SEBI (AIF) Regulations, 2012.

Under the Old Policy, a VCF was defined to mean a fund established in the form of a trust, a company including a body corporate and registered under SEBI (VCF) Regulations, 1996, which: (i) has a dedicated pool of capital; (ii) raised in the manner specified under the Regulations; and (iii) invests in accordance with the Regulations.

This revision has been incorporated to align the concept of VCFs under the SEBI (AIFs) Regulations, 2012 (the "**2012 Regulations**"), which brought the entire regime governing the VCFs under the 2012 Regulations.

Investment by foreign venture capital investors

The TISPROI (Third Amendment) Regulations, 2016 (the "**TISPROI Third Amendment, 2016**") provided that foreign venture capital investors ("**FVCIs**") can invest in any Indian company engaged in the sectors mentioned in Schedule 6 of TISPROI Regulations and startups *irrespective* of the sector in which they are engaged, under the automatic route.

Earlier FVCIs could only invest in VCFs or Indian Venture Capital Undertaking under Schedule 6 of TISPROI Regulations. For our detailed analysis of the TISPROI Third Amendment, 2016, please refer to our earlier publication.[35]

To this extent, the revisions incorporated under the TISPROI Third Amendment, 2016 have been carried forward to the FDI Policy, 2016. It may be noted here that the FDI Policy, 2016 does not go on to define a *startup*. However, reference may be made to the TISPROI Third Amendment, 2016 which does provides for a definition of *startup*.[36]

Further, in line with the TISPROI Third Amendment, 2016, it has been clarified that FVCIs can also invest in Category I AIFs. It may be noted here that Category I AIFs include VCFs. This revision once again appears to have been incorporated in order to align with the fact that the VCFs are now classified as Category I AIFs pursuant to the 2012 Regulations. Accordingly, since FVCIs were permitted to invest in VCFs under the Old Policy, the clarification has been provided to state that they can continue to invest in Category I AIFs.

Furthermore, it should be noted that the Old Policy stated that in case a VCF was a trust, the foreign investment by a FVCI required FIPB approval. However, where the VCF was a company, the FVCI could invest in such company subject to compliance with pricing guidelines, reporting requirements, mode of payment and minimum capitalization norms (amongst other things).

This requirement to take FIPB approval in case of an investment by a FVCI into a VCF trust has been eliminated in the FDI Policy, 2016 and accordingly, the policy with respect to the investment by FVCIs has been liberalized.

Investment by qualified foreign investors

The concept of qualified foreign investors ("**QFIs**") has been removed in the FDI Policy, 2016. This revision again seems to be in nature of a clarification since with effect from June 1, 2014, QFIs have been brought under the regime governing Foreign Portfolio Investors pursuant to the SEBI (Foreign Portfolio Investors) Regulations, 2014.

Establishment of branch office, liaison office or project office

A new paragraph has been added to the FDI Policy, 2016 (through Press Note 5) clarifying that where a branch office, liaison office or project office (or any other place of business in India) is established by an applicant in the Defense, Telecom, Private Security or Information and Broadcasting sectors, then approval of RBI is not required, in cases where FIPB approval, license or permission by the concerned Ministry or Regulator has already been granted.

Sector specific conditions on FDI

We set out below the current sector specific conditions applicable under the FDI Policy, 2016.

Prohibited sectors

Amongst others, the Old Policy stated that FDI is prohibited in the "Real Estate Business or Construction of Farm Houses". The FDI Policy, 2016 has clarified that *"real estate business*" shall not include development of townships, construction of residential or commercial premises, roads or bridges and REITs.

35. For a detailed analysis of the TISPROI Third Amendment, 2016, please refer to http://induslaw.com/publications/pdf/alerts-2016/may-18-05-2016.pdf

36. "**Startup**" shall mean an entity, incorporated or registered in India not prior to five years, with an annual turnover not exceeding INR 25 Crores in any preceding financial year, working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property. Provided that such entity is not formed by splitting up, or reconstruction of a business already in existence.

For this purpose:

i. "**entity**" shall mean a private limited company (as defined in the 2013 Act), or a registered partnership firm (registered under Section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008.

ii. the expression "**turnover**" shall have the same meaning as assigned to it under the 2013 Act.

iii. An entity is considered to be working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property if it aims to develop and commercialize: (a) a new product or service or process; or (b) a significantly improved existing product or service or process that will create or add value for customers or workflow.

Provided that it will not include the mere act of developing: (a) products or services or processes which do not have potential for commercialization; or (b) undifferentiated products or services or processes; or (c) products or services or processes with no or limited incremental value for customers or workflow.

Maximum investment in permitted sectors

Under the FDI Policy, 2016, in addition to investments made under Schedule 1 to 10 of TISPROI, Schedule 11 (*Investment By a Person Resident Outside India in an Investment Vehicle*) of the Regulations has been included to determine the maximum amount of investments that can be made under a particular sector.

This change has been brought about to bring the FDI Policy, 2016 in parity with TISPROI, which was amended through the TISPROI Second Amendment, 2016.

Sector specific caps and conditions

We set out below key caps and conditions in relation to major sectors.

Agriculture and Animal Husbandry

Under the FDI Policy, 2016 foreign investment in Animal Husbandry '*under controlled conditions*' was allowed up to 100% under the automatic route. It should be noted that Press Note 5 omitted the terms *'under controlled conditions*' after Animal Husbandry. Consequently, the description of the term '*under controlled conditions*' has been removed from the FDI Policy, 2016 by Press Note 5. However, it may be noted that '*controlled conditions*' continue to apply to Floriculture, Horticulture and Cultivation of Vegetables & Mushrooms.

Manufacture of items reserved for production in Micro and Small Enterprises

Under the FDI Policy, 2016, the entire paragraph with respect to manufacture of items reserved for production by Micro and Small Enterprises ("**MSMEs**") and the conditions on FDI thereof have been omitted.

It is pertinent to mention in this regard that on April 10, 2015, the DIPP removed the remaining 20 items from the original list of over 800 items reserved for exclusive production by the MSME sector.

Accordingly the FDI Policy, 2016 also removed the separate sector and conditions for FDI in manufacture of items reserved for production in MSMEs.

Since the FDI Policy, 2016 permits 100% FDI in the manufacturing sector under the automatic route and there are no separate conditions on FDI in MSME, it can be presumed that FDI in manufacturing by MSMEs is also permitted up to 100% under the automatic route.

Food Products manufactured or produced in India

Newly issued Press Note 5 states that notwithstanding the provisions of the FDI Policy, 2016, foreign investment up to 100% under the government approval route is allowed in entities engaged in trading, including through e-commerce, in respect of food products manufactured and/or produced in India.

It is pertinent to note that the Old Policy and the FDI Policy, 2016 didn't have separate conditions for foreign investment in entities engaged in the trading of food products manufactured or produced in India.

The Trading of any product (including food products) was subject to the conditions of wholesale trading, single brand product retail trading or multi brand retail trading (as relevant) specified in the policies.

Broadcasting Carriage Services

The FDI Policy, 2016 allowed foreign investments in Teleports, Direct to Home, Cable Networks, Mobile TV, Headed in the Sky Broadcasting Service and Cable Networks (together, "**Broadcasting Carriage Services**") under the automatic route up to 49% and under the approval route beyond 49%.

The position has been changed through Press Note 5, which provides that foreign investment in the entities providing Broadcasting Carriage Services can be made up to 100% under the automatic route.

However, a note has been added to the paragraph dealing with Broadcasting Carriage Services, which states that infusion of fresh foreign investment beyond 49% in a company not seeking a license or permission from the relevant ministry, which results in the change of ownership pattern or transfer of stake by an existing investor to a new foreign investor, will require governmental approval.

Courier Services

Under the FDI Policy, 2016, the paragraph dealing with FDI limit in the Courier Services sector has been removed. The FDI Policy, 2016 states that subject to applicable laws and regulations, security and other applicable conditions, foreign investment is permitted up to 100% under the automatic route in sectors or activities not listed in the FDI Policy, 2016. Therefore, it can be presumed that FDI in Courier services is permitted up to 100% under the automatic route.

Civil Aviation

The FDI Policy, 2016 permits foreign investment up to 100% in Airports under the automatic route in respect of *green-field* projects and up to 74% in *brown-field* projects.

Foreign Investment beyond 74% for *brown-field* projects is permitted under the government route.

With a view to aid in modernization of existing airports to establish a high standard and help ease the pressure on these existing airports, foreign investments in brown-field airport projects have been further permitted up to 100% FDI under automatic route pursuant to Press Note 5.

Further it should be noted that the FDI Policy, 2016 allowed foreign investment up to 49% under the automatic route in Scheduled Air Transport Services, Domestic Scheduled Passenger Airline and regional Air Transport Service.

Through Press Note 5, this limit has been raised to 100%, where foreign investment up to 49% is permitted under the automatic route and foreign investment beyond 49% can be made through the approval route.

For NRIs, foreign investment up to 100% will continue to be allowed under the automatic route. However, investments by foreign airlines into Indian companies up to the limit of 49% of their paid up capital continue to be subject to the conditions laid down in the FDI Policy, 2016.

Defense

The FDI Policy, 2016 has provided that foreign investment above 49% is permitted in the defense sector through the government approval on case-to-case basis, wherever it is likely to result in access to modern and *'state-of-art'* technology. In this regard, the following changes have been brought about in the FDI Policy, 2016 through Press Note 5:

- Foreign investment beyond 49% is now permitted through the government approval route, in cases resulting in access to modern technology or for other reasons to be recorded. The condition of access to *'state-of-art'* technology in the country has been done away with; and
- FDI limit for the defense sector has also been made applicable to Manufacturing of Small Arms and Ammunitions covered under the Arms Act 1959.

Pharmaceuticals

The FDI Policy, 2016 provided that foreign investment in the pharmaceutical sector is allowed up to 100% under the automatic route in *green-field* pharmaceuticals and up to 100% under the approval route in *brown-field* pharmaceuticals.

Press Note 5 now permits up to 74% foreign investment under the automatic route and foreign investment beyond 74% under government approval route in *brown-field* pharmaceuticals. Additionally, Press Note 5 prescribes the following conditions for investment in *brown-field* pharmaceuticals:

- The entity seeking foreign investment must maintain production levels of National List of Essential Medicines ("**NLEM**") and their supply in the domestic market, which were at the time of induction of foreign investment, over the next five years at an absolute quantitative level. The benchmark for this level would be decided with reference to the level of production of NLEM drugs and/or consumables in the three financial years, immediately preceding the year of induction of foreign investment. Of these, the highest level of production in any of these three years would be taken as the level.
- The entity seeking foreign investment must maintain in value terms R&D expenses, which were at the time of induction of foreign investment, for 5 years at an absolute quantitative level. The benchmark for this level would be decided with reference to the highest level of R&D expenses, which has been incurred in any of the three financial years, immediately preceding the year of induction of foreign investment.

The entity seeking foreign investment must provide complete information of technology transfer, if any, along with the induction of foreign investment.

Foreign investment limit in *green-field* pharmaceuticals remains unchanged.

Private Security Agencies

The FDI Policy, 2016 provided that foreign investment in private security agencies was allowed up to 49% through the approval route. Pursuant to Press Note 5, foreign investment up to 49% in Private Security Agencies is now permitted under the automatic route and foreign investment beyond 49% and up to 74% can be made through the approval route.

In addition to the above, certain conditions have been added under the FDI Policy, 2016 to the effect that FDI in Private Security Agencies is subject to compliance with the Private Security Agencies (Regulation) (PSAR) Act, 2005.

Further, it is prescribed that for the purposes of the FDI Policy in the sector, the terms *"Private Security Agencies"*, *"Private Security"* and *"Armoured Car Service"* will have the meaning prescribed to these terms under PSAR Act.

Single Brand Product Retail Trading

According to the FDI Policy, where the proposed foreign investment in a company engaged in single brand retail is more than 51%, sourcing of 30% of the goods purchased was to be done from India.

Press Note 12 of 2015 prescribed that the procurement requirement had to be met annually from the commencement of the business.

However, this condition was relaxed under the FDI Policy, 2016 to the effect that the procurement requirement would have to be met, in the first instance, as an average of five years' total value of the goods purchased, beginning 1st April of the year of the commencement of the business (i.e. opening of the first store).

Thereafter, it would have to be met on an annual basis. Other conditions with respect to Single Brand Product Retail Trading as provided in Press Note 12 of 2015 have been included in the FDI Policy, 2016.

Under the FDI Policy, 2016, Clause (v) of Notes to the paragraph relating to Single Brand Retail Trading, stated that government may relax sourcing norms for entities undertaking Single Brand Retail Trading of products having *'state-of-art'* and *'cutting edge technology'* and where local sourcing was not possible.

Through Press Note 5, Clause (v) of the Notes have been amended to state that sourcing norms will not be applicable up to 3 (three) years from the commencement of business (i.e. opening of the first store) for entities undertaking Single Brand Retail Trading of products having 'state-of-art' and '*cutting edge technology*'. Thereafter sourcing requirement as detailed above will be applicable.

Banking (Private Sector)

Under the Old FDI Policy, the cap on FDI in private sector banks was limited up to 74% but investments by Foreign Institutional Investors ("**FIIs**") and/or Foreign Portfolio Investments ("**FPIs**") could not exceed 49% of the total paid up capital of the bank.

Under the FDI Policy, 2016, though the FDI cap is kept at 74%, the other conditions prescribe that the aggregate investments from FIIs and/or FPIs can be increased up to the sector limit of 74% of the total paid-up capital (as opposed to 49%) by the bank concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body.

Infrastructure Companies in the Securities Market

Under the Old FDI Policy, a *commodity exchange* was treated as a separate sector. However, under the FDI Policy, 2016, a *commodity exchange* is categorized under an *Infrastructure Company in the Securities Market* wherein 49% investment is allowed under the Automatic Route.

Foreign investment in *commodity exchanges* will be subject to the guidelines of the Central Government or SEBI from time to time. The Old FDI Policy mentioned that the cap on FDI in commodity exchanges was 49% through a mix a FDI (of up to 26 per cent), FII and FPI (of up to 23 per cent) of the paid-up capital.

This condition was removed under Press Note 8 of 2015 and up to 49% foreign investment (without any demarcation for FDI, FII or FPI) was permitted. The FDI Policy, 2016 incorporates the same position.

The Old FDI Policy had only one condition with regards to an *Infrastructure Company in the Securities Market* that FIIs or FPIs can invest only through purchases in the securities market. The FDI Policy, 2016 adds additional conditions, which are as follows:

- No non-resident investor or entity (including persons acting in concert) will hold more than 5% of the equity in commodity exchanges; and
- Foreign investment in commodity exchanges will be subject to the guidelines of the Central Government and SEBI from time to time.

Insurance

Before, FDI of up to 49% in the total paid up capital of the company was subject to verification by the Insurance Regulatory and Development Authority under Press Note 1 of 2016.

Under the FDI Policy, 2016, along with the word verification the term *'approval'* has been added. Further, the condition in Press Note 1 of 2016 stated that an insurance company shall ensure that ownership and control remains at all times in the hands of Indian entities referred to in the Indian Insurance Companies (Foreign Investment) Rules 2015.

However, the FDI Policy, 2016 has amended the condition to state that ownership and control remains at all times in the hands of resident Indian entities as determined by the Department of Financial Services or the Insurance Regulatory and Development Authority of India as per the rules and regulation issued by them from time to time.

Power Exchange Sector

The Old FDI Policy permitted FDI limit of up to 26 per cent and FII and FPI limit of up to 23 per cent of the paid-up capital in the power exchanges sector. These limits were removed by Press Note 8 of 2015 and up to 49% foreign investment (without any demarcation for FDI, FII or FPI) was permitted. The FDI Policy, 2016 incorporates the same position.

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5.4 INSOLVENCY AND BANKRUPTCY (APPLICATION TO ADJUDICATING AUTHORITY) RULES, 2016

Introduction

On November 30, 2016, the Ministry of Corporate Affairs notified the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (the "**Rules**") that shall apply to matters relating to the corporate insolvency resolution process.

Amongst other things, the Rules primarily specify the manner in which an application is to be filed by a *financial creditor, operational creditor* and a *corporate applicant* to the adjudicating authority.

Application to Adjudicating Authority

- **Financial Creditor**

  A *financial creditor* may by itself or jointly make an application for initiating a corporate insolvency resolution process against a corporate debtor. Such application shall be filed in Form 1 (annexed to the Rules) along with documents and records specified in the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (the "**Regulations**").

  Where such *financial creditor* is assigning or transferring a debt, the application shall be accompanied with a copy of the assignment or transfer agreement.

- **Operational Creditor**

  Where an *operational creditor* intends to initiate a corporate insolvency resolution process against a corporate debtor, it shall be required to file an application in Form 9 (annexed to the Rules) along with such additional documents that may be specified in the Regulations.

- **Corporate Applicant**

  Where a *corporate applicant* intends to initiate a corporate insolvency resolution process against a corporate debtor, it shall be required to file an application in Form 6 (annexed to the Rules) along with such additional documents that may be specified in the Regulations.

  Further, it should be noted that under the Rules, the *adjudicating authority* may permit a *financial creditor, operational creditor* and a *corporate applicant* to withdraw the application by way of a request made by the respective party before the admission of the application.

Filing of application

As the rules for conduct of proceedings under the Insolvency and Bankruptcy Code, 2016 have not been notified, an application made by an *operational creditor, financial creditor* and/or a corporate applicant shall be filed to the *adjudicating authority* in accordance with rules of the National Company Law Tribunal Rules, 2016 (20, 21, 22, 23, 24 and 26 of Part III).

Authors: Ran Chakrabarti and Nandita Bose

5.5 INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (INSOLVENCY RESOLUTION PROCESS FOR CORPORATE PERSONS) REGULATIONS, 2016

Introduction

On December 1, the Ministry of Corporate Affairs notified the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (the "**Regulations**") to govern the corporate insolvency resolution process under the new Insolvency & Bankruptcy Code (2016) (the "**Code**").

Consisting of ten chapters and five schedules, the Regulations lay down an extensive procedure to be followed by a corporate person and insolvency professionals in a corporate insolvency resolution process.

Eligibility, rights and obligations of insolvency professionals

The Regulations list the *eligibility criteria* for a person to be appointed as an insolvency professional for a corporate insolvency resolution process. Under the Regulations, a person who by himself or through an entity that he is a part of, is 'independent' of the corporate debtor, may be appointed as an insolvency professional. An explanation to the term 'independent' has been provided in the Regulations. To avoid conflict of interests, the Regulations prohibit one insolvency professional entity (including any partner or director) to act on behalf of *different* stakeholders in a corporate insolvency resolution process.

Without prejudice to the rights granted to an interim resolution professional under the Code, the Regulations permit such interim resolution professionals appointed by the adjudicating authority to access the books of account, records and other relevant documents and information (to the extent relevant for discharging his duties under the Code) of the corporate debtor.

On appointment of an interim resolution professional, the insolvency professional shall be required to make a public announcement within 3 (three) days of appointment in a form and manner prescribed in the Regulations. The expenses on the public announcement shall not form part of the insolvency resolution process costs.

Extortionate transactions

Section 50 of the Code empowers the liquidator or the insolvency resolution professional to make an application to the adjudicating authority to avoid extortionate credit transactions that incur an operational or financial debt within 2 (two) years of the date of commencement of insolvency resolution process.

In light of the above and in exercise of the powers conferred on the Insolvency and Bankruptcy Board of India (the "**Board**"), the Board has classified the following transactions in the Regulations that would be considered extortionate credit transactions:

- those which requires the corporate debtor to make *exorbitant payments* in respect of the credit provided; or
- those which are *unconscionable* under the principles of law relating to contracts.

Proof of claims

Any person claiming to be an operational creditor, financial creditor, workman or employee shall be required to submit proof (in specified formats) of their respective claim to the interim resolution professional. Further, such person may submit supplementary documents or clarifications in support of their claims before the constitution of the committee (*discussed below*).

The Regulations include an indicative list of documents that may be submitted by these parties to the resolution professional. The interim resolution professional or the resolution professional may also call for such other evidence or clarification as they deem fit from a creditor for substantiating the whole or part of its claim.

On receipt of the claim, the insolvency resolution professional is required to verify the claims raised within 7 (seven) days from the last date of receipt of claims and also maintain a list of creditors with relevant details such as amount claimed by creditors, security interest and other related matters. Further, such list shall be available to the adjudicating authority, members, and directors of the corporate debtor. The claims denominated in foreign currency shall be valued in Indian currency at the official exchange rate as on the insolvency commencement date.

Committee of creditors, meeting of committee and voting by the committee

Pursuant to the Regulations, a committee of operational creditors shall be set up *inter alia* where the corporate debtor does not have any financial debt. The members of the committee (specified in Regulation 16(2) of the Regulations) shall have voting rights in proportion to the debt due to such creditor or debt represented by such representative (as the case may be) in context of the total debt.

