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Investments from China require Government Approval- Fair Dealing is a Key

The unequivocal lockdown declared by the Government of India towards the end of March 2020 is primarily considered to be the most potential and effective preventive measure against COVID-19. However, everything has its own cost and in the present case, where India is undergoing economic slowdown, which may make many Indian corporates an easy target for acquisition by foreign entities.

Thus, in order to curb this opportunistic or the price advantageous takeovers in the time of worldwide catastrophe, the Ministry of Commerce and Industries, Government of India has notified **Press Note 3 (2020 series) dated April 17, 2020** which seeks impose stricter measures on foreign investment in India. This step is consistent with the recent measures adopted by the other jurisdictions like European Union, Australia, etc. to protect their domestic companies from opportunistic takeovers.

The key to get the approval of the Government of India, is the fair dealing and fair pricing. For instance, one of factor is that the proposed investment or the acquisition should be at the fair price i.e. atleast the price prevailing prior to the COVID-19 impact on India.

Amended Provision for foreign investments

Under the revised framework, any investment in India from the following shall entail Government's approval:

1. Entity based in a country which shares land border with India; or
2. Beneficial owner of investment is situated in or is a citizen of such country.

Likewise, the restriction shall be applicable for transfer of ownership of an Indian entity, directly or indirectly in favour of the restricted persons mentioned above. Previously, only Pakistan and Bangladesh were in such stringent purview. But now 7 countries are in the mandatory approval zone, including Bhutan, Nepal, Myanmar, Afghanistan and China (in addition to Pakistan and Bangladesh).

The provisions have been notified vide **Foreign Exchange Management (Non-debt Instruments) Amendment Rules, 2019 ("**NDI Amendment Rules") in the Official Gazette on April 22, 2020 by the Department of Economic Affairs, Ministry of Finance**.**

Government Restrictive Actions and Impact

The revised directions are a result of growing apprehensions about the Chinese entities taking over or acquiring Indian entities facing economic stress caused by COVID-19 outbreak.

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The new restrictions will have a major impact not only on the greenfield and brownfield investments from China but also on the existing investment structures where investors from China have invested. In the manner:

- many of Indian start-ups including BigBasket, Make My Trip, Zomato and Swiggy have raised large funds from Chinese investors. By virtue of the amended provision, these companies will now see a regulatory intervention during future fundraising from such investors;

- further, the Government has not demarcated between the sectors, which means that any investment from the restricted countries in any sector shall be under the scrutiny of the Government;

- -the usage of the term 'investment' in the press release for the restrictions, the Government has amplified its supervisory powers by impliedly including every form of investment, whether direct or indirect, primary or secondary in its arena of assessment.

- the existing contracts having obligations to issue/transfer shares (through fresh issuance, exercise of options or conversion of non-equity instruments into equity), to Chinese investors or to entities whose beneficial ownership lies with Chinese citizens (or any other investor from restricted territory) will also come under the approval mode;

- acquisition of an entity located in a foreign jurisdiction by investors from China or other neighboring countries, having existing investments in India.

The amended provision, which is prospective in nature, is a test by virtue of which any potential investment for acquisition or set up or transfer of ownership from neighboring countries such as China, will pass through the eyes of the Government to review the bonafide of the transaction from the point of view of fair pricing and the interest of economy as a whole. This shall give a chance to the Government to prevent the price advantageous or hostile or opportunistic takeovers being faced by the Indian entities at the time of distressed economy owing to COVID-19 pandemic.

<u>Fair Dealing as a Key</u>

We see fair dealing in the pricing may likely be the key to pass through the Government Approval process, i.e. where the government is satisfied that no undue benefit is obtained out of the stressed situation occurred due to the COVID-19. This fair dealing may be established through various factors, where one of the factors is undertaking the investment at the price, which is not opportunistic. The other factors such as the nature and size of the investment, credentials of the Investor, sector of investment etc., subjective to the investment would also be considered.

Further Clarifications

The Government has acted proactively by issuance of the revised norms, but there are certain issues, which are yet to be addressed.

Beneficial Ownership and size of Investments

The term 'Beneficial Owner' as used in the press note 3 and the NDI Amendment Rules is subject to wide enough interpretation to include every form of investment, i.e. a person holding even a single share could also be potentially covered under it. There is a need of clarity on what amounts to beneficial ownership that may necessitate the required approvals from the Government of India. For instance, seeking prior approval for small or immaterial investment (based upon the size and quantum of acquisition) may be waived.

Hong Kong to be considered part of China?

Hong Kong is a special administrative region in South China that enjoys a measure of autonomy under a "one country, two systems" policy agreed at the time of its 1997 handover from Britain. Further, India has a separate tax treaty with Hong Kong, which is in addition to China. Therefore, it may be inferred that the Government of India recognizes Hong Kong as a separate autonomous region for tax and investment purposes. However, in the absence of any specific exclusion in the press release and its extensive scope applying to the countries sharing land borders with India, it is unclear whether investment from Hong Kong is also subject to the approval requirements at par with investments from mainland China or not.

Thus, in the coming times, clarification on these issues may be expected from the Government.

Approval Process

The term 'Government's Approval' here means the approval of the competent authorities as mentioned in the Standard Operating Procedures issued by Department for Promotion of Industry and Internal Trade (**"DPIIT"**) (earlier known as Department of Industrial Policy and Promotion) on abolition of Foreign Investment Promotion Board (**"FIPB"**) in the year 2017.

The application for obtaining the Government's approval will be filed online on the revamped FIPB portal, rechristened as Foreign Investment Facilitation Portal in the prescribed format and required documents. DPIIT will identify the concerned Administrative Ministry/Department and e-transfer the proposal to the concerned Administrative Ministry/Department (Competent Authority), which will be further scrutinized and final directions may be issued and communicated within an expected period of 2 to 3 months from the receipt of application by the DPIIT.

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