L&S UPDATE

An e-update to clients from Lakshmikumaran & Sridharan

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CORPORATE

FDI Policy revised to curb opportunistic takeovers

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The extant COVID-19 pandemic has been plaguing individuals and industries alike. The Government of India has, with a view to curb opportunistic takeovers/acquisitions of Indian companies due to the COVID-19 pandemic, reviewed and revised the extant foreign direct investment ("**FDI**") policy dated August 28, 2017 ("**FDI Policy**"), issued by the Department for Promotions of Industry and Internal Trade ("**DPIIT**") vide press note 3 of 2020 dated April 17, 2020 ("**Press Note 3**").

ANALYSIS

Restriction on FDI from bordering countries:

As per the revised FDI Policy, an entity situated in a country which shares a land border with India ("**Bordering Country**"), or any person who is a beneficial owner of an investment into India, and is situated in or is a citizen of any such Bordering Country (collectively, the "**Restricted Person**"), can invest in India (other than in sectors/activities prohibited for foreign investment) only with prior government approval.

This implies that now (a) entities situated in or controlled by citizens of Afghanistan, Nepal, Myanmar, China, Bhutan; or (b) individuals of these countries will need a prior government approval for investing in India (entities incorporated in, and citizens of, Bangladesh and Pakistan were required to obtain a government approval for an investment into an Indian entity earlier also).

Additionally, investment by citizens of Pakistan and entities incorporated in Pakistan in defence, space, atomic energy and other sectors/activities prohibited for foreign investment remains completely prohibited as earlier.

Beneficial ownership also covered:

Press Note 3 also clarifies that any transfer of an existing or future FDI in an entity in India which results in the beneficial ownership in the Indian entity being held in by a Restricted Person, will also require government approval.

While the basic intent appears to be regulating investments made directly or indirectly through other jurisdictions, the manner of determination of the beneficial ownership remains unclear as the Press Note 3 does not prescribe any percentage threshold or the number of levels that will be considered for ascertaining the 'beneficial ownership' of the investment in an Indian entity.

In the present form and in absence of any clarifications, the ambit of Press Note 3 is wide enough to cover multi-layered downstream investments and may entail significant scrutiny of the investment proposals.

INTENT AND IMPLEMENTATION

While the government has issued the Press Note 3 with an intent to curb opportunistic takeovers in Indian companies due to COVID-19 pandemic, the revised regulations will operate to regulate all investments directly or indirectly by citizens and entities of a Bordering Country. It appears that the government is seeking to regulate all the incoming investments from a Bordering Country (directly or indirectly) to ascertain the intent of such an investment.

The Press Note 3 will come into effect from the date of a notification issued under the *Foreign Exchange Management Act, 1999* ("**FEMA**"). The notification under FEMA will be issued by the Reserve Bank of India ("**RBI**").

Upon implementation of the revised regulations, any investment falling within the purview of Press Note 3 will need to undergo the process of a government approval which presently is elaborated in the standard operating procedure ("**SOP**") for processing FDI proposals dated June 29, 2017 ("**2017 SOP**").

CONUNDRUM

While the government's stated intent behind the Press Note 3 is to curb opportunistic takeovers on account of COVID-19, Press Note 3 will have implications for companies having investments in India from a Restricted Person. This is because as per the existing provisions of the Press Note 3, and in absence of any clarifications, additional equity infusions by citizens or companies of a Bordering Country in their existing Indian entities are also likely to fall within the purview of Press Note 3 and will consequently require government approval.

At present, the language of the Press Note 3 is wide enough to regulate investments made by pure financial investors/investment funds from other jurisdictions having any Restricted Person as a beneficiary as well.

CONCLUSION

Press Note 3 appears to have been issued with an intent to curb opportunistic takeovers by citizens and companies of any Bordering Country.

However, in its current form, the Press Note 3 subjects every investment (directly or through any other jurisdiction) by a Restricted Person into Indian entities (engaged in permitted sectors) to scrutiny by the government. This potentially covers investments by financial investors having any Restricted Person as a beneficiary and will also impact future investments by any Restricted Person into Indian entities already having investments by a Restricted Person.

While the Press Note 3 has been issued, the revised regulations will come into effect only after the RBI issues a notification under FEMA for its implementation.

We hope that the RBI will come up with a comprehensive framework for the revised regulations including details on the manner of ascertaining 'beneficial ownership' and providing reasonable exceptions in order to clarify the position around the restrictions sought to be imposed under the revised regulations.

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