A committee formed under this Regulation and its members shall have the same rights, powers, duties and obligations as a committee comprising financial creditors and its members (as the case may be).

The first meeting of the committee has to be convened within 7 (seven) days of filing a report by the insolvency resolution professional to the adjudicating authority.

The Regulations empower the insolvency resolution professional to convene a meeting of creditors as and when it considers necessary or when a request is made by the members of the committee representing 33% of the voting rights.

Notice of the meetings of the committee shall be given at least 7 (seven) days prior to the date of the meeting and the same may be delivered by hand, post or electronic means. Amongst other things, such notice shall contain the agenda of the meeting and state the process and manner of voting by electronic means. The quorum of the meeting of the committee shall be members representing at least 33% of the voting rights who are present either in person or by video conferencing or other audio and visual.

However, the committee may modify the percentage of voting rights required for quorum in respect of any future meetings of the committee. Regulations 24 and 25 also lay down the process of conducting meetings of the committee by the insolvency resolution professional and the manner in which the committee is required to vote.

Authority of India as per the rules and regulation issued by them from time to time.

Conduct of Corporate Insolvency Resolution Process

The interim resolution professional is required within 7 (seven) days of his appointment to appoint two registered valuers to determine the liquidation value of the corporate debtor. The Regulations also list certain categories of persons who may not be appointed as the registered valuer.

A creditor is permitted to assign or transfer any debt due to such creditor to any other person, subject to both parties providing the interim resolution professional or the resolution professional (as the case may be) the terms of such assignment or transfer and the identity of the assignee or transferee.

Insolvency Resolution Process Costs

The applicant is required to fix expenses to be incurred on or by the interim resolution professional. The applicant shall bear these expenses, which shall be reimbursed by the committee to the extent it ratifies. The amount of expenses ratified by the committee shall be treated as insolvency resolution process costs.

Resolution Plan

A resolution applicant shall submit a resolution plan prepared in accordance with the Code and the Regulations to the resolution professional, 30 (thirty) days before expiry of the maximum period permitted under the Code for the completion of the corporate insolvency resolution process.

The resolution plan shall contain measures required for its implementation, the specific sources of funds that will be used to pay the insolvency resolution process costs and other related details. On being approved by the committee, the resolution plan is required to be submitted to the adjudicating authority by the insolvency resolution professional with a certification that: (i) the contents of the resolution plan meet all the requirements of the Code and the Regulations; and (ii) the resolution plan has been approved by the committee.

All proceedings under the plan may be initiated from the insolvency commencement date, however, the committee may instruct the resolution professional to make an application to the adjudicating authority under Section 12 of the Code to extend the insolvency resolution process period.

INDUSLAW VIEW

The Regulations are necessary to provide additional detail to the mechanics of the new insolvency process outlined in the Code. They intend to rationalize the process and procedures for corporate insolvencies. Although the process highlighted in the Regulations appear to be clear, paving the way for an efficient resolution process, its implementation, without established infrastructure and trained insolvency resolution professionals is bound to lead to initial questions of procedure before competent authorities.

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5.6 THE ROLE OF THE NATIONAL COMPANY LAW TRIBUNAL AND THE TRANSFER OF INSOLVENCY PROCEEDINGS

Introduction

On December 7, 2016, the Ministry of Corporate Affairs published 2 (two) notifications relating to the commencement of certain sections of the Companies Act, 2013 (the "**Commencement Notification**") and the Companies (Transfer of Pending Proceedings) Rules, 2016 (the "**Transfer Rules**").

The Commencement Notification[37] deals with the role of the National Company Law Tribunal (the "**Tribunal**") in matters relating to the winding up, the compromise, merger and amalgamation of companies and other issues, including the variation of shareholder rights and the reduction of share capital.

The Transfer Rules[38] deal with the transfer of all insolvency proceedings under the Companies Act, 2013 (the "**Act**") to the Tribunal.

Both notifications came into effect on December 15, 2016.

THE COMMENCEMENT NOTIFICATION

The Commencement Notification brings into effect the following sections of the Act.

- **Winding Up**
  - **Definition of Company Liquidator**

    Section 2(23) of the Act defines a "**Company Liquidator**" in relation to winding up as a person appointed by the Tribunal, in case of winding up by the Tribunal, and a person appointed by the company or the creditors in case of voluntary winding up.

    Such person should be selected from a panel of professionals maintained by the Central Government as Insolvency Professionals registered under the Insolvency and Bankruptcy Code, 2016 (the "**Code**").

  - **Furnishing of false information during incorporation**

    Section 7(7)(c) of the Act empowers the Tribunal to directly remove the name of the company from the Registrar of Companies or pass an order for winding up upon satisfaction that the incorporation of such company was based on furnishing of false information.

  - **Winding up or dissolution of a company with charitable objects**

    Section 8(9) of the Act provides that upon winding up or dissolution of a company registered under section 8, if there are any surplus assets of such company, it can either be transferred to another company with similar objects, or the sale proceeds thereof can be credited to the Rehabilitation and Insolvency Fund under the Code.

37. Notification S.O. 3677 (E)

38. Notification G.S.R 1119 (E)

- **Actions to be taken in pursuance of inspector's report**

  Section 224(2) of the Act provides that in specific circumstances, if it appears to the Central Government from any report from the inspector that it is required to expedite the process for any company liable to wound up under the Act, then it may do so by filing a petition for winding up of such company with the Tribunal.

- **Voluntary winding up of Company, etc., not to stop investigation proceedings**

  Section 226 of the Act lays down that neither a voluntary winding up by a company nor an order of winding up passed by the Tribunal shall stop an investigation to be initiated or continued.

  Where an order to wind up is already passed by the Tribunal, the Inspector shall inform the Tribunal of such pending investigation and the Tribunal may pass such order as it may deem fit.

- **Winding up of the Tribunal**

  Sections 270 to 288 of the Act lay down the modes of winding up (i.e. winding up by the Tribunal or voluntary winding up), the procedures for winding up of a company by the Tribunal, appointment and removal of Company Liquidators, jurisdiction of the Tribunal and setting up of an advisory committee under the directions of the Tribunal.

- **Powers and duties of Company Liquidator**

  Sections 290 to 303 of the Act lay down that the powers and duties of the Company Liquidators are subject to the directions by the Tribunal. The sections provide for appointment of professional assistance to the Company Liquidator with the sanction of the Tribunal and dissolution of the company by Tribunal.

- **Debts of all description to be admitted to proof**

  Section 324 of the Act provides that subject to certain conditions, all debts and all claims against the company are admissible to proof against the company.

- **Winding up provisions**

  Sections 326 to 365 of the Act lay down that subject to certain conditions, overriding preferential payments towards workmen's due and debts due to secured creditors, and other priority payments are to be made at the time of winding up of the company.

  The submission of final report of winding up is to be made by the official liquidator to the Central Government or the Tribunal, as the case may be.

  The Company Liquidator has certain powers, subject to sanction of the Tribunal, when the company is being wound up by the Tribunal. The sections also provide a procedure of winding up by the Tribunal and the provisions regarding appointment and powers of official liquidator.

- **Continuation of pending legal proceedings**

  Section 370 of the Act provides that any pending litigation for partnership firm, limited liability partnership, cooperative society, etc., registered as company, shall continue as if the registration did not take place. If properties of such a company are insufficient, an order may still be obtained for winding up the company.

- **Stayed or Restrained Proceedings**

  Section 372 and 373 of the Act lays down that no legal proceedings in relation to company under winding up can commence without the Tribunal's approval

- **Winding up of unregistered and foreign Companies**

  Sections 375 and 378 of the Act related to winding up of unregistered companies and foreign companies doing business in India. An unregistered company cannot be wound up voluntarily and can be wound up if it is dissolved or has ceased to carry on business or is unable to pay its debts or by the Tribunal.

- **Closure of place of business of a foreign company**

  Section 391(2) of the Act provides that winding up shall equally apply to the closure of the place of business of foreign company in India as if it were an Indian company.

- **Merger and Amalgamation of Companies**

  - **Power of Tribunal to compromise, arrangements and amalgamations**

    Section 230 (except subsections (11) and (12)) and section 231 of the Act lay down that a compromise or arrangement will be dealt by the Tribunal on the application of the company or creditors. It lays down the power of the Tribunal to enforce compromise or arrangement upon the company, failing which the Tribunal may make an order for winding up.

  - **Merger and Amalgamation of Companies**

    Sections 232 and 233 of the Act impose an obligation on the Tribunal, where an application for merger and amalgamation of companies are made, that the Tribunal shall look into the manner and procedure in which such merger and amalgamation shall take place and only upon being satisfied with compliance of the procedures, make such orders to sanction the compromise.

  - **Power to acquire shares from dissenting shareholders**

    Sections 235 to 240 of the Act provide for buying out of shares held by dissenting shareholders and minority shareholding, and lay down the power of Central Government to provide for amalgamation of companies in public interest.

    Further, the provisions state that the liability of officers in respect of offences committed prior to merger, amalgamation or compromise shall continue after such merger, amalgamation or acquisition has taken place.

- **Variation of shareholder's right**

  Section 48 of the Act provides that where different classes of shares exist in a company, if variation of shares by one class affects the rights of the others, consent by 75 per cent of that class of shareholders is required.

- **Reduction of Share Capital**

  Section 66 of the Act lays down that any reduction of share capital should be confirmed by the Tribunal after being satisfied that the debt or claim of every creditor has been discharged. Tribunal shall give notice of such reduction to the Central Government, Registrar of Companies, SEBI and creditors, who may make any representation within three months. A certificate from the Statutory Auditor is to be filed with the Tribunal confirming that accounting treatment is in accordance with Accounting Standards.

THE TRANSFER RULES

- **Cases other than winding up**

  Transfer of all proceedings under the Act, other than that of winding up, shall be transferred to benches of Tribunal exercising territorial jurisdiction.

- **Voluntary winding up**

  All proceedings relating to voluntary winding up pending before the High Court shall continue to be dealt with by the High Court in accordance with the provisions of the Act.

- **Winding up on the ground of inability to pay debts**

  All proceedings relating to the winding up of companies on the ground of inability to pay its debts pending before High Court, and where the petition has not been served on the respondent shall be transferred to the Bench of the Tribunal.

  In all cases where opinion has been forwarded by the Board for Industrial and Financial Reconstruction for winding up of a company to a High Court (and where no appeal is pending), the proceedings for winding up initiated under the Act (pursuant to section 20 of the Sick Industrial Companies (Special Provisions) Act, 1985) shall continue to be dealt with by such High Court in accordance with the provisions of the Act.

- **Winding up on the grounds other than inability to pay debts**

  All proceedings relating to winding up of companies on grounds other than that of inability to pay its debts pending before a High Court (and where the petition has not been served on the respondent) shall be transferred to the Bench of the Tribunal exercising territorial jurisdiction

- **Transfer of Records**

  The Transfer Rules also provide for transfer of records and state that no fees are to be paid for proceedings transferred to the Tribunal under these Rules.

INDUSLAW VIEW

The notifications essentially facilitate the new mechanism for the resolution of corporate insolvency under the Code. The establishment of the Tribunal (and the National Company Law Appellate Tribunal, earlier this year) were viewed as a welcome measure and a revolution in the dispute-redressal mechanism under Company Law.

However, the only *lacuna* in the powers vested in such tribunal was its incapacity to administer and interpret amalgamations and compromises and the revival and rehabilitation of companies.

This *lacuna* has been now been removed. Further, the notifications have laid out a clearer structure for the role and powers of the Tribunal. The role of the High Court has now been effectively substituted by the Tribunal.

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5.7 INSOLVENCY AND BANKRUPTCY CODE, 2016: A CRITICAL ANALYSIS

Introduction

It's no secret that the Indian banking industry has a rather large number of loans outstanding that have simply gone wrong. With non-performing loans estimated at just over INR 6.3 trillion[39] market. In this context, the new Insolvency and Bankruptcy Code (the "**Code**") passed by Parliament earlier this year, promises to address the structural problems hampering the efficient recycling of capital and rebalance the rights of creditors, giving them much needed recourse to take timely and effective action against defaulting borrowers.

It is hoped that the Code will become effective by the end of this year[40] and in order to achieve this, institutions need to be set up and regulations are required to be put in place. At the beginning of August, India's central government gave notice for the appointment of a chairman and board for the new Bankruptcy Board constituted by the Code, essentially kick-starting the process for the future operation of the Code.

So what does the new Code contain and how effective will it be in promoting the efficient and timely resolution of insolvent entities? This article will highlight the key parts of the Code and assess its likely impact on the Indian debt market.

THE CURRENT REGIME

In India, insolvency and bankruptcy are terms that are common with many other jurisdictions. However, they are not *synonymous* and should not be confused to mean the same thing (they often are). *Insolvency* refers to a situation where any person or a body corporate is unable to fulfill its financial obligations (often occurring due to several factors such as a decrease in cash flow, losses and other related issues).

Bankruptcy on the other hand is a situation whereby a court of competent jurisdiction has declared a person or other entity insolvent, having passed appropriate orders to resolve it and protect the rights of the creditors.[41]

Put otherwise, the difference is that one comes before the other: insolvency is a state of affairs, which triggers the legal process of bankruptcy.

Note that the position in India is slightly different than in England & Wales, whereby the distinction between insolvency and bankruptcy is determined by whether the entity is a body corporate (governed by the insolvency regime) or an individual (governed by the bankruptcy regime).

At present, the laws governing insolvency and bankruptcy in India are not consolidated. Insolvency of individuals is dealt with under the Presidency Towns Insolvency Act, 1909 (the "**Presidency Act**") and the Provincial Insolvency Act, 1920 (the "**Provincial Act**").

Insolvency for companies is dealt with under a number of pieces of legislation including the Companies Act, 2013 (the "**Companies Act**"); the Sick Industrial Companies Act, 1985 (the "**SICA**"), the Recovery of Debt Due to Banks and Financial Institutions Act, 1993 (the "**Recovery Act**") and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**").

As a result of this overlap, several institutions have jurisdiction over the insolvency and bankruptcy process. The Company Law Board, the High Courts, the Debt Recovery Tribunals and the Board of Industrial and Financial Reconstruction deal with the insolvency of entities they govern, which leads to the problem of concurrent jurisdiction, systemic delays and other related complexities.[42]

Providing a coherent and unified structure under a consolidated legal framework to deal with insolvency and bankruptcy in India has long been overdue. To this end, the *Rajya Sabha* passed the Code on 11th May 2016 and sections 188 to 194 of the Code relating to the constitution of the Insolvency & Bankruptcy Board (the "**Board**") came into force on 5 August 2016.

The Code seeks to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner by creating authorities and agencies that will specifically deal with insolvency processes framed under the Code.

The Code will therefore merge the insolvency related provisions under the Companies Act, SARFAESI, the SICA, and the Recovery Act. Furthermore, the Presidency Act and Provincial Act stand repealed.

THE NEW REGIME

- **The Insolvency and Bankruptcy Board of India**

  The Code provides for the constitution of the Board,[43] having 10 members including representatives from the Reserve Bank of India and the Central Government to *regulate* insolvency procedures in India.

  It is intended that the Board shall act on the general directions of the Central Government in matters which *inter alia* include the registration and functioning of Insolvency Professional Agencies, Insolvency Professionals and Information Utilities, making regulations, bye-laws and guidelines on matters relating to bankruptcy and insolvency.[44]

39. http://www.business-standard.com/article/finance/banks-finances-to-improve-by-this-year-end-116101900007_1.html

40. http://www.livemint.com/Politics/q5GLjNtmPVP964fwAtPVSJ/Bankruptcy-code-to-come-into-force-by-yearend-Shaktikanta.html

41. Raj Kumar S. Adhukia, A Study On Insolvency Laws In India Including Corporate Insolvency (http://www.mbcindia.com/Image/18%20.pdf) last visited on 10.05.2016 at 12.17 pm

42. Insolvency and Bankruptcy Code: A legislation to promote investments, develop credit markets – (http://indianexpress.com/article/india/india-news-india/insolvency-and-bankruptcy-code-a-legislation-to-promote-investments-develop-credit-markets/#sthash.782eZ4x4.dpuf)

43. See Section 188, The Code

44. See Section 196, The Code

The Code vests in the Board powers of a civil court under the Code of Civil Procedure, 1908 with respect to discovery and the production of books and other related matters.

However, until the Board is established, a financial sector regulator authorized by the Central Government shall exercise the powers and functions of the Board under the Code.[45] The purpose of vesting such powers in such interim regulator is ambiguous as the Code specifically provides for procedures and rules for setting up and functioning of the Board.[46]

- **Insolvency Professional Agencies and Insolvency Professionals**

  The Code further provides for the establishment of Insolvency Professional Agencies ("**IPAs**") who, *inter alia* shall develop and regulate *information utilities* (agencies collating information from companies and intended to identify those with insolvency risk) and Insolvency Professionals ("**IPs**") who shall be a specialized class of professionals, registered with the Board and enrolled with IPAs[47] to deal and manage the Insolvency Resolution Process (the "**IRP**").

  In our view, the establishment of a number of IPAs as opposed to a single IPA for regulating the functioning of IPs and other matters may lead to further complexities, delays and conflict of interest.[48] Amongst other things, the Code does not clarify if an IP will be eligible to enroll with multiple IPAs.[49]

- **Information Utilities**

  Information Utilities established under the Code shall be required to perform functions relating to storing financial information in an accessible format, publish statistical information and identify those entities, which are at insolvency risk. It is unclear at the moment as to what methodology Information Utilities will use to determine insolvency risk, though it is anticipated that the use of traditional financial ratios common in the covenants in loan agreements will no doubt, play a role. It is further unclear as to whether the jurisdiction of the Information Utilities will extend over both public and private companies and to what extent that information will be made public, potentially raising key confidentiality issues. Will there be just one Information Utility or will there be several? Again, the risks of duplication and co-ordination will arise in the event that there are several Information Utilities.

- **The Insolvency Resolution Process**

  Broadly, the IRP under the Code envisages: (a) a fresh start process; (b) individual IRP; (c) corporate IRP; (d) individual bankruptcy process; and (e) the liquidation of a corporate debtor firm.[50]

- **Individuals and Partnership Firms**

  In case of individuals and partnership firms, the Code provides for the below mentioned methods for resolving disputes.

  - **Fresh Start Process**

    Pursuant to the *fresh start process*, a debtor who is unable to pay off his or her debts may apply personally or through an IP to the adjudicating authority for a discharge from its *qualifying debts* (debts which are liquidated, unsecured and not excluded debts and up to INR 35000).[51]

    However, such discharge is permitted only if the debtor *qualifies* under certain thresholds, demonstrating that his or her gross annual income does not exceed INR 60000, that the aggregate value of the assets of the debtor does not exceed INR 20000, the debtor does not own a house and other particular criteria.[52]

    Where the application under section 80 of the Code is filed by the debtor himself and not through an IP, the adjudicating authority shall direct the Board to nominate an IP for the fresh start process.

    When a debtor files an application, an interim moratorium shall commence on the date of filing of the application. Further, the IP shall within 10 days of his appointment submit a report to the adjudicating authority either recommending acceptance or rejection of the application with reasons. The Code provides a short period of 14 days from the date of submission of the report by the IP to pass an order admitting or rejecting the application.

    If such application is accepted, then on such date, the moratorium period shall commence for all the debts and shall cease to have effect at the end of 180 days beginning from the date of the admission of the order.[53]

45. See Section 195, The Code

46. Infra note 8

47. See Section 206, The Code

48. PRS Legislative research, Issues for Consideration, Insolvency and Bankruptcy Code, 2015 (http://www.prsindia.org/uploads/media/Bankruptcy/IBC%202016%20%20Issues%20for%20consideration.pdf) last visited on 10.05.2016 at 1.35 pm

49. Id.

50. See Section 208, The Code

51. Press Information Bureau, Government of India. Ministry of Finance, Summary of the Recommendations of the Bankruptcy Law Reforms Committee (http://pib.nic.in/newsite/PrintRelease.aspx?relid=130208) last visited on 10.05.2016 at 2.34 pm

52. See Section 80(2), The Code

53. See Section 85(1) read with Section 85(5), The Code

A creditor mentioned in the order is given a chance to raise objection once he receives such order on several grounds, such as the inclusion of the debt as a qualifying debt, incorrectness of details of the debt and other grounds.[54]

In assessing the validity of creditor objections, the IP shall be required to prepare and draw up a final list of qualifying debts within specified time periods. A debtor or creditor who is aggrieved by such action of the IP may file an application to the adjudicating authority challenging such action.[55] The Code provides the interested parties with an option to replace the IP.[56]

To obtain a discharge order, the IP is required to prepare a final list of all qualifying debts and submit the list to the adjudicating authority at least seven days before the moratorium comes to an end.[57] On the expiry of this period, the adjudicating authority will pass an order on discharging of the debtor from the qualifying debts and give an opportunity to the debtor to start afresh.[58]

- **Individual IRP**

  In the event of an individual IRP, the debtor or creditors may initiate an IRP by submitting an application through an IP to the adjudicating authority.[59] Similar to the fresh start process, an interim-moratorium shall commence on the date of the application in relation to all debts and shall cease to have effects on the date of admission of the application.[60]

  Further, the IP shall within 10 days of his appointment submit a report to the adjudicating authority, either recommending acceptance or rejection of the application with reasons.

