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## NEW FDI RESTRICTIONS INTRODUCED FOR E-COMMERCE MARKETPLACE ENTITIES

### 1. INTRODUCTION

On December 26, 2018, the Department of Industrial Policy and Promotion under the Ministry of Commerce (the “DIPP”), through a press note (the “Press Note”),<sup>1</sup> introduced certain changes to the conditions applicable to e-commerce entities<sup>2</sup> under the consolidated foreign direct investment policy of 2017 (the “FDI Policy”).<sup>3</sup>

The DIPP has given companies time until February 1, 2019, to comply with the guidelines introduced by the Press Note.

### 2. CHANGES INTRODUCED THROUGH THE PRESS NOTE

The Press Note amends paragraph 5.2.15.2 of the FDI Policy, which sets out guidelines for e-commerce entities to receive 100% foreign direct investment (“FDI”) under the automatic route.<sup>4</sup> These guidelines also apply to e-commerce entities with FDI already. Further, the FDI Policy permits 100% FDI, under the automatic route, in *marketplace models of e-commerce*.<sup>5</sup> No FDI is permitted in *inventory-based models of e-commerce*.

Although the original content under the FDI Policy largely remains the same, the Press Note has introduced key changes which will have sweeping impact on e-commerce in India.

We discuss these changes, along with their possible impact, below.

#### 2.1 Control of Inventory

The position prior to the Press Note was as follows:

- (a) If an e-commerce marketplace entity exercises *ownership* over inventory, it will be deemed to be an inventory-based model and cannot receive FDI.

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<sup>1</sup> Press Note No. 2 (2018 Series), available at [https://dipp.gov.in/sites/default/files/pn2\\_2018.pdf](https://dipp.gov.in/sites/default/files/pn2_2018.pdf).

<sup>2</sup> The FDI Policy defines e-commerce as the “*buying and selling of goods and services including digital products over digital & electronic network*”. Further, an e-commerce entity is “*a company incorporated under the Companies Act 1956 or the Companies Act 2013 or a foreign company covered under section 2 (42) of the Companies Act, 2013 or an office, branch or agency in India as provided in section 2 (v) (iii) of FEMA 1999, owned or controlled by a person resident outside India and conducting the e-commerce business.*” These definitions remain unchanged in the Press Note.

<sup>3</sup> Please refer to page 38 of the FDI Policy for paragraph 5.2.15.2, available at [https://dipp.gov.in/sites/default/files/CFPC\\_2017\\_FINAL\\_RELEASED\\_28.8.17.pdf](https://dipp.gov.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf).

<sup>4</sup> Under the FDI Policy, FDI can be received by companies under the *automatic route* or the *government route*. Under the *automatic route*, the non-resident investor or the Indian company does not require any approval from government of India for the investment. Under the *government route*, prior approval of the government of India is required. Proposals for FDI under the government route are considered by the respective administrative ministry or department of the government of India.

<sup>5</sup> The FDI Policy defines a marketplace-based model of e-commerce as “*providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller*”.

- (b) An e-commerce marketplace entity is not permitted to have more than 25% of the sales value generated through its marketplace platform from one vendor or a vendor's group companies (the "**Previous 25% Restriction**").

The changes introduced under the Press Note are as follows:

- (a) In addition to *ownership*, if an e-commerce marketplace entity exercises *control* over inventory, it will be deemed to be an inventory-based model and cannot receive FDI. A marketplace entity will be deemed to *control* the inventory of a vendor if more than 25% of the purchases of such a vendor are from the marketplace entity or its group companies.
- (b) A vendor will not be allowed to sell on a marketplace entity's platform if the *control* of the vendor's inventory is deemed to be with such marketplace entity or its group companies.
- (c) The Previous 25% Restriction has been removed.

## 2.2 Services by the Marketplace Entity

The position prior to the Press Note was that e-commerce marketplace entities shall not directly or indirectly influence the sale price of goods or services, and shall maintain a level playing field.

The clarification introduced under the Press Note is that services may be provided to vendors on an e-commerce marketplace, only at arm's length and in a fair and non-discriminatory manner by: (a) marketplace entities; or (b) other entities in which a marketplace entity has *direct or indirect equity participation* or *common control* (the "**Fairness Requirement**"). These services include, among other things, logistics, warehousing, advertising, marketing, payments and financing.

Interestingly, the Press Note specifically sets out that *cashback* provided to buyers by group companies of a marketplace entity shall be fair and non-discriminatory. This appears to be the only exemption contemplated for now. However, a marketplace entity providing services to a vendor on terms which are not made available to other vendors *in similar circumstances*, will be deemed unfair and discriminatory. The Press Note is silent on what will be considered *similar circumstances*.

## 2.3 Equity Ownership

The Press Note has introduced a new restriction which states that a vendor will not be allowed to sell on a marketplace entity's platform if such marketplace entity or its group companies hold any stake or have equity participation in the vendor.

## 2.4 Exclusivity

The Press Note has introduced a new restriction which states that a marketplace entity shall not *mandate* any vendor to sell any product *exclusively* on such marketplace entity's platform.

## 2.5 Submission to the Reserve Bank of India

The Press Note has introduced a new requirement for marketplace entities to provide a certificate, along with a report of a statutory auditor, to the Reserve Bank of India (the "**RBI**"), confirming compliance with the guidelines under the Press Note, by the 30<sup>th</sup> of September every year, for the preceding financial year. Therefore, the first set of documents, post the Press

Note, will have to be submitted to the RBI by September 30, 2019, for the financial year 2018-2019.

