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## FDI Policy amended to curb acquisitions of Indian Cos due to COVID-19 - Press Note 3 of 2020

On April 18, 2020, the Central Government amended the Consolidated FDI Policy 2017 (“**FDI Policy**”), with the stated view of curbing “opportunistic takeovers/acquisitions of Indian companies” due to COVID-19. Press Note 3 of 2020 (“PN 3”) issued by DPIIT amends paragraph 3.1.1 of the FDI Policy, to introduce the following two new restrictions (while leaving prior restrictions intact):

1. An entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route.
2. Government approval will also be required where subsequent changes in beneficial ownership (by way of direct or indirect transfers) of any existing or future FDI would result in such beneficial ownership falling within the purview of the first restriction.

The largest impact will be to investments from China, although this development will also impact investments from Pakistan, Bangladesh, Myanmar, Bhutan, Afghanistan and Nepal.

This development is expected to have a large impact on the fundraising efforts of start-ups and other companies, in a time where sources of funding have already diminished.

Companies that already have Chinese investors on board will find follow-on rounds difficult to undertake if those investors do not waive their rights to play pro-rata. This policy change will also impact exits for financial investors, as potential transferees may need to be tested for compliance with the beneficial ownership, citizenship and location restrictions. Similar challenges may be faced by holders of rights of pre-emption in Indian companies against other shareholders. The exercise of such rights, and the effect of PN 3 on the same, are likely to either result in delays while approvals are sought, or disputes where the implications of PN 3 on existing rights of pre-emption or capitalisation will come into scrutiny.

This policy change may also impact foreign entities, who have subsidiaries, group companies or investee companies in India, and who are seeking to raise funds in their own offshore jurisdictions, or whose shareholders are looking to sell their stakes, or who are looking to further capitalise their Indian interests.

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It is important to note that existing provisions in the FDI Policy may permit companies to seek approvals once, and attempt to use those approvals for additional foreign investment up to a cumulative amount of Rs. 50,000,000,000 (fifty billion Rupees) into the same entity within an approved foreign equity percentage/or into a wholly owned subsidiary. This means that tranching investments may not require separate approvals for each tranche, subject of course to the terms of such approvals. Companies undertaking or planning capital events based upon existing approvals may need to re-evaluate the same, as similar dispensations already available under the FDI Policy for approvals already granted may need to be revisited in light of the revised policy.

Concerns will also be felt around the fact that PN 3 uses, but does not define, the terms “beneficial owner” and “beneficial ownership”. These terms could be potentially be interpreted by reference to similar terms under either the Companies Act, 2013, or the Reserve Bank of India’s Master Direction - Know Your Customer Directions, 2016. However, given that these terms are defined very differently under these two pieces of legislation, it would be important to see if clarity emerges within the construct of exchange control laws. The use of the terms “direct or indirect” will also create a degree of uncertainty as to how to determine the ambit of the restrictions. The amendments will come into force with effect from the date of the FEMA notification operationalising this policy change, and perhaps clarity will emerge therein.

Based on the provision being amended through PN 3, it appears that portfolio investments by FPIs are outside the ambit of the proposed changes. There is some concern in some quarters that PN 3 could also be read as applying to portfolio investments by FPIs, although a plain reading would not support this. Portfolio investments by FPIs are otherwise regulated by SEBI, and recent press reports suggest that SEBI has recently asked custodians for details of investments coming from or via China into Indian stock markets. Therefore, it is not unlikely that SEBI might independently consider similar measures as well. Any overly conservative readings or additional severe measures would have a meaningful impact on Indian stock markets, since a number of public market funds that invest into India are based out of Hong Kong.

Whether such changes would result in claims under the applicable bilateral investment treaties, would also need further evaluation.