  When the application is admitted, a moratorium shall commence in relation to all the debts and shall cease to have effect at the end of the period of 180 days beginning with the date of admission of the application.[61]

Furthermore, the adjudicating authority may issue instructions for conducting negotiations between the debtor and its creditors with a view to arriving at a repayment plan.[62] If however, the application is rejected by the adjudicating authority on grounds of *mala fide* intention on part of the debtor, then such order may record that the creditor is entitled to file for bankruptcy.[63]

On admitting the application, the adjudicating authority shall issue a notice inviting claims from creditors. Pursuant to such claims, the debtor shall prepare a repayment plan in consultation with the IP[64] and submit such plan to the adjudicating authority. This process will be followed by a meeting of the creditors to vote in respect to the repayment plan.

The repayment plan or any modification needs to be approved by 75% of the creditors present in person (or through proxy) and voting on the resolution.[65]

The IP is responsible to provide the adjudicating authority a copy of the report of the meeting and then the adjudicating authority shall either approve or reject the plan. Such repayment plan shall be binding in nature.

- **Bankruptcy**

  Formal bankruptcy of an individual or partnership can only be initiated following the failure of the IRP in the following circumstances:[66]

  - When an application for IRP has been rejected by the adjudicating authority for reasons such as the plan not being approved by 75% of the creditors;[67] or
  - When the repayment plan has been rejected by the adjudicating authority; or
  - When the adjudicating authority passes an order that the repayment plan has not been completely implemented.

54. See Section 188, The Code
55. See Section 86, The Code
56. Id.
57. See Section 89, The Code
58. See Section 92, The Code
59. See Section 92(2), The Code
60. See Section 94 read with Section 95, The Code
61. See Section 96, The Code
62. See Section 101, The Code
63. See Section 100, The Code
64. See Section 100(4), The Code
65. See Section 105, The Code
66. See Section 111, The Code
67. See Section 121, The Code

The Code states that either a debtor or a creditor can file an application for bankruptcy within 3 months from the date of the order passed by the adjudicating authority.[68]

When debtors or creditors file such an application, an interim-moratorium will commence on all actions against the property of the debtor. The Code further states that the IP may be proposed as a bankruptcy trustee and the estate of the bankrupt shall vest in the bankruptcy trustee immediately after his appointment.[69] Under the Code, the bankruptcy order passed by the adjudicating authority shall have effect until the debtor is discharged. When debtors or creditors file such an application, an interim-moratorium will commence on all actions against the property of the debtor. The Code further states that the IP may be proposed as a bankruptcy trustee and the estate of the bankrupt shall vest in the bankruptcy trustee immediately after his appointment.[70] Under the Code, the bankruptcy order passed by the adjudicating authority shall have effect until the debtor is discharged.

The Code lays down the following priority in which all debts will be paid off:[71]

- Costs and expenses incurred by the bankruptcy trustee;
- Workmen's dues for the period of twenty-four months preceding the bankruptcy commencement date;
- Debts owed to secured creditors (ranking equally with workmen's dues);
- Wages and any unpaid dues owed to employees, other than workmen, of the bankrupt for the period of twelve months preceding the bankruptcy commencement date;
- Any amount due to the Central Government and the State Government; and
- All other debts and dues owed by the bankrupt including unsecured debts.

- **Companies and Limited Liability Entities**
  - **IRP**

    The Code provides an exhaustive, unambiguous insolvency regime and speedy process for revival of companies and limited liability entities[72] and a corporate debtor or creditors can initiate the IRP.[73]

    Under the Code, in case of insolvency and liquidation of corporate entities, a minimum default of INR 1 (one) lakh (approximately USD 1500) should have occurred. Some commentators have suggested that this threshold is low and it will be the duty of the adjudicating authorities to firmly distinguish vexatious claims from the legitimate claims of creditors.

    With respect to creditors, the Code lays down different procedures to be followed by operational creditors and financial creditors to initiate the IRP. Financial creditors refer to any person to whom a *financial debt* is owed and an operational creditor refers to any person to who a debt with respect to *goods or services* is owed.

    It is likely that financial creditors will initiate the insolvency process, since they normally have access to the debtor's financial records and will be able to assess whether an insolvency scenario is just around the corner.

    In case of companies, the Code prescribes a limit of 180 days from the date of admission of the application (extendable for a period of 90 days with approval of 75% of the creditors) within which the IRP should be completed.

    On admission of the application by the adjudicating authority it shall declare a moratorium on specified activities, call for the submission of claims and appoint an interim IP. In case of corporate entities, on the first meeting of creditors by a majority vote of 75%, an IP shall be appointed who shall conduct the entire IRP.[74]

    Such IP shall be responsible for preparing an information memorandum in a manner specified by the Board for formulating a resolution plan.[75] An applicant may also submit such resolution plan to the IP on the basis of such information memorandum. The Code states that the IP shall be responsible for examining the plan to ensure that it provides for management of the affairs of the corporate debtor and does not contravene any provision of the law (amongst other things).

68. Except in cases where the resolution professional recommends that a meeting of creditors is not required to be summoned. See Section 106
69. See Section 121(2), The Code
70. See Section 154, The Code
71. See Section 178, The Code
72. Supra Note 10
73. See Section 6 & 7, The Code
74. See Section 23, The Code
75. See Section 29, The Code

Such plan shall be presented to a committee of creditors, who may approve it with the consent of not less than 75% of the creditors.[76] If the adjudicating authority is satisfied with such resolution plan, then it may by order approve the plan, which will then be binding on the corporate debtor. However, the adjudicating authority may also reject the plan. Where the adjudicating authority rejects the plan because the requisite creditors have not approved it, he shall pass an order of liquidation.

- **The liquidation process**

  The adjudicating authority can initiate the liquidating process in the following circumstances:

  - on the expiry of maximum period permitted for completion of IRP;
  - when the adjudicating authority rejects the resolution plan;
  - where the committee of creditors, before the confirmation of the resolution plan, notifies the adjudicating authority of its decision to liquidate the corporate debtor; or
  - Where the corporate debtor contravenes the resolution plan, approved by the adjudicating authority.

  Where the adjudicating authority passes a liquidation order, the IP shall act as the liquidator and if the process cannot be resolved within 180 days, the assets of debtor may be sold to repay its creditors.

  Note that the Code further makes provision for a *fast track* insolvency process for companies with smaller operations. The process will have to be completed within 90 days unless extended with the approval of 75% of creditors.

- **Distribution of assets**

  The Code lists the order of priority for the proceeds from the sale of the liquidation assets, set out below.[77]

  - IRP costs and the liquidation costs paid in full;
  - workmen's dues for the period of twenty-four months preceding the commencement of liquidation;
  - debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in the Code;

    (Note that the debts specified in (2) and (3) shall rank equally between and among themselves).
  - wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;
  - financial debts owed to unsecured creditors;
  - any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;
  - debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;

    (Note that the debts specified in (6) and (7) shall rank equally between and among themselves)
  - remaining debts and dues;
  - preference shareholders; and
  - equity shareholders or partners, as the case may be.

  The liquidator shall receive or collect claims of creditors within a period of 30 days from the date of commencement of liquidation process.

  Note that the Code provides a list of assets and monies that shall be *excluded* from the liquidation estate assets such as all sums due to any workman from the provident fund, pension fund and gratuity fund.

  It should also be noted that the Code further provides for the treatment of *preferential* transactions and transactions that are *undervalued* in nature. In case of *undervalued* transactions, the adjudicating authority may declare such transactions to be void and reverse the effect of such transaction.

  Amongst other things, the Code mandates the creation of an Insolvency and Bankruptcy Fund to receive voluntary contributions from the Central Government, any person or from other sources. Any person who has contributed to the fund may in case of proceedings initiated in respect of such person withdraw funds (not exceeding the amount of contribution). However, it is unclear why any person would voluntarily contribute to the fund?

76. See Section 30(4), The Code

77. See Section 53, The Code

- **The adjudicating authority**

  The Code vests powers in the Debt Recovery Tribunal (the "**DRT**") to act as the adjudicating authority in relation to insolvency matters for individuals and firms.[78] All appeals from the DRT shall be submitted before the Debt Recovery Appellate Tribunal (the "**DRAT**").[79]

  The adjudicating authority with respect to insolvency matters of companies and limited liability entities shall be the National Company Law Tribunal (the "**NCLT**"). Appeals from any order of the NCLT shall be submitted before the National Company Law Appellate Tribunal (the "**NCLAT**").[80] An appeal from the order of the DRAT or the NCLAT may be filed before the Supreme Court of India.

- **Penalties**

  In an attempt to curb fraudulent and corrupt practices by any IPA, IP or Information Utility, in the event that they contravene any provision of the Code, a penalty equivalent to three times the loss incurred or three times the amount of unlawful gain (whichever is higher) shall be applicable.

  The Code specifies that the penalty shall not exceed INR 1 (One) Crore (approximately USD 150000). Limiting the threshold may destroy the purpose of the provision in cases where such IP, IPA or Information Utility has received an unlawful gain more than the threshold specified.[81]

  The Code also penalizes any person who has made an unlawful gain or loss with an amount equivalent to such loss or gain.[82]

  The Code further provides penalties for corporate entities that do not declare assets owned by it or, otherwise fraudulently conceal such assets. In such cases, officer of the corporate debtor shall be punished with imprisonment of up to five years, with a fine of up to INR One (1) Crore (approximately USD 150000).

  The Code also penalizes individuals for providing incorrect information. The punishment in this case will be imprisonment for a term, which may extend to one year, or with a fine, which may extend to INR Five (5) Lakhs (approximately USD 7500) or both. However, punishments may vary depending on the offences committed by individuals and officers of the company.

CONCLUSION

The Code intends to rationalize the processes and procedures for bankruptcy and insolvency, improve the recovery rates of debt and increase creditor confidence in India, and it should hopefully go some way to address the rights of lenders to enforce security in a distress situation, potentially bringing down the rate of non-performing loans.

Under the new regime, it's the creditors who will be able to kick off the process (and not the High Court or the NCLT), which is a welcome change. Unsecured creditors will get a seat on the creditors committee, getting to vote on the resolution plan on par with secured creditors.

However, much work will need to be done to make the work of IPs coherent. Why have several IPAs when one would do? Arguably, the penalties for not declaring assets are not stringent enough (and we assume that those penalties will fall under the amounts owed to government in the insolvency waterfall).

Delay in enforcement perhaps, is the biggest hurdle that the new Code faces. Currently, there are 70,000 cases before the DRT and it will be difficult to see to what extent this is going to impact the ability to take on and resolve new cases filed under the Code. Furthermore, the provisions for appeals and the lack of clarity on issues such as payments to creditors on liquidation could prove to be a setback for the effective implementation of a scheme for insolvency disputes.

With avenues for appeals and disputes, it remains to be seen to what extent IPs can essentially take *control* over distressed assets and sideline promoters of companies in default scenarios and we should watch the developing jurisprudence before the adjudicating authorities with interest.

Ultimately, the risk is that the *bark* of the new Code isn't followed through with an effective snap at the heels of the borrower and its promoters and a *bite*. In that context, it's important that the new regime successfully demonstrates teeth with a resolution in favor of creditors within a six-month time frame. It's only when lenders see an effective and efficient recycling of capital, will we see confidence returning to the debt markets and future lending at lower rates.

78. See Section 179, The Code

79. See Section 181, The Code

80. Supra Note 10

81. See Section 220, The Code

82. See Section 220(4), The Code

6. FUND INVESTMENT

6.1 FOREIGN VENTURE CAPITAL INVESTORS IN INFRASTRUCTURE AND STARTUPS

Introduction

The Reserve Bank of India (the "**RBI**") notified an amendment to the FEMA 2000 on April 28 2016 by issuing the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Third Amendment) Regulations, 2016 (the "**Amendment Regulations**").

The Amendment Regulations reflect new proposals laid out in the Start-Up India: Action Plan launched by the Government under a notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India (the "**DIPP**") on February 16, 2016 (the "**DIPP Notification**").

The Amendment Regulations essentially permit Foreign Venture Capital Investors ("**FVCIs**") to invest in the *infrastructure sector* and *startups* in any sector.

Removing limitations on investment

The Amendment Regulations substitute the existing sub-regulation (5) of Regulation 5 (Permission for Purchase of Shares by Certain Persons Resident Outside India) of FEMA 2000, with a clause that states that FVCIs registered with SEBI may make investments in the manner and subject to the terms and conditions specified in Schedule VI of FEMA 2000.

This amendment is intended to remove limitations on FVCIs being allowed to invest only in a venture capital fund (a "**VCF**") or an Indian venture capital undertaking (an "**IVCU**") and is consequential to and an attempt to harmonize the regulation with the amendments to Schedule VI of FEMA 2000.

Prior to the Amendment Regulations, under Schedule VI of FEMA 2000 an FVCI was allowed to invest in equity, equity linked instruments, debt, debt-linked instruments, debentures of an IVCU or VCF through an Initial Public Offer or Private Placement Schemes, after receiving permission from the RBI.

The new regime

The Amendment Regulations have substituted the old Schedule VI of FEMA 2000 with a new schedule (the "**New Schedule 6**").

Under the New Schedule 6, a registered FVCI may purchase:

- equity or equity linked instruments or debt instruments, issued by an Indian company engaged in any of the 10 sectors annexed to the New Schedule 6 (the "**Annexure**") and whose shares are not listed on a recognized stock exchange at the time of issue of the said securities or instruments;
- equity or equity linked instruments or debt instruments issued by a startup, irrespective of the sector in which it is engaged;
- units of a Venture Capital Fund (a "**VCF**") or of a Category I Alternative Investment Fund or units of a scheme or of a fund set up by a VCF or by a Category I Alternative Investment Fund, subject to terms and conditions as may be laid down by the RBI.

The Amendment Regulations define a "**Category I Alternative Investment Fund**", to mean:

"an Alternative Investment Fund registered under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 which raises money and invests in such funds or sectors or activities or areas in accordance with the said Regulations".

This new definition was introduced with a view to bring Category I AIF investments by FVCIs under the purview of Schedule VI of FEMA 2000.

The New Schedule 6 under the Amendment Regulations also states that FVCIs registered under the SEBI (Foreign Venture Capital Investors) Regulations, 2000, do not require any prior approval from the RBI for any investments made under Schedule VI.

Permissible sectors

It is pertinent to note that previously, the list of sectors in which an FVCI could invest was not specified in the foreign exchange regulations, but inferred from the definition of a "**venture capital undertaking**" under Section 10(23FA) of the Income Tax Act, 1961.

Expanding permissible sectors

Historically, the RBI while granting approval to an FVCI, would impose conditions that an FVCI can only invest in the nine sectors mentioned in the letter of approval issued by the RBI.

Those nine sectors were: (1) biotechnology; (2) IT relating to hardware and software development; (3) seed research and development; (4) nanotechnology; (5) research and development of new chemical entities in the pharmaceutical sector; (6) the dairy industry; (7) the poultry industry; (8) hotel-cum-convention centers with seating capacity of more than 3000; and (9) the production of bio-fuels.

The Amendment Regulations now formalizes these 9 sectors by including them in the Annexure, and adds the *infrastructure sector* as the 10th permissible sector.

The Amendment Regulations clarify that the *infrastructure sector* will include the same activities defined under '*infrastructure*' under the external commercial borrowing guidelines and policies notified under the extant FEMA regulations.

Investment in Startups

In addition to these 10 sectors, it is interesting to note that FVCIs are also allowed to invest in a startup *irrespective* of the sector it is engaged in, provided that the investee company meets the criteria laid down to qualify as a startup.

The definition of "**startup**", in the Amendment Regulations, means:

"an entity, incorporated or registered in India not prior to five years, with an annual turnover not exceeding INR 25 Crores in any preceding financial year, working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property,

Provided that such entity is not formed by splitting up, or reconstruction of a business already in existence.

For this purpose,

v. *'entity' shall mean a private limited company (as defined in the Companies Act, 2013), or a registered partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008.*

vi. *the expression 'turnover' shall have the same meaning as assigned to it under the Companies Act, 2013.*

vii. *An entity is considered to be working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property if it aims to develop and commercialize (a) a new product or service or process; or (b) a significantly improved existing product or service or process that will create or add value for customers or workflow.*

Provided that it will not include the mere act of developing (a) products or services or processes which do not have potential for commercialization; or (b) undifferentiated products or services or processes or (c) products or services or processes with no or limited incremental value for customers or workflow."

This definition resonates with the definition of '*startup*' provided in the DIPP Notification.

INDUSLAW VIEW

The inclusion of the definition of Category I Alternative Investment Fund read in conjunction with the deletion of the definition of an Indian Venture Capital Undertaking indicates a harmonisation with the introduction of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 and the repeal of the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996.

While it may be a little late in the day for this change, it is certainly a positive effort by the RBI to harmonize the regulations with the SEBI regulations.

The Amendment Regulations provide much-awaited clarity on transfer of investments by FVCIs, clarifying that an FVCI may:

- acquire securities or instruments, by way of subscription or secondary transfer, and
- transfer, by sale or otherwise, to any person resident or non-resident, any security or instrument it is allowed to invest in, at a price that is mutually acceptable to the buyer and the seller or issuer.

It is further clarified that an FVCI may receive the proceeds of any liquidation of VCFs or of Category-I Alternative Investment Funds or proceeds of schemes or funds set up by the VCFs or Category-I Alternative Investment Funds.

Further, formalizing the nine sectors for FVCI investments by bringing them into FEMA 2000 (whilst also adding a tenth one to the list) brings about much needed clarity on the sectoral limitations for FVCI investments.

Generally, the New Schedule 6 makes FVCI investments clearer. Opening up investments in startups *irrespective* of the sector and clarifying transfer options for FVCI investments are welcome measures and we would expect this to bolster new investments under the FVCI route.

The Amendment Regulations have also introduced some significant changes to the regime under FEMA 2000. Adding the *infrastructure sector* as the 10th permissible sector is certainly one of them.

In summary, the Amendment Regulations are necessary to action the Start-Up India: Action Plan. The regulator's decision to open up investments in *startups* (irrespective of the sector in which it is operating in) is a very welcome move.

This will create a more favorable environment for the growth and promotion of new and innovative startups, which should have a positive effect on the entire economy.

It is interesting to note that even though the definition of 'startup' is borrowed from the DIPP Notification, the Amendment Regulations do not mention the requirements for being recognized as a startup under the DIPP Notification.

These requirements include recommendation from an incubator established in a post-graduation college in India, or a letter of support from an incubator funded or recognized by the government, or a letter of funding of at least 20% by an incubation fund, angel fund or private equity investor, or a letter of funding by the government.

However, the DIPP Notification mentions that until a mobile app or portal is launched, the DIPP may find alternative arrangements for recognizing a startup. Therefore, we may, in course of time see further amendments to the FEMA regulations to give effect to the requirements prescribed under the DIPP Notification.

While the Amendment Regulations are a welcome move to define and acknowledge *startups* as a separate category, opening up new avenues for investments into *startups* in the current business and regulatory environment, we are not sure if the regulators have managed to create a watertight definition, free of ambiguity.

While regulators have tried to clarify the expression 'working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property' used in the definition, the tests laid down are still subjective.

For example, the criteria for what constitutes a *new product* or *service* have not been clarified and it still remains to be seen how this is read and interpreted.

The standard to determine *novelty* under applicable intellectual property laws may be a principle for such determination, however, we consider that the intention of the regulator was not to apply such strict standards in this context.

Further, *several* startups could simultaneously exploit an identical or similar new idea or product.

In such a scenario, it will be hard to distinguish which product or service is new and which is not.

Also, a *significantly improved existing product or service* may be hard to interpret in this context, and it is difficult to identify an objective test to determine what is significant and what is not.

Having said this, we do not believe there is much more the regulator could have clarified at this point in time, and we will have to wait to see how the regulations are interpreted in practice in order to assess its real practical consequence.

Finally, it is interesting to note that *startups* involved in developing products or services or processes, which do not have potential for *commercialization* have been excluded from the definition. This raises questions over the meaning of commercialization and should encourage startups to come up with a robust and detailed business plan on how they intend to commercially exploit their product or service.

Authors: Avimukt Dar, Anindya Ghosh and Aakash Dasgupta

6.2 HUBTOWN CASE – REALISTIC INTERPRETATION OF 'ASSURED RETURNS' FROM A FEMA PERSPECTIVE

Introduction

The Supreme Court, in its judgment in *IDBI Trusteeship Ltd. V. Hubtown Ltd.*[83] on November 15, 2016, has set aside the Bombay High Court's judgment (summarised below) regarding the validity of structured investments by foreign investors, where an assured return is guaranteed, holding a corporate guarantee for payments due to an investor, valid.