### 3. **INDUSLAW VIEW**

The changes introduced through the Press Note are likely to have far-reaching consequences for small and large players in the e-commerce space in India.

#### 3.1. **Control of Inventory**

The language used in the Press Note<sup>6</sup> states that an e-commerce marketplace entity will be deemed to control the inventory of a vendor if *more than 25% of the purchases of such a vendor are from the marketplace entity or its group companies*.

This leads to two possible interpretations. The first interpretation is that ‘*purchases of such a vendor from the marketplace*’, relates to ‘*sales generated by such a vendor through the marketplace*’ (“**Interpretation 1**”).

The second interpretation is that the restriction relates to *purchases by the vendor from the marketplace entity and its group companies* (“**Interpretation 2**”).

The implication of these two interpretations is entirely different.

The general industry view appears to be veering towards Interpretation 1. However, there are substantial arguments to justify Interpretation 2, which are set out below.

The language of the Press Note:

- | refers to *purchases* of a vendor, and not *sales* by a vendor;
- | refers to purchases from a *marketplace entity*, and not purchases or sales on the *marketplace*; and
- | refers to purchases from the marketplace entity or *its group companies*. Reference to *group companies* suggests that the restriction is on sales *to* the vendor, and not sales *by* the vendor.

Interpretation 2 appears to target marketplace entities which channel inventory to vendors for ultimate sale on the marketplace platform.

#### (a) **Questions arising from Interpretation 1**

If Interpretation 1 is taken, the following questions arise:

- (i) Will this restriction, which seemingly applies to *products*, apply to pure-play *service providers* such as cab aggregators, travel platforms and hospitality aggregators, whose partners’ revenue or income is derived mainly from them?
- (ii) Will food delivery services be hit by this, as well? Will the restaurants and home kitchens whose substantial revenue comes from these food delivery services be prohibited from operating on their platform? Will the kitchens operated by or under the control of the food delivery services be hit by the restriction?
- (iii) Will indigenous craftsmen and other small vendors, who depend substantially on marketplace platforms, be forced to delist their products from the platform?

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<sup>6</sup> Please refer to paragraph 5.2.15.2.4(iv) of the Press Note.

- (iv) Will the inventory of brick-and-mortar stores, which is also listed on marketplace platforms and generates substantial revenue through these platforms, be deemed to be controlled by the marketplace platform?

**(b) Questions arising from Interpretation 2**

If Interpretation 2 is taken, the following questions arise:

- (i) Can a vendor sell 100% of its products on a marketplace platform, if it does not purchase more than 25% of its products from the marketplace entity or its group companies?
- (ii) How will this play out in light of the exclusivity restriction?<sup>7</sup>

**(c) Other questions arising out of Interpretation 1 and Interpretation 2**

The Press Note conjures up a number of other considerations which will require further reflection.

- (i) Since the Previous 25% Restriction has been deleted altogether, can the sales from one vendor, along with its group companies, constitute up to 100% of the total sales on a marketplace entity's platform?
- (ii) How will the marketplace entity or its statutory auditor have access to the financial statements and accounts of each vendor on the platform, to determine whether the vendors' sales, as per Interpretation 1, or purchases, as per Interpretation 12, are within the limit of 25%?
- (iii) Will each vendor on the platform be required to submit a certificate of compliance to the marketplace entity, or will the statutory auditor of the marketplace entity be required to carry out an audit of every single vendor on the platform?
- (iv) How can a marketplace entity control what the vendor does? What happens in a case where a vendor makes a commitment to the marketplace entity and then defaults on such commitment?
- (vi) What happens to marketplace entities which are not able to adhere to the restrictions for the financial year 2018-19, given the transactions on their platforms till date?

**3.2. Services by the Marketplace Entity**

The Fairness Requirement introduced under the Press Note raises questions for instances where a marketplace entity has minority participation in another company without control of its board of directors. In such a case, how will the Fairness Requirement be enforced in respect of entities where the marketplace entity does not have control?

Further, the reference to *similar circumstances* is a fairly vague term. It begs questions on what constitutes *similar circumstances*, and what degree of flexibility or preferred treatment is intended to be permissible.

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<sup>7</sup> Please refer to paragraph 5.2.15.2.4(xi) of the Press Note.

### 3.3. Equity Ownership

The restriction appears to be very wide and applies even if the entity that has equity participation from a marketplace entity is allowed to carry on retail sales under the FDI Policy.

### 3.4. Exclusivity

The Press Note states that a marketplace entity *shall not mandate* any vendor to sell any or all of its products exclusively on its platform. This can be viewed as being a restriction only if such exclusivity is *imposed* by the marketplace entity. It does not prohibit a vendor from *voluntarily* selling exclusively on the platform.

However, it is unclear whether this condition will be deemed to be violated in the event a vendor has brick-and-mortar stores or sells on its website, but also has an arrangement with a marketplace platform on an exclusive basis.

### 3.5. Conclusion

It is certain that, in the near future and over time, a number of other questions will arise with respect to the Press Note and the intention behind the changes introduced. Meanwhile, it may be prudent for the DIPP to extend the effective date of the Press Note from February 1, 2019, to provide companies adequate time to comply with the revised guidelines, given that a month may not be sufficient.

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