BRIEF FACTS

- In 2009 and 2010, Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. ("**FMO**"), a foreign investor, invested in an Indian company, Vinca Developer Pvt. Ltd. ("**Vinca**") by way of: (i) equity shares, which entitled FMO to 10% voting rights in Vinca; and (ii) compulsorily convertible debentures ("**CCDs**"), which upon conversion, would entitle FMO to 99% voting rights in Vinca.
- Vinca used these funds to invest in certain optionally partially convertible debentures ("**OPCDs**") of Amazia Developers Pvt. Ltd. ("**Amazia**") and Rubix Trading Pvt. Ltd. ("**Rubix**"). IDBI Trusteeship Pvt. Ltd. ("**IDBI**") was appointed as the debenture trustee for the issue of OPCDs by Amazia and Rubix. IDBI stated that the funds from the issue of these OPCDs would be utilized by the companies for investing in real estate projects, which were compliant with the FDI Policy.
- In order to secure the said OPCDs, and ensure due payment by Amazia and Rubix, Hubtown Ltd. ("**Hubtown**"), an entity which owns 49% voting on equity in Vinca, issued a corporate guarantee in favour of IDBI, amongst others, for the benefit of Vinca. Subsequently, both Amazia and Rubix defaulted on payments due under the OPCD trust deeds. IDBI therefore enforced the corporate guarantee and demanded payment from Hubtown with respect to the defaults. IDBI received no reply or payment from Hubtown in this regard, and so brought the matter to court.

LAWS APPLICABLE

- The foreign exchange control laws in India, through the Foreign Exchange Management Act, 1999 ("**FEMA**") and the regulations thereunder, along with the Foreign Direct Investment Policy ("**FDI Policy**") in India, set out the instruments by which a foreign entity can invest in India, the kind of entities that can invest and receive investment, the caps applicable to certain sectors, and the modes and procedures relating to investment into the equity of an Indian entity.

83. Supreme Court, Civil Appeal No. 10860 of 2016.

- The FDI Policy permits foreign direct investment into Indian entities only by way of equity instruments, or any instruments that are compulsorily convertible into equity. Investments that are *optionally convertible* into equity are not considered as FDI, and investments on the basis of fixed or assured returns, are not permitted. Further, FDI is not permitted in real estate sector, but it is allowed in projects related to townships, construction of houses, roads, bridges and other related infrastructure assets.
- Under Order XXXVII Rule 3 of the Code of Civil Procedure, 1908 (the "**CPC**"), the conditions and principles governing leave to defend a summary suit are laid down. A landmark case regarding Order XXXVII Rule 3 of the CPC, as it stood prior to its amendment, was the Supreme Court's judgment in *Mechelec Engineers and Manufacturers v. Basic Equipment Corporation*[84] ("**Mechelec's case**"). After this provision in the CPC was amended, the Supreme Court's verdict in *Milkhiram (India) Private Ltd. v. Chamanlal Brothers*[85] ("**Milkhiram's case**"), governed the interpretation of Order XXXVII Rule 3.

HIGH COURT'S JUDGMENT

Hubtown argued that FMO had knowingly devised this structure of investment to circumvent the FDI Policy, by routing funds downstream to Amazia and Rubix, after the primary investment in Vinca, which was the holding company for both Amazia and Rubix. Upon conversion of FMO's CCDs into Vinca's equity, FMO would receive certain fixed returns from the OPCD investment in Amazia and Rubix, when the payments were received by Vinca.

Hubtown argued that if the corporate guarantee were actually enforced, an illegal, impermissible investment structure would be effectuated. The Bombay High Court *prima facie* agreed with Hubtown, that the entire structure had been devised by FMO to bypass the FDI Policy, and was a colourable, illegal transaction, which could not be effected by enforcing Hubtown's corporate guarantee. The Bombay High Court granted Hubtown unconditional leave to defend the suit. IDBI challenged this judgment of the Bombay High Court in the Supreme Court.

SUPREME COURT'S JUDGMENT

The Supreme Court, ruling in IDBI's favour, held that Hubtown will be granted leave to defend the suit only upon (a) depositing the principal sum invested by FMO (amounting to INR 418 Crores) with the Bombay High Court; *or* (b) providing security for the said principal sum, within 3 months of the date of the Court's decision. It further directed the expeditious trial of the suit at the Bombay High Court (preferably within the period of a year from the date of its judgment).

The Court's observations and conclusions in this case are summarised below:

- **Alleged violation of FEMA**

  The Supreme Court remarked that FMO's investment in the shares and CCDs issued by Vinca would by itself not violate FEMA regulations. This view of the Supreme Court appears to be driven by the fact that the suit has been filed only for the invocation of Hubtown's corporate guarantee, at which stage there is no infraction of the foreign exchange laws of India (considering that the debenture trustee as well as the party on behalf of whom the payment is being made are both Indian companies). Further, the Supreme Court opined that it would not constitute a breach of FEMA regulations if FMO utilised the funds received pursuant to the overall structure agreements in India, upon conversion of the CCDs held by it in Vinca after the requisite time period.

- **Position of law on Summary Procedure**

  The Supreme Court observed that the law, as it stands now, vests the discretion to refuse or grant the leave to defend under Order XXXVII of the CPC with the trial judge. In light of the amendment of Order XXXVII Rule 3, as well as the binding decision in Milkhiram's case, the Court laid down certain general principles in this regard (while superseding the principles stated in Mechelec's case). The principle most pertinent to this case was of Hubtown having raised a 'plausible but improbable' defence, and the Court thereafter imposed the deposit and security condition on Hubtown based on this defence.t constitute a breach of FEMA regulations if FMO utilised the funds received pursuant to the overall structure agreements in India, upon conversion of the CCDs held by it in Vinca after the requisite time period.

INDUSLAW VIEW

The decision of the Bombay High Court in this matter had previously created an element of uncertainty in the minds of foreign investors, since it appeared that guarantors could drag foreign investors to court, and deny the enforceability of their obligations under guarantees by alleging FEMA violations. There was also a feeling that FEMA provisions would now be liberally and holistically interpreted by the courts and not just the regulators.

However, the Supreme Court has given welcome guidance that if and when the monies are repatriated it is up to the RBI as the primary regulator to decide whether there was any violation of FEMA regulations and the court could not lightly take an 'indirect' approach to a contract that on the face of it did not involve a non-resident party and was therefore outside the ambit of FEMA. While avoiding a decision on merits, and leaving that to the trial court, the Supreme Court appears to have, *prima facie*, affirmed the structure in order to ensure that grounds of public policy do not facilitate injustice. This approach towards enforceability of rights is reassuring for foreign investors and their investees undertaking downstream transactions.

Authors: Avimukt Dar, Stuti Agarwal and Nikita Rajwade

84. 1977 SCR (1)1060

85. AIR 1965 SC 1698

7. INTELLECTUAL PROPERTY

7.1 THE NATIONAL INTELLECTUAL PROPERTY RIGHTS POLICY

Introduction

The Union Cabinet has approved the new National Intellectual Property Rights Policy (the "**Policy**") on 13th May 2016.[86]

The Policy is a visionary document, aiming to create awareness of intellectual property rights ("**IPR**") in general and promote the creation, commercialization, protection and enforcement of IPR in India.

The Policy further aims to promote entrepreneurship and enhance access to healthcare, food security and environment protection amongst other sectors of social, economic and technological importance.

Objectives

The Policy lays down the following 7 (seven) objectives through detailed action plans.

IPR awareness

The Policy aims to start a nation-wide program under the slogan 'Creative India, Innovative India' to create awareness about IPRs and its benefits, focusing specially on the rural areas where most people are ignorant about their rights and benefits.

Amongst other things, it seeks to create such awareness in not only rural areas, but also specific industries (both public and private).

It also recommends inculcating IPR education in the curriculums of different educational institutions, right from the basic school level at an appropriate stage.

Generation of IPRs

The Policy recommends conducting a baseline intellectual property ("**IP**") audit across sectors to assess the potential of IPR protection and accordingly formulate programmes to develop them further.

It recommends devising mechanisms to ensure that IPRs reach medium and small enterprises, start-ups and grass-root innovators.

The Policy promotes research and development ("**R&D**") through tax benefits available under various laws, the infusion of funds from corporates to public R&D units as a part of Corporate Social Responsibility and aims to expand the ambit of the Traditional Knowledge Digital Library (the "**TKDL**") so as to allow public research institutions as well as private parties to use TKDL for further R&D.

Legal and Legislative Framework

The Policy, while acknowledging that the current legal and legislative framework is compliant with international standards, accepts that there is room for much improvement. The Policy seeks to review and amend, update or improve existing IP laws necessary in an ever-changing technological environment and recommend constructive negotiation of international treaties, in consultation with stakeholders, to improve the IPR regime.

It recommends participating in deliberations to develop legally binding international instruments to protect Traditional Knowledge, Genetic Resources and Traditional Cultural Expressions.

It also seeks to amend the Indian Cinematography Act, 1952 to provide for penal provisions for illegal duplication of films and to combat piracy in the entertainment sector.

Administration and Management

The Policy proposes increased interaction between various IP Offices in order to facilitate more effective administration.

In this context, it should be noted that the Department of Industrial Policy and Promotion (the "**DIPP**") is allotted the charge of administration of the Copyright Act, 1957 and the Semiconductor Integrated Circuits Layout-Design Act, 2000, which were earlier under the jurisdiction of the Department of Education and the Department of Electronics and Information Technology respectively.

The Policy also makes a recommendation to the IP Offices to continue with their structuring, digitization and modernization processes taking into account the rapid growth and diversity of IP users and services, higher responsibilities and increased workload.

Commercialization of IPR

The Policy recognizes the need of IPR commercialization by its owners in order to leverage financial value out of the IPR.

It encourages entrepreneurship and makes a recommendation for organizing a public platform to connect creators and innovators with investors, buyers and potential users.

It promotes licensing, technology transfers, patent pooling, IP valuation as well as use of free and open source software for maximum commercialization.

Enforcement and Adjudication

In addition to educate the general public about the importance of IPR, the Policy acknowledges the need for an efficient adjudication mechanism to prevent misuse or abuse. It sets out the objective of building capacity of enforcement agencies at various levels, including:

- creating IPR Cells in State Police Forces;
- organizing IPR workshops for judges, so that they effectively adjudicate IP disputes;
- affording jurisdiction to the Competition Commission of India in matters relating to licensing practices that may have an adverse effect on competition;

86. See the following link for the full text http://dipp.gov.in/English/Schemes/Intellectual_Property_Rights/National_IPR_Policy_12.05.2016.pdf

- setting up of specialized commercial courts for adjudicating IP disputes; and
- adopting alternative dispute resolution mechanism for resolving IP disputes.

Human Capital Development

The Policy aims to develop a pool of IP experts and professionals in policy and law, strategy development, administration and enforcement for realizing the full potential of IP for economic growth.

Some key measures proposed by the Policy are the strengthening of existing and the creation of new IPR cells and technology development and managements units and the formulation of institutional IP policies in educational institutions.

Operational changes in the current IP structure

Present IP structure

Currently, IPR in India is governed by a range of legislation, including the Patents Act, 1970; the Trade Marks Act 1999; the Designs Act, 2000; the Geographical Indications of Goods (Registration and Protection) Act, 1999; the Copyright Act, 1957; the Protection of Plant Varieties and Farmers' Rights Act, 2001; the Semiconductor Integrated Circuits Layout-Design Act, 2000 and the Biological Diversity Act, 2002.

The practice and procedures under the above statutes are administered by the following government organizations:

- The DIPP under the Ministry of Commerce and Industry administers the practice and procedures for patents, trademarks, designs and geographical indications;
- The Ministry of Human Resource Development administers copyrights;
- The Department of Information Technology, Ministry of Communications and IT, manages rights and registration relating to semiconductor integrated circuits and layout designs;
- The Ministry of Agriculture manages the protection of new plant varieties and farmers' rights; and
- The Ministry of Environment and Forests is entrusted with regulating the preservation of biological diversity.

Policy Recommendations

The Policy makes the DIPP a nodal point[87] to *"coordinate, guide and oversee implementation and future development of IPRs in India*".

However, it clarifies that the responsibility for actual implementation of the plans of action remains with the Ministries and Departments concerned with their existing assigned sphere of work.

It aims to re-designate the institution of the Controller General of Patents, Designs and Trademarks ("**CGPDTM**") as the Controller General of Intellectual Property Rights.

The Policy also aims to set up a Cell for IPR Promotion and Management under the aegis of DIPP to *"facilitate promotion, creation and commercialization of IP assets*".

The Policy also brings the administration of the Copyright Act, 1957 (earlier under the Department of Higher Education) and the Semiconductor Integrated Circuits Layout Design Act, 2000 (earlier under the Department of Electronics and Information Technology) under the jurisdiction of the DIPP.

INDUSLAW VIEW

The Policy, in spirit, aims to keep up with the changing trends and requirements of contemporary global economy and innovation in technology.

The Policy, as a guideline, promotes creation, awareness and enforcement of IP at various levels; though in our view, the Policy should have focused more on tangible actions to protect IPR through efficient registration mechanisms and a time bound dispute resolution processes, which are essential if India is going to become a magnet for global capital to invest in R&D.

While the Policy is also influenced by the US push for having a better and stronger IP regime in India, it does particularly mention that India has to remain compliant with the Agreement on Trade Related Aspects of Intellectual Property Rights.

The Policy appears to diplomatically balance the interests of all stakeholders, including multi-nationals on one hand and Indian pharmaceutical companies on the other.

However, it contains no detail on concrete strategies to direct and make more efficient the practice and procedures followed by the IP Offices. This appears to be left to the responsible Ministries and respective Departments, who are required to implement the visions listed under the Policy by way of rules, regulations and further amendments to the existing IP laws.

The Policy may also have missed a great opportunity to lay down some policy level changes in the substantive law. For example, certain suggestions made by the IPR Think Tank (initially appointed for formulating the IPR Policy) included introducing a law on utility models for 'small inventions', making a law for the protection of trade secrets, creating a new system for protection of traditional knowledge and providing 'first-time patent' fee waiver and support to micro, small and medium enterprises. Substantive suggestions like these would have set out certain binding actions for the Ministries and respective Departments to incorporate new rules and regulations for the promotion and protection of IP Rights. Unfortunately, the Policy does not cover these aspects.

The approaches proposed under the Policy may be difficult to implement forthwith at all levels due to the nature of such amendments and also due to the current lack of infrastructure and resources available to each IP Office. Whether the Policy will result in meaningful change on the ground remains to be seen.

Authors: Suneeth Katarki, Aditi Verma Thakur and Trisha Raychaudhuri

87. Elaborated in Objective no. 4 of the Policy

7.2 COPYING EDUCATIONAL MATERIALS IN THE COURSE OF INSTRUCTION DOES NOT AMOUNT TO INFRINGEMENT

Introduction

In its recent judgment, the Delhi High Court has held that the compilation of photocopies of various copyrighted material used *"in the course of instruction"* by teachers and educational institutions, does not amount to an infringement of copyright.[88]

The Court, while dismissing the suit, held that compilation of photocopies or the act of photocopying course material is an integral part of any education and to hold the same to be an infringement would be tantamount to interpreting the law resulting in the regression of the evolvement of human beings for the better.

BACKGROUND

The suit was filed by five foreign publication houses, namely Oxford University Press, Cambridge University Press, United Kingdom, Cambridge University Press India Pvt. Ltd., Taylor & Francis Group, U.K. and Taylor & Francis Books India Pvt. Ltd., (together, the "**Plaintiffs**") in 2012 against Rameshwari Photocopy Services ("**Defendant No. 1**") and the University of Delhi ("**Defendant No. 2**").

Defendant No. 1, ran a photocopy kiosk operating in the premises of Defendant No. 2, assisting students to make and share copies of resource books and references included as part of course curricula.

A permanent injunction was sought for restraining the Defendants from infringing the copyright of the Plaintiffs in their publications by photocopying, reproducing and distributing copies of substantial portions of the Plaintiffs' publications and circulating the same by compiling them into course packs.

By an interim order passed in October 2012, Defendant No. 1 was restrained from making and selling course packs and re-producing the publications of the Plaintiffs (or substantial portions thereof) by compiling the same either in book form or in a course pack, until the final disposal of the application for interim relief.

While the Plaintiffs claimed copyright infringement by the Defendants, the Defendants claimed that the same was a "*fair use*" of the works within the meaning of Section 52 (1)(i) of the Copyright Act, 1957 ("**Act**").

The Defendants contented that the practice of photocopying itself was practised in all universities in the world for use in research and for use in the classroom by students and by teachers and that the same were recognised by the Act.

It is pertinent to note that essentially, the principle of "*fair use*" provides for reasonable or fair copying of copyrighted content for certain purposes, without acquiring permission from the copyright owner.

Section 52 of the Act provides a list of "*fair use*" exceptional acts in India. Such limited copying does not amount to copyright infringement under the Act. Copying for educational use is one of the fair uses for which copying is allowed.

ISSUES

The main issues in the suit were as follows:

- Whether the making of course packs by the Defendants amounted to the infringement of the Plaintiffs' copyright under Section 51 of the Act ("**Issue 1**");
- Whether the making of course packs by the Defendants fall under Section 52 or any of its provisions and exceptions ("**Issue 2**");
- Whether the action of Defendant No. 2 in allowing Defendant No. 1 to make photocopies and to supply photocopies to students by granting it a license to do so, would be tantamount to infringement by Defendant No.1 or Defendant No.2 ("**Issue 3**"); and
- Whether there is a contravention of the Berne Convention and TRIPS Agreement in permitting the Defendants to continue with the act of making and distributing copies of the Plaintiffs' copyrighted works ("**Issue 4**").

JUDGMENT

The Court, deciding in the Defendants' favour, dismissed the suit and held that the acts of the Defendants did not amount to infringement of the Plaintiffs' copyright. The Court's observations and conclusion on each of the above issues are summarized as follows:

- **Issue 1**

  In deciding the first issue, the Court held that the making of course packs by Defendant Nos. 1 and 2 did not amount to an infringement of the Plaintiffs' copyright.

  The Hon'ble Court discussed in detail the interpretation of the provisions under Sections 2(m), 14, 16, 51 (a) and 52 of the Act as well as the object behind the same.

  The Court noted that Section 51(a)(i)[89] does not have the element of commercial or monetary gain to the infringer, when he does the infringing act in relation to a copyrighted work. The Court also observed that unless an act of infringement is specifically

88. Judgment: The Chancellor, Masters & Scholars of the University of Oxford & Ors. Versus Rameshwari Photocopy Services & Anr. Ref: CS(OS) 2439/2012, I.As. No. 14632/2012 (of the plaintiffs u/O 39R-1&2 CPC), 430/2013 (of D-2 u/O 39 R-4 CPC) & 3455/2013 (ofD-3 u/O 39 R-4 CPC).

89. Section 51: Copyright in a work shall be deemed to be infringed- (a) when any person, without a licence granted by the owner of the copyright or the Registrar of Copyrights under this Act or in contravention of the conditions of a licence so granted or of any condition imposed by a competent authority under this Act-

(i) does anything, the exclusive right to do which is by this Act conferred upon the owner of the copyright

90. Section 52 (1) The following acts shall not constitute an infringement of copyright, namely:

(i) the reproduction of any work—

(i) by a teacher or a pupil in the course of instruction; or

(ii) as part of the questions to be answered in an examination; or

(iii) in answers to such questions;

listed in Section 52, it would not be considered an exception to infringement on the basis of its "*fair use*" aspect.

Having said that, the Court did provide a liberal interpretation of the Act and took a view that a balance is required to be maintained between the owner of the copyright in protecting its works on the one hand and the interest of the public to have access to such works on the other hand.

- **Issue 2**

The Court, while deciding the second issue, discussed in length Section 52 and the applicability of various listed exceptions to copyright infringement under the same.

In particular, it noted that Section 52(1)(a) provides for a general exception to copyright infringement and therefore, ruled that the same will not be applicable in the present scenario. This was for the reason that there are specific clauses, namely, Sections 51(1)(h), (i) and (j), covering acts in relation to education. The Court specifically pointed out that clause (h) is specifically in relation to '*non-copyright subjects*', and therefore, held that the same will not be applicable to the matter as well. Nobody argued that clause (j) will be applicable as it is specifically in relation to '*performance*' of a copyright subject.

The Court further observed that copyrighted works used by teachers in educational institutions *"in the course of instruction"* would include reproduction of any copyrighted work, and the same will be an exception to copyright infringement under Section 52(1)(i)[90].

Widely interpreting the word *'teacher'* in the clause, the Court reasoned that Defendant no. 2 was reproducing the copyrighted works on behalf of its teachers and hence, held that the clause covered the present case.

In this regard, reliance was also placed on *Longman Group Ltd. vs. Carrington Technical Institute Board of Governor* (1991) 2 NZLR 574 wherein, it was held that in its ordinary meaning the words, "*course of instruction*" would include anything in the process of instruction and that so long as the copying forms part of and arises out of the course of instruction, it would include preparation of material to be used in the course of instruction. Once reproduction (photocopy) is expressly permitted under Section 52, no limitation should be placed thereon.

The Court also commented that the law must change with the times and in this day and age when students have access to modern technology such as camera phones and photocopying machines, they should not be deprived of the same.

Further, if the libraries of universities issued books to students who would thereafter photocopy the relevant portions themselves, either by hand or by taking photocopies, such an act would not constitute infringement, coming well within the purview of fair use.

Therefore, by using the same analogy, the acts of the Defendants in making such photocopies available to its students, owing to the limited number of books, the price of the same and the possible damage to such books due to repeated photocopying by students, could not be held to be an infringement.

Relying on the judgment in, *The Williams & Wilkins Company vs. The United States* 487 F.2d 1345 (Ct.Cl. 1973), the Court said:

"when the effect of the action is the same, the difference in the mode of action cannot make a difference so as to make one an offence".

The Court, hence, held that the action of the Defendant No. 2 making a master photocopy and distributing the same to the students would not constitute infringement of copyright in the said books under the Act.

- **Issue 3**

The Court held that the acts of Defendant No. 1 in compiling such course packs and supplying the same for a charge did not amount to infringement. The Court further drew parallels with the Bar Association library within the premises of the Court where Advocates, instead of carrying voluminous books from their residence and offices to the Courts, would simply have the relevant portions photocopied from the books in the library.

Initially the same was done by advocates issuing the book from the library and taking it to the photocopier outside of the court premises. However, for the convenience of advocates and with a view to avoid books being taken out of the library, the photocopier was granted a license to operate within the court premises.

The Court held that "*merely because the photocopying is done by the person desirous thereof himself but with the assistance of another human being, would not make the act offending.*"

Additionally, it cannot be said that Defendant No. 1 was working commercially as the price per page was 75 paise which included operating costs incurred by the Defendant No. 1 and was in no way a price which competed with the price fixed by the Plaintiffs.

- **Issue 4**

The Court, keeping in mind the object of the Berne Convention and TRIPS Agreement, ruled that India, under various international covenants had the freedom to legislate to what extent the utilization of the copyrighted works for teaching purposes was permitted, stressing that the act of copying was "*justified by the purpose*" and did not "*unreasonably prejudice the legitimate rights of the author*".

In this context it should be noted that Indian legislation is enacted, keeping in mind such international covenants. Therefore, if Indian legislation, in the present factual context, had not imposed any such limitation, the Court could not impose such limitations on its own accord. The Court was also of the opinion that the Copyright Act of India could not be judged on the bedrock of Copyright Acts of other countries as the context and social backgrounds were different.

INDUSLAW VIEW

The judgment passed by the Delhi High Court could have far reaching consequences: it essentially prioritizes a social objective ahead of foreign right holders, on the assumption that "*fair use*" can be demonstrated.

The Court has shown its reluctance in taking a strict view of the Act, allowing the "*fair use*" exception in support of the photocopier and the university, and considered their actions to be reasonable and proportionate in the context of educational use.

By doing this, the Court has tried to draw a balance between the rights of intellectual property holders and the public interest in the interest of dissemination of information and imparting education.

This judgment and approach of the Court is a welcome for educational institutions in India at large. An appeal has been preferred against the said judgment before a Division Bench of the Delhi High Court and now, it remains to be seen if the appellate court will find more value in the social objective involved in the case or in the rights of the copyright owners.

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8. INTERNATIONAL LAW

8.1 BITS & PIECES: INDIA'S BILATERAL INVESTMENT TREATY REVISITED

Introduction

Back in March 2015 the Government of India released a draft model bilateral investment treaty (the "**Draft BIT**") for public consultation and comments, which we analyzed in our earlier article in May 2015.[91]

Since then, the Law Commission of India submitted a report analyzing the Draft BIT and suggested changes (the "**Report**"). Taking into account the Report and comments from other stakeholders, the Government of India amended the Draft BIT and published its finalized bilateral investment treaty in January 2016 (the "**Model BIT**").

The Model BIT is intended to replace existing bilateral investment treaties and this article highlights to what extent the Report and other comments from stakeholders have been incorporated into the Model BIT.

Bilateral Investment Treaties

Bilateral investment treaties are agreements between states that essentially give foreign investors rights against the host state in the event that a change in law or other measures essentially devalue or expropriate the investment made. As of December 2013, India had signed 83 bilateral investment treaties, of which, 72 were in force.[92]

Recent BIT Jurisprudence

There has been no shortage of cases filed against the Government of India.

In November 2011, an arbitration tribunal in the case of *White Industries v Republic of India* held India liable for failing to ensure its treaty obligation to provide "effective means of asserting claims and enforcing rights" pursuant to Article 4(2) of the India-Australia BIT read in conjunction with Article 4(5) of the India-Kuwait BIT.

The tribunal held that the delay in enforcing an award in favor of White Industries against Coal India was a denial of the effective means to enforce its rights relating to an investment and awarded White Industries the sum of just over USD 4 million (with interest).

In 2012, Vodafone B.V. invoked the India-Netherlands Bilateral Investment Treaty claiming that India's Direct Tax Bill, which sought to retrospectively tax its 2007 acquisition of Hutch Telecom, was a failure to accord '*fair and equitable*' treatment, notwithstanding India's Supreme Court ruling in favor of Vodafone over its tax dispute with the Government of India.

Norwegian firm Telenor and Russian firm Sistema have also filed notices under respective bilateral treaties following the cancellation of 122 telecommunications licenses for 2G Spectrum by India's Supreme Court, which effectively expropriated their investments.

In March 2012, the Children's Investment Fund ("**CIF**") filed a notice of dispute, invoking the India-UK and the India-Cyprus Bilateral Investment Treaties. CIF had invested in Coal India and alleged that its sale of assets below market value on the directive of the Government of India was essentially a devaluation of its shares.

More recently, in March 2015, Cairn Energy filed a notice under the India-UK Bilateral Investment Treaty in relation to a USD 1.6 billion tax claim brought in context of a group re-structuring that Cairn submit triggered no transfer of value or taxable event in India.[93]

The Draft BIT and the Report

Faced with a rising spike of claims against it, the Government of India rolled out the Draft BIT that raised eyebrows for several reasons. The Report, in particular, pointed out several deficiencies with the draft.

Essentially, the Report concluded that the Draft BIT needed to be more investor friendly. Having restrictive clauses in the BIT would deter foreign investors from investing in India and also adversely affect Indian investors abroad.

The Report suggested a change to the definition of "**Investment**" concluding that "*real and substantial business*" and the list of elements that constitute such business was unnecessary and could be used to narrowly interpret the definition.

Even the provision defining *"control*" was viewed as interfering at the very root of corporate freedom and potential investors could be uncomfortable with such a clause. The Law Commission took the view that a general reference to ownership and control in good faith would suffice.

The Law Commission also noted that *"owned*" which was defined to be owning more than 50 per cent of the capital or funds or contribution into the company, conflict with existing capital requirements under India's foreign investment policy, where foreign investment of less than 50 per cent would automatically be excluded from the protection of the treaty.

Crucially, it suggested that government procurement be included in the treaty protection because foreign investors often enter a country through the government procurement process, for example, through infrastructure projects. Excluding government procurement from the treaty protection would lead to the exclusion of many activities contributing substantially to the Host State's development.

The Report also concluded that there was room for improvement to provide more adequate protection to investors, the absence of which could possibly disincentivise foreign investors from investing in India. However, on the controversial issue of taxation, the Report suggested that it was not necessary to include taxation within the purview of the treaty, as the power to tax is an integral part of the state's prerogative, which is well recognized in international law.

91. http://www.mondaq.com/india/x/405104/Government+Contracts+Procurement+PPP/BITS+And+Pieces+Reassembling+Indias+Bilateral+Investment+Treaty

92. http://finmin.nic.in/bipa/bipa_index.asp?pageid=1

93. http://www.cairnenergy.com/assets/files/cms/indian_tax_dispute_investor_conference_call_transcript.pdf

The Draft BIT asserted the supremacy of the Host State in determining whether or not any conduct on its part is a subject matter of taxation and therefore excluded it from the scope of the treaty. The power of a state to tax anyway exists independent of a treaty, unless the tax itself is arbitrary and blatantly discriminatory.

Further, the Draft BIT imposed specific transparency obligations on Investors. The Report suggested that the Host State should be equally required to make information publicly available, including information relating to laws and regulations, administrative procedures, rulings, judicial decisions, and international agreements, as well as draft or proposed rules.

The Report also suggested that the Draft BIT should also incorporate a '*denial of benefit*' clause where investors could be denied protection benefits in case of corruption and involvement in illegal activities. However, this could lead to minor non-compliance having the disproportionate effect of denying the Investor the benefit of the treaty.

Following public consultation and stakeholder feedback, many changes have been made to the Draft BIT, giving the Model BIT a more investor friendly approach.

Preamble

The pro-investment approach of the Model BIT begins with the preamble itself. This is in contrast to the earlier Draft BIT whose preamble included only *"promotion*" as an objective. The Model BIT now incorporates *"promotion*" and "*protection*" of the investment as its objective, which will be viewed favorably by investors, as protection of the investment is as important as the promotion of it.

Investment

The key change made to the Draft BIT is the definition of Investment itself. The narrow definition in the earlier Draft BIT has given way to broader based definition, which is a welcome change.

The Model BIT defines "**Investment**" to mean an enterprise, constituted, organized and operated in good faith by an investor in accordance with the law of the Party who's territory the investment is made, taken together with the assets of the enterprise, has the characteristics of an investment, such as the commitment of capital or other resources, certain duration, the expectation of gain or profit, the assumption of risk and a significance for the development of the Party in whose territory is made.

It should be noted that the deletion of the earlier requirement in the Draft BIT of having a long term commitment of capital in the Host State, engaging substantial numbers of employees reduces the scope for subjective interpretation and thereby makes the definition more pro-investment.

The definition also drops the requirement for the enterprise to have "*real and substantial business operations*" in the territory of the Host State, something that raised objections on the basis of its subjective interpretation.

In a further concession to Investors, the definition now explicitly includes: (a) shares, stocks and other forms of equity instruments of the enterprise or in another enterprise; (b), debt instrument or securities of another enterprise; (c) a loan to another enterprise wherein the enterprise is an affiliate of the investor or where the original maturity of the loan is at least 3 years; (d) licenses, permits, authorizations or similar rights (e) rights conferred by contracts of a long term nature such as for cultivating, extracting and exploiting natural resources; (f) copyrights, know-how and intellectual property rights such as patents, trademarks, industrial designs and trade names; (g) movable or immovable property related rights; and (h) any other interest involving substantial economic activity deriving significant financial value.

This is a welcome change and in particular, (d) and (e) should give Investors investing in large infrastructure or natural resource projects a degree of confidence against any termination of a concession agreement or license by the Host State pursuant to a change in law, or otherwise, through alleged impropriety.

It should be noted in this context that historically, a substantial number of licenses granted to foreign joint ventures to operate mobile telecommunications services or to Indian companies to extract coal were cancelled on the grounds of alleged corruption in their procurement. With the inclusion of (d) and (e) into the definition, such allegations would at the very least, be justiciable, and therefore reduce the risk of arbitrary cancellation or termination.

However, the Model BIT still specifies what an Investment *excludes* and debt securities issued by a government or a government-owned or controlled enterprise, or loans to a government or government-owned or controlled enterprise still remain outside of the definition of Investment.

In our view, this remains problematic since any foreign lending to public sector undertakings or subscription for securities, would remain outside of the scope of the treaty. Foreign portfolio investment continues to remain outside of the definition of Investment.

Finally, it should be noted that the exclusion of *goodwill* and similar *intangible rights* may be a cause for concern for investors as such rights are normally incidental to the rights included in the definition such as intellectual property rights.

Scope

Article 2 of the Model BIT maps out its scope and general provisions. It states that the treaty applies to Investments in existence on the date of entry into force of the treaty and nothing in the treaty shall apply to either party in respect of any measure of law that existed before the date of entry into force of the treaty.

The treaty does not apply to any measure taken by local government (which is defined to be local councils and should not be confused with State governments), any law or measure relating to taxation, pre-investment activity relating to the establishment of the Investment

(which could be substantial in major infrastructure or energy and natural resource projects), government procurement or services supplied by a governmental authority other than on a commercial basis.

In our view, excluding government procurement will likely impact the confidence of investment into the defense sector (a central plank of the Make in India campaign)[94] and cancellation of procurement will likely mean that foreign defense companies will be unable to resort to the treaty to counter claim against any cancellation or termination by the Government of India. It should be noted in this context that in 2014, the Government of India cancelled a contract for the supply of 12 Augusta Westland helicopters with *Finmeccanica*, on allegations of corruption.

The exclusion of taxation matters is controversial. Following the invocation by Vodafone and Cairn Energy of their home state's respective bilateral investment treaties with India, it is clear that the intention is to make taxation measures exempt from the scope of the treaty.

The Model BIT clearly states that where the Host State asserts (in its own discretion) that the subject matter of the dispute relates to taxation, any decision of the Host State shall be non-justiciable and excluded from the scope of the treaty.[95] This effectively means that any retrospective taxation ruling taken in accordance with Indian law would be binding on the Investor. If it effectively expropriates the value of the Investment, the Investor will be unable to seek compensation from the Government of India through international arbitration.

This basically limits taxation related matters to the scope and ambit of Double Taxation Avoidance Agreements, and their future scope and ambit will become increasingly important.

Clearly, a disproportionate tax dispute, determined solely by the Host State, could amount to an effective expropriation of the Investment and its continued omission from the Model BIT will continue to cause Investor concern.

Standard of treatment

It is customary under bilateral investment treaties for the host state to ensure that investors receive fair and equitable treatment and are provided full protection and security on terms no less favorable than those offered to other investors and entities of the home state.[96]

Article 3.1 of the Model BIT protects Investments from measures which constitute a violation of customary international law through: (i) the denial of justice in judicial proceedings; (ii) the fundamental breach of due process; (iii) targeted discrimination on manifestly unjust grounds (such as gender, race or religious belief); or (iv) manifestly abusive treatment, such as coercion, duress and harassment.

The corresponding provision in the Draft BIT referred to measures that constituted un-remedied violations of due process or manifestly abusive and outrageous treatment, involving continuous and unjustified coercion.

Arguably, the revised provision is more beneficial to Investors since it sets out more grounds for challenging a measure, though it remains an open question as to whether those four grounds are the only possible causes of a violation of customary international law.

It should also be noted that Article 3.2 of the Model BIT now provides for *"full protection and security"* to investors with respect to their investments. However, the definition limits the scope of such security to *"physical security of investors and to the investments made by the investors of the other party and not to any other obligation whatsoever."*

This narrows existing jurisprudence on the interpretation of the standard provision. Tribunals in various investor state disputes have generally opined that full protection and security implies a broad scope and that a safe and secure environment should be rightfully extended to investors.

By defining and limiting the scope of this provision to *"physical security"*, in our view, such protection is limited (excluding *legal* security and damage to *intangible* assets and goodwill) and falls short of *full* protection and security provided under customary International Law.

National Treatment

It is customary for bilateral investment treaties to guarantee foreign investors the same treatment that the host state affords its own entities. The Model BIT provides that each Party would not apply measures to Investments that are less favorable in like circumstances to domestic investments with respect to the management, conduct, operation, sale or other disposition of investments in its territory.[97]

Under the Draft BIT, this provision was limited to those measures taken by the Union Government, effectively excluding measures taken by State Governments. The Model BIT however, now includes measures taken by State Governments (though not local councils) within the purview of this provision.

It should be noted that in this context, State Governments within India (being a quasi-federal state) have the power to make decisions independent of the Union Government that could impact the Investor and the Investment. Why, however, the decisions taken by local councils should be excluded from the treaty is not clear.

Limiting the scope of this provision to decisions by the Union Government would have otherwise posed a challenge with respect to investments made at state level and the decisions of State Governments. Therefore including actions of State Governments within the scope of the treaty should provide greater confidence to Investors.

94. http://www.makeinindia.com/sector/defence-manufacturing/

95. See Article 2.4(ii)

96. Based upon the Calvo Doctrine under Public International Law

97. See Article 4.1

Expropriation

Article 5 of the Model BIT deals with expropriation of the Investment and the consequences thereof. Of note, it is recognized that expropriation may be *direct* or *indirect* and further, that indirect expropriation may occur if a measure, or a series of measures, has an effect equivalent to direct expropriation, substantially or permanently depriving the investor of fundamental attributes of its investment (without formal transfer or seizure).

However, it should be noted that the *sole* fact that a measure or series of measures have an adverse effect on the value of the investment does not in *itself* establish that an indirect expropriation has occurred.[98]

Normally, following an expropriation, the customary international legal remedy is to provide *adequate, prompt* and *effective* compensation. This has been modified in the Model BIT and the Host State need only provide *adequate* compensation that is:

"at least equivalent to the fair market value of the expropriated investment on the day before the expropriation takes place". [99]

The provision goes on to benchmark the valuation criteria to include asset value, (including declared tax value of tangible property) and other appropriate criteria to determine fair market value.

Of concern however, is the exclusion of non-discriminatory regulatory measures or awards by judicial bodies that are designed and applied to protect legitimate public interest or public purpose objectives such as public health, safety and environment.[100] Jurisprudence by international tribunals on what constitutes a *legitimate public interest or public purpose* is therefore of crucial importance to investors.

In summary, expropriation, *per se*, is not necessarily catastrophic, as long as the Investor is adequately, promptly and effectively compensated for its loss. While the Model BIT provides a benchmark against fair market value, it is an improvement on the terms of the Draft BIT that set out a number of mitigating factors that could operate to reduce the value of the compensation.

Interestingly, under Article 7 of the Model BIT (which was not included in the Draft BIT), the Host State shall accord to Investors and Investments, non-discriminatory treatment with respect to measures, including *"restitution, indemnification, compensation or other settlement, it adopts or maintains relating to losses suffered by investments in its territory owing to war or other armed conflict, civil strife, state of national emergency or a natural disaster".*

Subrogation

Article 8 of the Model BIT provides for the subrogation of rights to a State or its agency if they have paid the Investor under a guarantee or a contract of insurance in respect of the Investment.

This provision was absent from the Draft BIT and foresees the Home State compensating the Investor against the acts of the Host State and then claiming against the Host State.

Impliedly, this allows Investors to shift the burden of the claim to its Home State. Further, this may be viewed in a positive light by not only foreign investors but also Indian investors making investments abroad, in the event that the Government of India underwrites the Indian investor.

Transparency

Article 10 of the Model BIT is a new clause that did not have a corresponding provision in the Draft BIT. The provision has been added to make the general application of law, regulations, procedures and administrative rulings in respect of any matter covered by the Treaty to be easily accessible and available to interested parties. It seeks to reduce the ambiguity involved in the application of such law and also ensures the clarity of such laws and policies for the benefit of investors.

Corporate Social Responsibility

It is interesting to note that the Model BIT now includes corporate social responsibility activities, requiring investors to voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies and practices.[101]

This has been included with a view to encourage foreign investors to support various social causes in the Host State. However, it is questionable whether it is necessary since corresponding obligations are already prescribed under the Companies Act and inevitably, raises the question of conflicting standards of obligations.

Exhaustion of local remedies

Under the Model BIT, before an Investor can initiate arbitration proceedings against the Host State, it must first exhaust all local remedies. The Investor may initiate a claim before a competent domestic court of law, within one year from the date on which the Investor first acquires knowledge of the measure in question and knowledge that the investment has incurred a resulting loss.

However, the exhaustion of local remedies shall not apply to the Investor if it can demonstrate that the domestic legal remedies available are not capable of reasonably providing any relief in respect of the same measure or similar factual matters for which a breach of treaty is claimed by the investor.[102]

98. See Article 5.3 (b) (i)

99. See Article 5.1

100. See Article 5.5

101. See Article 12

102. See Article 15.1

Furthermore, it should be noted that if no domestic resolution to the claim is achieved within 5 years from the date on which the Investor first acquired knowledge of the measure in question, then the Investor must further issue a notice to the Host State to follow a further 6 month period of attempting to find a solution before invoking the treaty provisions.[103] In the event that a solution cannot be found, the Investor has just 6 months to invoke the treaty provisions.[104]

On the one hand, this is a welcome inclusion and gives the judicial machinery of the Host State a time bound obligation to conclude the matter, failing which, the Investor is free to invoke the treaty. However, Investors may feel that the obligation to pursue local remedies for 5 years is too long, and it should be considerably shorter.

Finally, it should be noted that the parties might establish an institutional mechanism to hear appeals of decisions by the tribunal constituted by the Model BIT, which is a departure from what was in the Draft BIT.[105]

Investor Obligations

It is interesting to note that the obligations placed upon the Investor in the Model BIT are significantly watered down from the Draft BIT. Previously, the draft contained provisions relating to corruption, disclosure and general compliance with Host State Law. Given that these provisions apply anyway to the Investor's entity incorporated in India, it raised the question as to whether it was necessary to repeat those obligations in the treaty.

Furthermore, it raised the question of a potential conflict of standards. A higher standard of disclosure and obligations placed on the Investor in the Draft Treaty than what was actually required under the law of the Host State would inevitably create confusion as to which standards should be followed. The deletion of these obligations from the Model BIT are therefore a welcome change, eliminating the risk of contradiction between treaty obligations and obligations under domestic law.

Provisions excluded

The Model BIT does not contain a *Most Favored Nation* clause, which ensures that the relevant parties treat each other in a manner at least as favorable as they treat third parties. Other common clauses that have been excluded include an *Umbrella Clause* (which guarantees the observance of obligations assumed by the host state against the investor) and a *Fair and Equitable Treatment Standard*, which may offer redress where the facts do not support a claim for expropriation.

It is pertinent to note here that the *Most Favored Nation* clause was excluded in the Draft BIT. The use of this provision, to essentially borrow beneficial substantive and procedural provisions from other BIT's has been a matter of concern.

The Law Commission in its report stated that the absence of a *Most Favored Nation* provision would expose foreign investors to the risk of discriminatory treatment by the Host State in the application of its domestic measures. Therefore, the Law Commission suggested that in order to achieve a balance, India could consider having a *Most Favored Nation* provision whose scope is restricted to the application of domestic measures, which would ensure non-discriminatory treatment to foreign investors, yet prevent foreign investors from *treaty shopping*. However, the Indian Government has not provided any detailed explanation for the absence of a *Most Favored Nation* provision in either the Draft BIT or the Model BIT.

INDUSLAW VIEW

As we stated in our previous article on this subject, the spike in dispute notifications issued under existing bilateral investment treaties has undoubtedly led the Government of India to reassess the terms of its existing treaties. Inevitably, an increase in foreign investment is bound to see a corresponding increase in disputes and the Government of India finds itself having to finely balance the legitimate interests of the state, with a predictable and stable environment for investment in general.

Does the Model BIT accept all the recommendations of the Law Commission Report? The Draft BIT received criticism for being too pro-state and for being heavily biased towards the Host State. However, in contrast, the Model BIT attempts to strike a better balance between the interests of the Host State and the interests of Investors. Concessions have been made to expand the definition of Investment, but the exclusion of government procurement from the ambit of the Model BIT may impact the Make in India campaign and the development of big-ticket infrastructure projects.

Practically, renegotiating India's existing bilateral investment treaties will be a time consuming and painstaking task. It also remains to be seen to what extent that the Government of India intends to overhaul existing free trade agreements with Singapore, South Korea and Japan (which contain investor protections and dispute resolution mechanisms) with terms similar to the Model BIT.

The ultimate question is whether India will be able to effectively implement the provisions of its Model BIT in its negotiations (and renegotiations) with other States. However, the Government of India seems confident that the economic balance of power lies in its favor.

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103. See Article 15.4

104. See Article 15.5

105. See Article 29

8.2 SOLAR PANELS, DOMESTIC CONTENT AND THE WTO

Introduction

The National Solar Mission or the Jawaharlal Nehru National Solar Mission (the "**JNNSM**") adopted by India in 2010 targets generation of 100,000 MW of grid connected solar power capacity by 2022.

It's an ambitious target in view of India's current generation capacity of approximately 5,000 MW,[106] but the intent of the Central Government is reflected in various policies and subsidy schemes floated to encourage growth of the solar industry.

The JNNSM aims to *"establish India as a global leader in solar energy, by creating the policy conditions for its diffusion across the country as quickly as possible*"[107].

In furtherance of that aim, we have recently seen favorable state level policies, a feed-in-tariff regime, viability gap funding mechanisms, capital subsidies, progressive net-metering arrangements and solar specific renewable purchase obligations that have created a supportive environment to develop solar power in the country.

The methodology so far

The Ministry of New and Renewable Energy (the "**MNRE**") has selected NTPC Vidyut Vyapar Nigam Limited ("**NVVN**") and the Solar Energy Corporation of India (the "**SECI**") as the agencies responsible for implementing the solar power project selection process.

The procedure adopted typically involves the government entering into long-term power purchase agreements ("**PPAs**") with solar power developers ("**SPDs**") wherein the government undertakes to purchase solar power generated by a particular SPD.

Generally, each PPA provides a guaranteed rate for a 25-year term at which the electricity generated by the SPD is bought by the government. The guaranteed rates are fixed by the Central Electricity Regulatory Commission at the national level and by the State Electricity Regulatory Commission at each state level.

The JNNSM is being implemented in several successive *phases*, with each *phase* initiated thus far being further divided into *batches*.

A *mandatory* domestic content requirement (known as a "**DCR**") was imposed on SPDs participating in phase I (batches 1 and 2) and phase II (batch 1) under the Guidelines for Selection of New Grid Connected Solar Power Projects[108] and the model PPAs.

The applicable DCR is reaffirmed through a *specific plan* that the SPDs have to submit to NVVN or the SECI (as applicable) after entering into the PPA, specifying how they are going to meet the requirements of the applicable DCR.

As a corollary, the SPD has to be in compliance with the applicable DCR in order to avail the guaranteed rates fixed by the government under the relevant PPA.

The DCR requirements depend on a number of criteria, such as phase and batch, the project selection period and other criteria,[109] though it should be noted that the DCR has consistently increased across all phases since 2010.

The rationale behind the DCR regime was based on the core principle of increasing economic opportunities, green technology and jobs in India while taking critically important steps in the global fight against climate change.

However, international trade obligations have had some impact on the realization of this object.

The WTO dispute

In 2013, the United States brought a claim before the WTO challenging India's DCRs on the ground that they violated Article III, para 4 of the GATT 1994[110] and Article 2.1 of the TRIMs Agreement.

It was argued that the DCR measures *modify* the conditions of competition in favor of solar cells and modules of Indian origin and in fact accord *less favourable* treatment towards imported solar cells and modules.

Elaborating further, it was argued that India's DCR measures were inconsistent with Article 2.1 of the TRIMs Agreement because they are *trade-related investment measures* that make the purchase of domestic products a requirement to obtain an advantage, thus falling under paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement.

The substance of India's defense was premised on two main arguments:

Article XX (j)[111]

DCR measures are justified on the ground that India's lack of domestic manufacturing capacity in solar cells and modules, and/or the risk of a disruption in imports, makes these "*products in general or local short supply*" within the meaning of that provision; and

106. Press Information Bureau Press release dated January 15, 2016; http://pib.nic.in/newsite/printrelease.aspx?relid=134497

107. Resolution, Jawaharlal Nehru National Solar Mission, Ministry of New and Renewable Energy, January 11, 2010

108. Guidelines for Selection of New Grid Connected Solar Power Projects, Ministry of New and Renewable Energy (July 2010)

109. WTO, India- Certain Measures Relating To Solar Cells And Solar Modules, Report Of The Panel dated February 24, 2016; https://www.wto.org/english/tratop_e/dispu_e/456r_e.pdf

110. Article III of the GATT 1994 is titled "National Treatment on Internal Taxation and Regulation". Paragraph 4 of Article III provides in relevant part: The products of the territory of any Member imported into the territory of any other Member shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

111. Article XX (j) establishes a general exception for measures essential to the acquisition or distribution of products in general or local short supply.

Article XX (d)[112]

DCR measures are also justified under the general exceptions, on the ground that they secure India's compliance with "*laws or regulations*" requiring it to take steps to promote sustainable development.

The WTO decision

At the outset the panel found that the DCR measures were *trade-related investment measures* covered by paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement.

This sufficiently establishes that the DCRs are inconsistent with both Article III, para 4 of the GATT 1994 and Article 2.1 of the TRIMs Agreement.

The panel observed that the terms *"products in general or local short supply*" refer to a situation wherein the available supply of a product, from all sources, does not meet demand in a relevant geographical area or market.

In light of this, the terms *"products in general or local short supply*" do not cover products at risk of becoming in short supply.

The panel determined that India had not demonstrated the existence of any imminent risk of a short supply and ruled that the DCRs were not justified under Article XX (j).

Addressing the defense of Article XX (d), the panel concluded that international agreements may constitute *"laws or regulations*" within the meaning of Article XX(d) only insofar as they are rules that have a *direct effect* in, or otherwise form part of, the *domestic legal system* of the member concerned.

Most of the instruments identified by India did not constitute *"laws or regulations*" within the meaning of Article XX(d), or were not international laws or regulations in respect of which the DCR measures secured compliance.

Therefore, the panel found that India failed to demonstrate that the DCRs were justified under Article XX (d).

INDUSLAW VIEW

The decision is bound to cause ripples in the international relations between the two countries. The Indian Power Minister has alleged similar practices by the US government, citing 16 cases where support has been given to domestic manufacturers in the US.

The Indian Power Ministry's response essentially alleges targeted prosecution against the developing world and the Minister was of the view that the US government should have been more magnanimous in its approach to the issue.

The MNRE's response to the ruling appears to maintain that the future course of action will involve protecting the domestic industry. While a notice of appeal has been filed with the appellate body at the WTO, the present government seems confident that the ruling will not affect the roll out of India's ambitious solar power capacity installation.

However, there are also some very important realities in play here. It is estimated that India needs investment of over US $ 100 billion[113] to achieve its green energy targets of 100 GW of solar power and 60,000 MW of wind power by 2022. What should then be the focus of governmental initiative and to what extent should the domestic solar panel manufacturing market be the sole beneficiary of that investment?

Industry reaction to the DCR regime in general has not been particularly positive. India's solar manufacturers still largely assemble products with core materials, (such as poly-silicon chips) purchased mostly from China.

As a result, Indian solar cells and modules end up becoming up to 10 per cent more expensive than those imported from China, Malaysia or Taiwan, countries from where most solar developers in India source their modules. Moreover, Indian solar cells are generally thought to be technologically inferior to those manufactured in other countries.[114]

DCRs therefore, perpetuate a cost for SPDs and although guaranteed PPAs may to a certain extent off-set that cost, it impacts dynamics for the cost of electricity in the consumer market. This could in the long run lead to generation of solar power being economically unfeasible.

Certain industry experts[115] take the view that the DCRs actually have little long-term benefits for domestic manufacturers. What is needed is a broader structural approach that would genuinely address domestic manufacturers' constraints and enable them to become cost-competitive in the international market.

Ultimately, producers of solar energy should have the freedom to import technology and materials, such as solar cells and modules, if importing is cost-efficient. Removing barriers to trade might attract more foreign and domestic investment in the solar sector leading to increased investment in the manufacturing of solar cells and modules.[116]

Following more investment in this sector, market forces will likely lead to a situation where solar power developers choose to buy domestically-manufactured solar cells and modules as a prudent business decision, without external pressure.

Authors: Ran Chakrabarti, Anubha Sital and Shaima Khan

112. Article XX (d) establishes a general exception for measures necessary to secure compliance with laws or regulations, which are not inconsistent with the provisions of GATT, 1994.

113. http://www.livemint.com/Politics/11yE8Bz6bgZZ6LhXXlB8eL/WTO-panel-rules-against-India-in-solar-dispute.html

114. http://economictimes.indiatimes.com/articleshow/51147890.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

115. http://www.ictsd.org/bridges-news/biores/news/wto-decision-on-local-content-requirements-will-not-affect-india-solar

116. http://www.financialexpress.com/article/fe-columnist/what-the-wto-panel-did-not-decide-on-solar-panels/226070/

9. PRIVATE CLIENT

9.1 PERMANENT RESIDENCY STATUS TO FOREIGN INVESTORS

Introduction

Taking forward its *Make in India* initiative, on August 31, 2016, the Union Cabinet approved the scheme for grant of permanent residency status ("**PRS**") with multiple entry to foreign investors, provided they fulfil certain conditions.

This scheme was reaffirmed pursuant to a press release dated November 29, 2016 though detailed rules regarding this new scheme are awaited.

PRS: ELIGIBILITY CONDITIONS

In order to be eligible for PRS, a foreign investor must fulfill the following criteria:

- Bring a minimum of Rs. 10 crores (approximately USD 1.46 million) within 18 months or Rs. 25 crores (USD 3.67 million) within 36 months;
- The foreign investment should result in generating employment for at least 20 resident Indians every financial year;
- The foreign investment needs to comply with restrictions under the FDI Policy;
- The foreign investment must conform to further rules as will be notified by the Government of India

In addition to the foreign investor bringing in such investment, PRS will also be granted to the spouse or dependents of the eligible foreign investor.

PRS will serve as a multiple entry visa without any stay stipulation. PRS holders will be exempted from registration requirements. PRS will be granted for a period of 10 (ten) years initially, with multiple entry facility. This can be renewed for another 10 (ten) years, if the PRS holder has not come to adverse notice.

PRS holders will be allowed to purchase one residential property for dwelling purpose. The spouse or dependents of the PRS holder will also be allowed to take up employment in the private sector (in relaxation to salary stipulations for employment visa) and undertake studies in India.

IMPACT OF THE NEW PRS PROVISIONS

- **TAXATION UNDER INDIAN LAWS**

A foreign investor with PRS in India, would be treated as an Indian resident, and therefore be subject to taxation under the Income Tax Act in India. The entire global income of such a foreign investor, would thus be taxed in India. Foreign investors would then have to plan their incomes accordingly, prior to availing the PRS scheme.

- **FDI POLICY**

The conditions under the PRS scheme, are subject to the restrictions under the Consolidated Foreign Direct Policy of India (the "**FDI Policy**"). The FDI Policy also provides for certain rules regarding investment by foreign investors, (for example, minimum capitalization norms, lock-in periods, sectoral caps, and other nuances).

Once the complete rules regarding this new PRS scheme are notified, the foreign investor must ensure that he is in compliance with both the FDI Policy as well as all the rules under the PRS scheme.

INDUSLAW VIEW

While at present the rules regarding resident status are governed by the Income Tax Act, 1961, the new PRS scheme seeks to grant residency status in India to foreigners who bring in specified quantum of investment and fulfil certain other conditions.

Foreign investors who fulfil the eligibility conditions by way of their investment, run the risk of having their global incomes taxed in India. Therefore, they would have to plan their investments into India accordingly.

The success or failure of the new PRS scheme will only become evident, upon notification of the relevant provisions and rules and examining how many foreign investors actually opt for such PRS in India.

Authors: Ran Chakrabarti, Stuti Agarwal

10. PROJECTS

10.1 Refinancing of Project Loans by Non-Banking Financial Companies

Introduction

The Reserve Bank of India (the "**RBI**") has recently allowed non-banking finance companies ("**NBFCs**") to refinance any existing infrastructure or other project loans by way of take-out financing, pursuant to a notification dated June 2, 2016 (the "**June 2016 Notification**").[117]

A summary of the key provisions of the Notification are set out below, together with our view on those changes.

History

Back in January 2014[118], the RBI (through the Department of Non-Banking Supervision) released the *Framework for Revitalising Distressed Assets in the Economy*, detailing guidelines to all Scheduled Commercial Banks and All-India Term-lending and Refinancing Institutions (such as Exim Bank, NABARD, NHB and SIDBI) on the refinancing of project loans and the sale of non-performing assets ("**NPAs**") by banks and other regulatory measures pursuant to a circular dated February 26, 2014 (the "**February 2014 Circular**")[119] and issued further conditions in relation to these issues pursuant to a circular dated August 7, 2014 (the "**August 2014 Circular**").[120]

Revised applicability and conditions

The RBI has now, pursuant to the June 2016 Notification extended the applicability of the conditions specified in the February 2014 Circular and the August 2014 Circular to NBFCs, essentially permitting NBFCs to refinance any existing infrastructure or other project loans by way of take-out financing, without a pre-determined agreement with other lenders, and fix a longer repayment period.

Further, such refinancing of loans would not be considered as restructuring if the following conditions are satisfied.

Loans up to Indian Rupees One Thousand Crore (Approximately USD 150 Million)

The following criteria applies:

- the loans should be *'standard'* in the books of the existing lenders, and should have not been restructured in the past;
- the loans should be substantially taken over (more than 50 per cent of the outstanding loan by value) from the existing financing lenders; and
- the repayment period should be fixed by taking into account the life cycle of the project and cash flows from the project.

Loans above Indian Rupees One Thousand Crore (Approximately USD 150 Million)

- The project should have started commercial operation after achieving the Date of Commencement of Commercial Operation;
- The repayment period should be fixed by taking into account the life cycle and cash flows from the project, and the boards of the existing and new lenders should be satisfied with the viability of the project. Further, the total repayment period should not exceed 85 per cent of the initial economic life of the project (or concession period in the case of PPP projects);
- The loans should be 'standard' in the books of the existing lenders at the time of the refinancing;
- In case of partial take-out, a significant amount of the loan (a minimum 25 per cent of the outstanding loan by value) should be taken over by a new set of lenders from the existing financing lenders; and
- The promoters should bring in additional equity, if required, so as to reduce the debt to make the current debt-equity ratio and debt service coverage ratio (DSCR) of the project loan acceptable to the NBFC.

It has been further specified that a lender who has extended only working capital finance for a project may be treated as *'new lender'* for taking over a part of the project term loan as required under the guidelines.

117. Notification RBI/2015-16/417DNBR.CC.PD.No.082/03.10.001/2015-16 dated June 02, 2016: https://rbi.org.in/Scripts/NotificationUser.aspx?Id=10434&Mode=0

118. https://rbidocs.rbi.org.in/rdocs/content/pdfs/NPA300114RFF.pdf

119. OD.BP.BC.No.98/21.04.132/2013-14: https://rbi.org.in/Scripts/NotificationUser.aspx?Id=8756&Mode=0

120. DBOD.BP.BC.No.31/21.04.132/2014-15: https://rbi.org.in/Scripts/NotificationUser.aspx?Id=9157&Mode=0

INDUSLAW VIEW

The June 2016 Notification allows NBFCs to further access the project financing, market and also *broadens* the option for project companies to seek funding from entities other than Scheduled Commercial Banks and All-India Term-lending and Refinancing Institutions.

It also aims to complement the government's focus on the infrastructure sector, by making refinancing of projects easier which in turn, should help financial institutions control their asset quality in relation to their exposure and further contribute to a secondary debt market in the infrastructure sector.

In this context, it must be acknowledged that secondary debt markets are generally driven by the incoming lender's view of the profitability of the project and it remains to be seen whether the ability to provide take out financing on these terms will entice NBFCs into the market.

Although it is no longer a *regulatory requirement*, should NBFCs refinance a project without a pre-determined agreement with existing lenders, it will put them at risk if the take out financing is only *partial.*

Projects often have a syndicate of lenders who normally sign up to an inter-creditor arrangement, regulating the distribution of re-payments and proceeds in a default scenario through a *'waterfall'*.

Commercially, NBFCs would still need to enter into inter-creditor arrangements with existing lenders, if the take out financing is less than the outstanding debt that the borrower owes to its existing project lenders.

Without an inter-creditor arrangement, there would be no contractual clarity on the right of repayment in a default scenario and what position the NBFC will take in the *'waterfall'*.

We would also question whether there should be a distinction in the criteria between project debt falling above or below Indian Rupees One Thousand Crore and whether it serves a useful purpose.

Irrespective of the size of the project, a refinancing of a distressed asset is likely to see the new lenders require equity infusions from the shareholders to ensure debt to equity levels are maintained.

Authors: Ran Chakrabarti, Arijit Sarkar and Priyank Nanavaty

10.2 Mining Reforms: Transfer of a Lease – a Smoother Ride?

Introduction

The Central Government has, on May 30, 2016, notified the Minerals (Transfer of Mining Lease Granted Otherwise than through Auction for Captive Purpose) Rules, 2016 (the "**Rules**").

These Rules have been notified pursuant to Section 12A of the Mines and Minerals (Development and Regulation) Act, 1957 (the "**Act**").

The Rules are a step forward towards enabling existing holders of mining leases (which were granted otherwise than through auction and being used for captive purpose) to transfer those leases to persons that meet the prescribed criteria.

This move is aimed to facilitate distressed companies to make a smooth exit and to address the concerns of banks and other financial institutions that have invested in such companies.

Conditions for transfer

Rule 4 specifies the following conditions for transfer of a mining lease:

- transfer is permitted only where the entire quantity of mineral extracted from such mining lease is being used in a manufacturing unit owned by the lessee;
- all approvals for transfer shall be subject to additional conditions, namely: all consents, approvals, permits, no-objections and the like as may be required under applicable laws for conducting mining operations, and which were obtained by the transferor, shall stand transferred *mutatis mutandis* to the transferee;
    - the transferee has to accept all the conditions and liabilities under any law for the time being in force which the transferor was subject to in respect of such mining lease;
    - on and from the date of transfer of the mining lease, the transferee shall be liable to the Central Government and the State Government with respect to any and all liabilities relating to the mining lease;
    - the transferee shall ensure that the entire quantity of mineral including rejects or tailings or slimes or dumps or overburden extracted from the mining lease shall be used exclusively for captive purpose and shall not be sold or exported; and
    - on and from the date of transfer of the mining lease, the transferee shall be bound by the provisions of the Act and the rules made thereunder.

It should be noted that the State Government may terminate the mining lease if the holder has, in the opinion of the State Government, committed a breach of any of the provisions of the Rules or has transferred such lease or any right, title, or interest therein otherwise than in accordance with the provisions of the Act or the rules made thereunder, as the case may be.

However, the holder of the mining lease shall be given reasonable opportunity of stating his case.

Procedure for transfer

Rule 5 sets out the procedure for transfer of a mining lease, requiring the holder of the lease making an application to the State Government (*in the format provided in Schedule I*).

The State Government is required to convey its decision to approve or reject such application within a period of 90 days. In the event the application is rejected, the reasons for such rejection shall be communicated to both the transferor and the transferee.

In the event the State Government does not convey its decision within a period of 90 days, the application for transfer is deemed accepted.

Within fifteen (15) days of approval, the State Government shall, based upon an estimation of the value of the resources, which are the subject of the mining lease, raise a demand upon the transferee for making an upfront payment of an amount equal to 0.50% of the value of the estimated resources.

The upfront payment shall be made in one lump sum within a period of thirty days from the date of receipt of the demand and shall be adjusted in full against the total amount payable for transfer.

Within fifteen (15) days of the upfront payment, the transferee shall sign the Mine Development and Production Agreement (the "**Agreement**") with the State Government.

Within fifteen (15) days of signing the Agreement, the transferee shall provide a performance security to the State Government in the form of a bank guarantee (*in the format provided in Schedule II*) or as a security deposit for an amount equivalent to 0.50% of the value of estimated resources.

The performance security shall be adjusted every five (5) years so that it continues to correspond to 0.50% of the reassessed value of estimated resources. The State Government is at liberty to invoke the performance security in accordance with the terms and conditions of the Agreement.

Thereafter, the transferor and the transferee are required to jointly submit a duly registered deed for transfer to the State Government within a period of thirty (30) days of submitting the performance security.

The approval given by the State Government for transfer shall be deemed null and void if the duly registered transfer deed is not submitted to the State Government.

The State Government shall then execute a mining lease deed with the transferee (*in the format provided in Schedule VII appended to the Minerals (Other than Atomic and Hydro Carbons Energy Minerals) Concession Rules, 2016*), within ninety days of registration of the deed for transfer of mining lease.

Transfer charges and payments

In cases where royalty is payable, the transferee shall, in addition to royalty, pay transfer charges to the State Government of an amount equal to 80% of the royalty paid.

The transferee is also required to contribute to the National Mineral Exploration Trust and the District Mineral Foundation, in accordance with the applicable rules.

Intimation

The State Government shall inform the Controller General, Indian Bureau of Mines in writing about the transfers made under Rule 5.

INDUSLAW VIEW

The Rules are an attempt to unlock projects that are in distress and attract M&A activity in the mining sector.

It will also be a relief measure for companies that are in distress and also benefit creditors to such companies.

However, the rules require that the resource must be used in a *manufacturing unit* of the lessee, so an incoming acquirer will not be able to *delink* the *resource* from its *captive use*.

Time bound obligations on the State Government to approve or reject such applications for the transfer of an existing mining lease is a welcome move. However, the requirement to pay transfer charges at a percentage of the estimated value of the resource will, in the absence of a clear and transparent pricing mechanism, lead to disputes on valuation.

It remains to be seen whether interested parties will consider paying an *additional* royalty (where royalties by the transferor are already being paid) amounting to 80 per cent of the royalty already paid as an acceptable condition.

Authors: Ran Chakrabarti, Anubha Sital and Shaima Khan

11. TAX

11.1 The Gist of GST: The Constitutional (122nd Amendment) Bill, 2014

Introduction

The Constitution (122nd Amendment) Bill, 2014 (the "**Bill**") paving the way for the implementation of the unified goods and services tax regime (the "**GST**") has been passed by the Rajya Sabha on 3rd August 2016, with amendments re-tabled and passed by the Lok Sabha on 8th August 2016.

The Bill now has to be ratified by the legislatures of not less than one-half of the States before the Bill is presented to the President for assent.

The passage of the Bill through parliament is a landmark in India's history of economic reforms and implementation of the GST will be the most significant economic reform in India's independent history and perhaps the largest wholesale restructuring of an indirect tax system ever.

The Bill paves the way for the GST, creating the single largest tax market in the world, by merging a multitude of indirect taxes such as excise, service tax, value added tax octroi and a other taxes into a single tax.

Under the Bill, the Center will be able to levy an integrated GST on the inter-state supply of goods and services.[121] The revenue under the GST regime will be shared between the Centre and the States and the Centre will compensate the States for any loss of revenue for a period of up to 5 (five) years.[122]

GST will simplify and harmonise the indirect tax regime in the country. It is expected to boost production by reduction of the cost of production and inflation in the economy, thereby making Indian business more competitive, domestically as well as internationally.

The present regime

Presently, the Constitution empowers the Central Government to levy a number of indirect taxes on the manufacturing and supply of goods and services. These taxes include excise duty, sales tax, service tax, *octroi*, customs duty and other taxes. Further, it empowers the State Governments to levy sales tax or value added tax (VAT) on the sale of goods.

The tax regime for goods and services is disjointed, which poses a burden of *"tax on tax"*, or the *"cascading"* of taxes whereby the government levies a tax not only on the value addition on a product, but also on the tax already levied on the product.

Key provisions of the bill

The Bill paves the way for the wholesale merger of the existing indirect tax regime into a *single market* through a new indirect tax regime, merging levies such as excise, sales tax and service tax.

Notably, the Bill excludes the taxing of alcohol for human consumption[123] and 5 (five) petroleum products (petroleum crude, high speed diesel, petrol, natural gas and aviation fuel).[124] The Goods and Services Tax Council (*discussed below*) will decide when GST will be levied on these petroleum products at a future date.

Powers of State and Union to frame GST laws

The Bill inserts a new article in the Constitution providing powers to the legislature of every State to make laws with respect to the GST imposed by the Union or such State. It provides the Parliament with the exclusive power with respect to GST where the supply of goods or services takes place in the course of inter-State trade or commerce.[125]

Goods and Services Tax Council

The Bill sets out the framework for a Goods and Services Tax Council and the President shall, by order, constitute a Council to be called the Goods and Services Tax Council.[126]

Composition of the Goods and Services Tax Council

The Goods and Services Tax Council shall consist of the Union Finance Minister as a chairperson, and its members shall include the Union Minister of State in charge of Revenue or Finance and the Minister in charge of Finance or Taxation or any other Minister nominated by each State Government.

The vice-chairperson of the Goods and Services Tax Council shall be chosen, from amongst themselves, by the members nominated by the State Government.

Functions of the Goods and Services Tax Council

The purpose of the Goods and Services Tax Council is to recommend:

- taxes, surcharges and cesses to be merged under the GST;
- model GST laws, principles of levy, apportionment of GST levied on supplies in the course of inter-State trade or commerce and principles that govern the place of supply;
- goods and services which may be subjected to or exempted from GST;

121. Clause 9 of the Bill, inserting Article 269A of the Constitution

122. Clause 19 of the Bill

123. Clause 14 of the Bill, amending Article 366 of the Constitution

124. Clause 17 of the Bill, amending the 7th Schedule of the Constitution

125. Clause 2 of the Bill, inserting Article 246A of the Constitution

126. Clause 12 of the Bill, inserting Article 279A of the Constitution

- the threshold limit of turnover below which goods and services may be exempted from GST;
- rates including floor rates with bands of GST;
- special rates to raise additional resources during any natural calamity;
- special provision with respect to Arunachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
- any other matters relating to the GST.

Quorum and Voting

The quorum for the meetings of the Goods and Services Tax Council shall constitute at least 50 per cent of the total members being present.

Every decision of the Goods and Services Tax Council shall be taken by a *three quarter* majority (75 per cent) of members present in voting. Given that the Center will have one third of the votes and the States will have two thirds of the vote, this effectively means that unanimity will be required.

Resolution of disputes

The Goods and Services Tax Council shall establish a mechanism to adjudicate any dispute arising out of its recommendations. Disputes can be between: (i) the Centre and one or more states; (ii) the Centre and States on one side and one or more States on the other; (iii) one or more States.

Integrated GST

The Bill inserts a new article (Article 269A) in the Constitution relating to the levy and collection of the GST. It provides that Centre may levy and collect GST on supplies in the course of inter-State trade or commerce and the tax collected will be divided between the Centre and the States in a manner to be provided by Parliament, by law, on the recommendations of the Goods and Services Tax Council.

It should be noted that the amount apportioned to a State shall not form a part of the consolidated fund of India.

The Parliament may, by law, formulate the principles for determining the *place* of supply, and *when* a supply of goods or services takes place in the course of inter-State trade or commerce.

The Bill also states that the supply of goods or services in the course of import into India shall be deemed to be supply of goods or services in the course of inter-State trade or commerce.[127]

Restrictions as to imposition of tax on the supply of goods or services

The Constitution currently imposes a restriction on the States to impose taxes on the *sale* or *purchase* of goods where such sale or purchase takes place:

- outside the state; or
- in course of the import of the goods into or exports of the goods out of India.

However, the Bill amends this provision to restrict the imposition of tax on the supply of goods and services and not on its sale.[128]

Compensation to States

Under the provisions of the Bill, Parliament shall, on the recommendation of the Goods and Services Tax Council, provide compensation to states for any loss of revenue from the date of introduction of the GST for a period of 5 (five) years.[129]

Transitional Provisions

The Bill provides that, any provision of any law relating to the tax on goods or services in force in any State, which is *inconsistent* with the provisions of the Constitution as amended by the Bill shall continue to be in force until amended or repealed by a competent legislature or other competent authority or until expiration of 1 (one) year from the time when the Bill comes into force, whichever is earlier.[130]

INDUSLAW VIEW

Clearly, the passage of the Bill is an enormous achievement to pave the way forward for the implementation of the GST, *harmonizing* a system of indirect taxation by merging all indirect taxes into one tax.

It seeks to settle the issues of the present indirect tax structure by enlarging the tax base, increasing compliance, eliminating the cascading of taxes and preventing economic disturbances caused by different inter-state taxes.

The Bill, however, should not be confused for the actual GST itself, which is currently in the form of a draft model law. Although the Bill sets out the framework for a single GST, this does not mean that there will be a *single* law. On the contrary, to implement the Bill (assuming that half of India's States consent to it), the Center and *each* State will need to pass further legislation, as recommended by the Goods and Services Tax Council, formulating the GST.

127. Clause 9 and 10 of the Bill

128. Clause 13 of the Bill, amending Article 286 of the Constitution

129. Clause 19 of the Bill

130. Clause 20 of the Bill

Noticeably, the Bill excludes alcohol and defers applicability to key petroleum products, which will mean that the existing convoluted tax (and the cascading of tax) will continue to apply to these products, somewhat contradicting the idea of creating a single tax market applying to all goods and services.

In particular, excluding petroleum products will mean that input tax credits may not be available in relation to the cost of manufacture of certain goods.

Furthermore, while the future GST will be beneficial for the large-scale sector (it will provide a single market from which to buy raw materials from any part of the country) the small-scale sector that produces and sells locally, is unlikely to benefit from a single market.

Since both Parliament and the State legislatures have the power to legislate on GST, the potential for conflict and the complexity that will arise as a result thereof, remains to be seen. Throw into that mix the ambit and decision-making process of the Goods and Services Tax Council and it should become clear that there will be ample scope for diverging views.

Given the broad mandate given to the Goods and Services Tax Council, it is possible that future exemptions or other dispensations given to particular States will somewhat complicate and erode the idea of a single GST.

Though the Bill has been passed, many steps still need to be taken to fully implement and realise a unified indirect tax structure. Much of this will depend upon the co-operation and cohesion between the Center and India's many States.

Authors: Ran Chakrabarti, Ishwer Upneja and Siddharth Marwah

11.2 Protocol Amending the India - Mauritius Tax Treaty

Introduction

On May 10, 2016, India and Mauritius signed the protocol (the "**Amendment Protocol**") amending the Treaty for Avoidance of Double Taxation and Prevention of Fiscal Evasion dated August 26, 1982 (the "**Treaty**").

The Amendment Protocol intends to tackle issues of treaty abuse, round tripping of funds and curb revenue loss. The key change that will raise investor's eyebrows is the imposition of a capital gains tax on the sale of shares by a Mauritian company holding shares in an Indian company.

Please note that investments made prior to April 1, 2017 are not subject to the amendments made pursuant to the Amendment Protocol.

We set out below a brief overview of the key amendments made to the Treaty by the Amendment Protocol.

Definition of 'Permanent Establishment'

The definition of a '*permanent establishment*' in relation to a business has been amended to include the provision of services by an enterprise through employees for a period of more than 90 (ninety) days in a period of 12 (twelve) months.

This inclusion will give the Indian government the power to tax the profits of a Mauritius based business providing services through employees who are present in India for a period of more than 90 (ninety) days (which need not run concurrently) in a period of 12 (twelve) months.

Tax on Interest

Presently, the Treaty provides an exemption on taxation of interest derived by the following Mauritian entities in India:

- A Government or local authority;
- An agency created or organised by the Government;
- A bank carrying on a bona fide business activity, which is resident in Mauritius.

The Amendment Protocol also specifically provides that interest derived by a non-exempted Mauritian resident from India can only be taxed at a rate not exceeding 7.5% (seven point five per cent).

Further, the Amendment Protocol removes the exemption provided to resident Mauritian banks carrying out *bona fide* business activity. However, the exemption under the Treaty will continue in relation to any interest arising from a claim or debt existing on or before March 31, 2017.

The exemptions provided to Government or local authorities (and agencies created or organised by the Government) in relation to the taxation of interest continue.

Tax on Fees for Technical Services

The Amendment Protocol provides for taxation by India of any fees for technical services arising in India and paid to a Mauritian business. Mauritius would also be able to tax the fees for technical services received by the Mauritius business. The tax that may be levied by India in such a case is capped at 10% (ten per cent).

However, if the Mauritian business has a *permanent establishment* in India, or the Mauritian resident performs the service in a personal capacity and has a fixed base in India, then Mauritius will not be able to tax the fee for technical services. In these circumstances, the provisions of Article 7 (*Business Profits*) and Article 14 (*Independent Personal Services*) of the Treaty as relevant would apply.

Tax on Capital Gains

A key change under the Amendment Protocol is that gains from any sale of shares of an Indian company by a Mauritian resident holder will be subject to tax in India (subject to a cap as set out below). Such tax can be levied only on the sale of shares that are acquired on or after April 1, 2017.

The Amendment Protocol provides that the tax on capital gains will be capped at 50% (fifty per cent) of the applicable tax rate in India during the period between April 1, 2017 and March 31, 2019. This is subject to the *Limitation of Benefits* provision (discussed below).

Tax on Other Income

The Amendment Protocol has also introduced a specific provision to the effect that any item of income of a Mauritian resident not dealt with in the Treaty may also be taxed in India if it arises in India.

Exchange of Information

The provisions on the exchange of information between India and Mauritius under the Treaty have been made much more expansive. In addition, affirmative obligations to gather information and disclose it have been added.

Of particular significance is the obligation to disclose information, regardless of whether the information is held by a bank or other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

Assistance in the Collection of Taxes

The Amendment Protocol adds an entirely new section with respect to assistance by Mauritius to India for the collection of taxes, which are due and payable to India from a Mauritian resident.

Whilst this provision cannot compel Mauritius to act against Mauritian Law, it does allow India to utilize the Mauritian revenue collection machinery to collect tax from a Mauritian resident.

The provisions also seek to provide an exemption, on an accepted revenue claim, from any time limit under Mauritian law for the collection of taxes.

Limitation of Benefits

A major change brought in by the Amendment Protocol is the introduction of a *Limitation of Benefits* provision. The *Limitation of Benefits* provision denies the benefit of capital gains (arising in the period between April 1, 2017 and March 31, 2019) being taxed at 50% (fifty per cent) of the applicable tax rate in India, to the following entities:

- A Mauritian resident whose affairs are arranged with the primary purpose of taking advantage of this benefit.
    - An entity not having bona fide business activities will be covered by this provision.
- A shell or conduit company.
    - A shell or conduit company has been defined as an entity having negligible or no business operations or with no real and continuous business activities being carried out in Mauritius.
    - A Mauritius company shall be deemed to be a shell or conduit company if its expenses on operations in Mauritius are less than Mauritius Rs. 1500000 (Mauritius Rupees one million five hundred thousand) or INR 2700000 (Indian Rupees two million seven hundred thousand) in the 12 (twelve) month period immediately preceding the date when the gains arise.
    - A listed company shall not be considered to be a shell or conduit company.

In these circumstances, the capital gains of the Mauritian entity will be taxed at the full applicable rate of tax in India.

In this context, it should be noted that the corresponding provisions in the India – Singapore Treaty defines a shell or conduit company as one that has an operating expenditure of less than the equivalent of INR 5000000 in the 24 (twenty four) month period preceding the date when the gains arise.

INDUSLAW VIEW

The Amendment Protocol makes many notable changes, which are the topic of discussion both in the media and amongst professionals with a cross border focus and involved or familiar with India – Mauritian structures.

Key amongst these are the *Limitation of Benefits* provision, the source-based taxation for capital gains on the transfer of shares of an Indian company by a Mauritius based shareholder, the expansion of the definition of *'permanent establishment'* to include a *'service PE'* and the provisions with respect to exchange of information and assistance in the collection of taxes.

The case law in India which led to a settled position that treaty benefits would be available based on a tax residency certificate seems set to change or evolve in a new direction. The changes with respect to *Limitation of Benefits* also seem likely to reopen debates about substance and operations, which seemed to have been settled. However, the *Limitation of Benefits* provisions will only apply to capital gains tax between April 1, 2017 and March 31, 2019.

The tax on capital gains provisions apply to the "*alienation of shares*", which seems to indicate that it will apply only to the transfer of equity shares and preference shares (the latter whether fully, partially, or non-convertible).

However, these provisions should not apply to debentures, unless those debentures are convertible into shares, and a conversion event has occurred resulting in the Mauritian transferor transferring shares and not the debentures.

Similarly, these provisions should not apply to the transfer derivatives, p-notes and other similar instruments, as long as no event has occurred under such instruments, which lead to the Mauritian transferor transferring shares.

The breadth of the provisions with respect to the exchange of information and assistance in the collection of taxes seem to reflect developments that are currently topical in the Indian media. The Government has publicly declared a campaign against corruption and black money and the widening of the exchange of information provisions certainly seems to coincide with the aim of clamping down on tax evasion.

The international secondment of employees will also have to be keenly scrutinized from an international tax perspective. The express provision with respect to a "*service PE*" brings this issue, already a hot button topic and the subject of interesting case law, into more focus.

Historically, Mauritius has been a preferred country to route investments into India due to the provisions of the Treaty, but will the changes brought in by the Amendment Protocol push investments through other routes? In this context, it is interesting to note that the India - Singapore Treaty provides for *residency-based* taxation for capital gains unlike the Amendment Protocol. However, the India - Singapore Treaty specifically provides that capital gains on the transfer of shares will be in force as long as the Mauritius Treaty provides for residence-based taxation in relation to the transfer of shares.

It remains to be seen as to whether the India - Singapore Treaty will be amended to bring in the concept of *source-based* taxation for capital gains and add assistance obligations in relation to collection provisions as seen in the Amendment Protocol.

In summary, the Amendment Protocol, juxtaposed with changes in Indian law on the treatment of trusts and *pass through* benefits (from an investment standpoint), raises the question as to whether the *preeminent* place of Mauritius in India's tax treaty landscape will continue.

It is clear that Mauritian structures for future investments will now need to be carefully assessed. Investors, who do not have feet on the ground in India or make infrequent investments in the country, may now consider the cost of compliance and structuring an Indian investment through Mauritius to be higher than other jurisdictions.

Whether, therefore, there will be a dip in the volume of investments into India through Mauritius remains to be seen. The Amendment Protocol does grandfather the application of tax on investments until a certain date, which might avoid an immediate dip in investments through the Mauritian route. At this time, as we continue to comb through the fine print, we perceive that the Amendment Protocol may prompt a change in India investment structures.

Over the years the media has speculated several times about the change to the India – Mauritius Treaty. The speculation is over, the changes are here, and certainly herald an interesting time.

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11.3 The Gist of GST: A Unified Direct Tax Market?

Introduction

"One Country, One Tax, One Market" were the excited claims of the architects of the Constitution (One Hundred and First) Amendment Act, 2016, passed by the Rajya Sabha on 3rd August 2016 and the Lok Sabha on 8th August 2016 and which received the assent of the President on 8th September 2016 (the "**Constitutional Amendment**").

The Constitutional Amendment paves the way forward for a unified goods and services tax (the "**GST**") heralded as the most important reform in indirect taxation in India's independent history and one of the most important economic reforms since 1991.

It's probably not an understatement to say that no country in history has undertaken to dismantle and restructure its taxation system in such an ambitious manner. But are the optimists justified in the euphoria that's not often associated with matters such as tax?

What does the Constitutional Amendment do? Does it really pave the way for one tax at one rate? The *devil*, as always, is in the *detail* and in this article, we'll look at the provisions of the Constitutional Amendment, the draft model law that it contemplates and assess how successful it will be in paving the way towards a *unified* indirect tax market.

THE GIST

The GST has had a long and winding road until now and to say that tax reform is a complicated affair in a vibrant and diverse federal democracy like India is an understatement.

Historically, India's constitution did not invest power to either the Center or the States to tax the supply of goods and services. Up until now, the Center has been able to tax services and goods during the production stage and the States have been able to tax the sale of goods. The Center does not have the power to tax the sale of goods and the States do not have the power to tax the provision of services.

The primary intent of the legislature is to bring in uniformity and harmony to the existing indirect tax laws governing goods and services in India and introduction of the GST will require a restructuring of the tax eco-system relating to computation and compliances in tax law, leading to a total facelift of the existing indirect tax system.[131]

The first thing to understand is that the Constitutional Amendment is not the same thing as the actual GST. Put otherwise, it simply *enables* the future structuring of India's indirect tax regime on goods and services, setting out the broad parameters of its future shape and how it will be negotiated.

The GST is supposed to merge the current regime of Central and State indirect taxes into a single tax, by subsuming central excise duty, additional excise duty, service tax, additional customs duty, special additional duty of customs (currently collected by the Centre) with value added tax, entertainment tax, central sales tax, *octroi* and entry tax, purchase tax, luxury tax and taxes on lottery, betting and gambling (currently collected by the States).

As a result of the merging of these taxes, the GST is anticipated to be a *single* tax on the *inter*-state supply of goods and services, covering the entire supply chain from the manufacturer to the consumer. Credits for taxes paid at each stage of the value chain will be available in subsequent stages of value addition, which makes the GST essentially a tax only on *value addition* at each stage. The final consumer will therefore bear only the GST charged by the last dealer in the supply chain, with the seller benefiting from set-off from the tax paid on previous downstream transactions.

But to say that the GST is just one *single* tax is slightly misleading. It will have three separate components. There will be a tax collected by the Center on the *inter*-state supply of goods and services, which will be shared between the Center and the States, known as the integrated goods and services tax (the "**IGST**"). There will also be a tax in relation to the *intra*-state supply of goods and services, which will be collected by the Center (the "**CGST**") and the States (the "**SGST**"). In this context, it should be noted that IGST will essentially be the sum of the CGST and the SGST, to ensure revenue neutrality.

The Constitutional Amendment essentially paves the way for the Center to collect and share with the States, revenue arising from the *inter*-state transfer of goods and services through the IGST. In order to do this, the Parliament will need to pass the proposed Integrated Goods & Services Tax Act (the "**IGST Act**"). The supply of goods and services *intra*-state will be governed by two pieces of forthcoming legislation, the Central Goods & Services Tax Act (the "**CGST Act**") and the State Goods & Services Tax Act (the "**SGST Act"**), which will need to be passed by the Center and the States, respectively.

While the Constitutional Amendment is an enormous step forward in breaking the historic deadlock on the issue of indirect taxation, the need to *choreograph* a uniform GST across the Center and the States and the *implementation* of an efficient administrative system between the Center and the States to collect, audit and distribute the revenue will be complicated issues requiring further deliberation and resolution before the new regime can take effect.

THE CONSTITUTIONAL AMENDMENT

Let us now turn to the key terms of the Constitutional Amendment. Essentially, it permits the Center to levy a tax on the *inter*-state supply of goods and services.[132] The revenue collected will be shared between the Centre and the States and to address the concerns of revenue loss by the States, the Centre will compensate the States for any loss of revenue for a period of up to 5 (five) years.[133]

131. http://www.ey.com/IN/en/Services/Tax/EY-goods-and-services-tax-gst

132. Clause 9 of the Constitutional Amendment, inserting Article 269A of the Constitution.

133. Clause 18 of the Constitutional Amendment.

The main highlights of the Constitutional Amendment are discussed below.

- **Powers of State and Union to frame GST laws**

  The Constitutional Amendment inserts a new article in the Constitution providing powers to the legislature of every State to make laws with respect to the GST imposed by the Union or such State. It provides the Parliament with the exclusive power with respect to GST where the supply of goods or services takes place in the course of *inter*-State trade or commerce. This essentially provides the framework for the anticipated IGST (in relation to *inter*-state supply of goods and services) and the CGST and SGST (in relation to the *intra*-state supply of goods and services).

- **Goods and Services Tax Council**

  The Constitutional Amendment sets out the framework for a Goods and Services Tax Council (the "**Council**") comprising of the Union Finance Minister as a chairperson and its members shall include the Union Minister of State in charge of Revenue or Finance and the Minister in charge of Finance or Taxation or any other Minister nominated by each State Government.

  The Council has the authority to consider and approve the taxes, cesses and surcharges to be merged under the GST (perhaps implying discretion in leaving certain taxes out) and approve the draft model law for the implementation of the GST regime (allowing the IGST, CGST and SGST). The Council also has powers to consider what goods and services may be subjected or exempted from the GST, what *threshold* limits apply to entities subject to the GST (for example, exemptions if turnover falls below a particular value), the floor rates and *bands* for GST (which again, implies discretionary power to agree different rates for different classes of goods and services) as well as special provisions for particular States.

  It should be noted that alcohol, the electricity market and petroleum products are currently excluded from the new regime, but it is anticipated that petroleum products will be brought within the purview of the GST in the future. At its last meeting in early November, the Council agreed to exempt items from GST, constituting up to 50 per cent of the weightage in the consumer price index basket.

  How does the Council take decisions? The quorum for meeting requires at least 50 per cent of its total members and every decision of the Council shall be taken by a *three quarter majority* (75 per cent) of members present and voting. Given that the Center will have one third of the votes and the States will have two thirds of the vote, while the Center cannot be out-voted, it will require agreement of a substantial number of States to take decisions.

  To date, the Council has met 4 (four) times. While it managed to agree on matters such as the threshold rates for businesses, anticipated to be Rs. 20 lakhs (except for businesses in the north eastern states, which is anticipated to be Rs. 10 lakhs), the division of administrative control over tax assessment has so far, proved to be problematic. It has been suggested that the States should have *sole* control over auditing businesses with a turnover of Rs. 1.5 crore or less, with dual administrative powers between the Center and the States for businesses above that threshold.

  Some commentators suggest that dividing administrative competence on the basis of thresholds is a bad idea, since turnover inevitably changes from year to year, requiring the transfer of jurisdiction for audit and administrative costs associated with that. The prospect of having the Center and the States administer the regime may lead to inefficiencies in the system, with a potential additional burden for business compliance.

  Up until now, the Council had been unable to decide what *rates* will apply to goods and services and the mechanism for compensating States that loose revenue under the new regime. What is almost certain is that it will not be a uniform rate for all goods and services. Latest indications in the media suggest that there will be *different* rates for *different* goods and services, falling broadly under 4 (four) bands set at 5 (five), 12 (twelve), 18 (eighteen) and 28 (twenty eight) per cent. In order to achieve compromise between stakeholders, multiple bands are perhaps unavoidable. Otherwise items currently taxed at low rates would necessarily become considerably more expensive for consumers at the lower end of the income pyramid.

  But the further challenge in setting the rate (or rates) is finding numbers that will be *revenue neutral* for the Center and the States (that is, a figure that will not put *either* out-of-pocket, or otherwise, in-pocket). Ultimately, the question of how to fund the loss of revenue for States as India moves to the new regime is going to be paramount. It seems likely that this will be addressed through an additional cess, or an increase in the GST rates for luxury goods, rather than the Central Government raising revenue from other taxable sources or the debt markets. Should the Council opt for an additional *cess*, it raises the question as to whether it will apply to all stages of the production chain, or simply the last stage of it and the danger of cascading taxes returns.

- **Integrated GST**

  The Constitutional Amendment inserts a new article (Article 269A) in the Constitution relating to the levy and collection of IGST. It provides that the Centre may levy and collect IGST on supplies in the course of *inter*-State trade or commerce and the tax collected will be *divided* between the Centre and the States in a manner to be provided by Parliament, by law, on the recommendations of the Council. This provides the framework for the enactment of the contemplated IGST Act (discussed further in section 4 (*The Model GST*) below).

  It should be noted that the amount apportioned to a State shall not form a part of the consolidated fund of India and that Parliament may, by law, formulate the principles for determining the place of supply, and when a supply of goods or services takes place in the course of *inter*-State trade or commerce. The Constitutional Amendment also states that the supply of goods or services in the course of *import* into India shall be deemed to be supply of goods or services in the course of *inter*-State trade or commerce.

- **Compensation to States**

  To address the risk of revenue imbalance as a result of the IGST, the provisions of the Constitutional Amendment provide that the Parliament shall, on the recommendation of the Council, provide compensation to the States for any loss of revenue from the date of introduction of the GST for a period of 5 (five) years. How this is going to be achieved is currently under discussion in the Council, though, as pointed out above, the possibility of an additional *cess* or the increase in rate of GST on luxury goods seems more likely to fund that deficit, rather than the Central Government raising new financing from other sources.

- **Transitional Provisions**

  The Constitutional Amendment provides that any provision of any law relating to the tax on goods or services in force in any State, which is inconsistent with the provisions of the Constitution as amended by the Constitutional Amendment shall continue to be in force until amended or repealed by a competent legislature or other competent authority or until expiration of 1 (one) year from the time when the Constitutional Amendment comes into force (8th September 2016), whichever is earlier.

  Although the Government has set an ambitious target of 1st April 2017 for the implementation of the new regime, it begs the question as to what happens if the regime isn't implemented by 9th September 2017. Would this provision mean that the *existing* law governing indirect taxation will lapse on 8th September 2017, essentially leaving the Center and the States without the constitutional power to raise indirect taxes?

THE MODEL GST

To facilitate the roll out of the GST after the Constitutional Amendment, the Ministry of Finance released the draft of the model GST law into the public domain in June 2016 (the "**Model GST**").[134] The Model GST contemplates the CGST Act, the SGST Act and the IGST Act. The IGST Act and the CGST Act will need to be passed by Parliament and each legislative assembly of each State will need to pass the SGST Act. We set out below the main highlights of the new regime below.

- **Defining Key Concepts**

  The Model GST defines key concepts including *Services, Business, Consideration, Deemed Export* and such other related aspects to bring out certainty in the taxing regime and it is essential that they remain uniform across the proposed IGST Act, the CGST Act and the SGST Act.

  However, some definitions have been drafted with a very wide ambit. In particular, "**Business**" could include activities that may not give rise to any monetary benefit.[135] Further, the definition of "**Services**" as meaning '*anything other than goods*' may lead to ambiguity when read in light with other laws.

- **Taxable Person**

  The Model GST defines a "**Taxable Person**" to be any person who has an aggregate annual turnover exceeding INR 1000000 (Indian Rupees Ten Lakhs) (approximately USD 15000) and carries on Business in any place in India and required to be registered under the Model GST. Government authorities have also been brought under the purview of the Model GST and shall be considered as Taxable Persons with respect to the activities they engage in. This provision in the Model GST brings in a uniform threshold for all the States with respect to the common activities with lower thresholds for special category States.[136]

  Exemptions from the category of Taxable Persons are available to: (1) employees providing services to an employer in the course of employment; (2) persons engaged in supplying goods that are not subjected to tax under the Model GST; and (3) any person, liable to pay tax on a *reverse charge* basis, receiving services of value not exceeding the amount as may be prescribed in a year for personal use, other than for use in the course or furtherance of his business.[137]

- **Registration**

  The Model GST sets out a detailed procedure for the registration of Taxable Persons including non-resident Taxable Persons, specialized agencies such as the United Nations and other international organizations. With respect to registration, the Model GST makes it mandatory for every person obtaining registration to have a *Permanent Account Number*. Although the Model GST requires Taxable Persons to register within 30 (thirty) days of its application, the law is silent on the timeline for grant of such registration. Separate registration is permissible for different verticals of a single business within a State.

- **Supply of goods or services**

  The liability to pay tax under the Model GST arises at the time of *supply* of the goods or services (and not *sale*). CGST and SGST[138] will be chargeable on the *intra*-state supply of goods and services and IGST will be chargeable on the *inter*-state supply of goods and services.

  The Model GST lays down detailed parameters to determine when the supply has taken place. The value of a supply shall be the transaction value (i.e. the price that is actually paid for the goods and services). Further, the Model GST mandates that registered Taxable Persons supplying goods and services shall at the time of the supply issue a tax invoice bearing all details of the tax to be paid.

  Note that the *inter*-state self-supply of goods and services (such as stock transfers) is taxable, even if there is no consideration. It is unclear at the moment whether an *Intra*-state stock transfers will attract CGST and SGST.

134. The Model GST Law contains the drafts of the Goods and Services Tax Act, 2016 and the Integrated Goods and Services Tax Act, 2016.

135. http://www.grantthornton.in/services/tax/indirect-tax/synopsis-of-the-model-goods-and-service-tax-law

136. D.S Rawat, Goods and Services Tax in India: Taking stock and setting expectations, http://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-gst-in-india-taking-stock-noexp.pdf

137. Section 9(3), Goods and Services Tax Act, 2016, Model GST.

138. See section 7(1) of the CGST and the SGST and section 4(1) of the IGST

- **Input Tax Credit**

  Registered Taxable Persons shall be entitled to claim an Input Tax Credit (i.e. a credit for the amount of tax such person has paid) and such credit shall be available for *set off* against the GST payable by him. "**Input**" means any goods, other than capital goods, subject to exceptions as may be provided under the Model GST, used or intended to be used by a supplier for making an outward supply in the course or furtherance of business. It should be noted that the purchaser of goods and services shall not be able to claim Input Tax Credit in the event that the seller is not a registered Taxable Person under the new regime.

  "**Input Tax**" has been defined in section 2 (57) of the Model GST as the tax charged on any supply of goods and/or services to him which are used, or are intended to be used, in the course or furtherance of his business.

  The time limit for claiming Input Tax Credit is 1 (one) year from the date of the invoice. In other words, tax paid by the manufacturer on inputs is deducted from the tax payable on the output produced. This concept operates through the manufacturing and distribution stage of production.

  Thus, unlike earlier tax policies, under GST, the tax is proposed to be collected only at the place of consumption.[139]

  A person willing to utilize Input Tax Credit shall claim the same within 1 (one) year from the date of invoice and should have possession of the tax invoice; receipt of the underlying supply of goods or services; evidence to confirm that the tax charged has been actually paid to the credit of the appropriate Government and should have submitted the return within the stipulated time period.[140]

  Essentially, Input Tax Credit provides businesses with the benefit of taxes paid further down the supply chain and therefore, eliminates the *cascading* of tax by taxing only the *value addition*.

- **Returns**

  The Model GST requires Taxable Persons to electronically provide regular returns of outward and inward supplies, inward tax credit availed, tax payable and tax paid. Further, it is mandatory for Taxable Persons to file annual returns before the 31st of December following the end of the financial year. Along with the returns, the Taxable Person is required to file audited financial statements, an annual return and a reconciliation statement. Returns under the Model GST are divided into: (1) monthly returns; (2) tax deducted at source (TDS) returns; (3) first returns (return filed by the Taxable Person before the end of the month of registration under the Model GST); (4) annual returns; (5) final returns (return to be filed before cancellation of registration by a Taxable Person); and (6) others returns

- **Refunds**

  Every Taxable Person claiming any refund under the Model GST shall be required to apply to the appropriate authority within 2 (two) years before expiry of the relevant date. The Model GST permits Taxable Persons to claim unutilized Input Tax Credit. When the amount claimed is less than INR 500000 (Indian Rupees Five Lakhs only) (approximately USD 7500) a mere declaration will be sufficient and no documentary evidence shall be required to be furnished.

- **Accounts and Records**

  Taxable Persons shall be responsible to maintain at the registered place of its business, books of accounts for a period of 60 (sixty) months from the last date of filing the annual returns. Additionally, such person shall also be bound to keep accounts that reflect a true and correct view of the production and supply of goods and services and details of any Input Tax Credit availed, if any. Where such Taxable Person is made a party to any proceeding or suit, he shall be responsible to maintain and keep all documents for a period of 1 (one) year from the date of disposal of such suit or proceeding.[141]

- **E-Commerce**

  With the growth of e-commerce activities, laws governing different sectors are evolving to include various business structures such as aggregators, facilitators and digital intermediaries. The Model GST also seeks to specifically cover the e-commerce sector and sets out specific guidelines for entities operating within this sector.

  Such e-commerce companies are required, at the time of credit of any amount to the account of a supplier of goods and services, to collect an amount from the amount payable to the supplier. Such collected amounts shall be required to be paid to the appropriate government with 10 (ten) days of the end of the month. The Model GST attracts a relatively low penalty of INR 25000 (Indian Rupees Twenty Five Thousand only) (approximately USD 375) for failure of e-commerce entities to provide information.

- **Transitional Provisions**

  Transitional provisions have been included in the Model GST specifying change of authorities, migration of the existing tax payer base (who shall be issued a provisional certificate of registration for a period of 6 (six) months), processing of existing refunds, CENVAT credit yet to be availed and treatment of long term construction contracts. In case of rise in price of pre-GST agreements, documents such as credit notes shall be required to be issued within 30 (thirty) days.[142]

139. http://www.prsindia.org/uploads/media/Constitution%20122nd/Brief--%20GST,%202014.pdf

140. https://www.pwc.in/assets/pdfs/services/tax/indirect_news_alert/2016/decoding_the_draft_model_gst_law-key_features_of_the_draft_model_gst_law.pdf

141. Section 47, the Goods and Services Tax Act, 2016, Model GST

142. http://www.grantthornton.in/services/tax/indirect-tax/synopsis-of-the-model-goods-and-service-tax-law/

- **Penalty**

  Historically, an area of dissatisfaction amongst taxpayers has been the propensity of the tax authorities to impose disproportionately high penalties for breaches of law, which may not be that serious. In order to address this concern, certain general principles have been incorporated in the Model GST. These principles include: (i) no substantial penalties shall be imposed for minor breaches of tax regulations or procedural requirements; (ii) no penalty shall be imposed in respect of any omission or mistake in documentation which is easily rectifiable and obviously made without fraudulent intent or gross negligence; and (iii) penalties shall be commensurate with the degree and severity of the breach.

CONCLUSION

The complexity of integrating a national indirect tax regime amongst a federal system of states is starting to make itself apparent in the meetings of the Council. Initial consensus on exemptions and the responsibility for administering the system seems to be eroding as the Center and the States grapple with the realities of how to transition the existing administrative regime to a new regime. What seems clear is that the idea of *one* tax anticipated by the GST is likely to be four taxes in a dual system.

Finalizing the rate structure and the mechanism for compensating States for loss of revenue will no doubt prove a difficult negotiation over the months to come and raising an additional cess on tobacco, aerated drinks and luxury goods at a high rate has been suggested by some. However, the problem with introducing a cess raises questions as to whether it will be a last point levy or a multi-point levy. If the latter, and there is no set-off mechanism, then a cascading of taxes will result: the very *opposite* of what the GST intends to achieve.

Excluding alcohol, the electricity market and deferring applicability to key petroleum products will mean that a convoluted tax (and the cascading of tax) will continue to apply in these sectors of the economy, somewhat contradicting the idea of creating a single tax market applying to all goods and services. In particular, excluding petroleum products will mean that Input Tax Credits may not be available in relation to the cost of manufacture of certain goods.

No doubt, the Parliament's winter session, scheduled to open on 16th November 2016 will be dominated by the need to pass the forms of the Model GST to give effect to the Constitutional Amendment and the Center will be hard pressed to implement the GST by April 2017.

The implementation of the GST is going to be complex affair and the implementation of the electronic payment architecture and institutions necessary to collect and distribute the revenue collected will be fraught with teething problems. Nevertheless, the new GST regime is an enormous achievement: *harmonizing* a system of indirect taxation by merging all indirect taxes into one tax (albeit in three different components).

The implementation of the GST will enlarge the tax base, increase compliance, eliminate to a great extent the cascading of taxes and reduce economic disturbances caused by different *inter*-state taxes: all necessary issues that must be dealt with if the Government is going to put in a solid framework for its flagship *Make in India* campaign.

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