



DIPP PRESS NOTE ON THE CONSOLIDATED FDI POLICY FOR E-COMMERCE

The Department of Industrial Policy and Promotion (DIPP) has issued Press Note 2 on 26 December 2018 which shall come into effect from 1 February 2019 (Press Note). The Press Note seeks to amend the Consolidated FDI Policy issued on 28 August 2017 (FDI Policy) in relation to foreign direct investments in the e-commerce sector.

The changes are material and significantly impacts the structure and business models of various e-commerce marketplaces (E-commerce Marketplace) which are owned by entities with foreign direct investments (E-Commerce Entity). Further, there are reports of India announcing a new draft e-commerce policy “in a few weeks” and even appointing a regulator for the sector.

Equity participation in seller entities

The most significant change has been the addition of the stipulation that any entity shall not be permitted to sell its products on an E-commerce Marketplace run by an E-commerce Entity if:

- (i) the E-commerce Entity or its group companies has an “equity participation” in such entity; or
- (ii) the E-commerce Entity or its group companies has control over the inventory of such entity.

Analysis: Many e-commerce entities operating in India have made (or entities controlled by them have made) investments in entities (First Level JV Entity) that are owned and controlled by an Indian resident. The First Level JV Entities establish further subsidiaries (Second Level JV Entity). In light of the current guidelines on downstream investments, these Second Level JV Entities or group entities are not subjected to similar obligations as applicable to foreign direct investment in First Level JV Entity.

The Press Note has introduced the ambiguous term “equity participation” and now, if an E-Commerce Entity or its group companies has any “equity participation” in a company, such company shall not be permitted to sell goods on the E-commerce Marketplace.

This raises many issues:

- First, whether in the structure set out above, Second Level JV Entities would be deemed to have “equity participation” by E-Commerce Entities or its group companies, especially since downstream investment rules indicate that Second Level JV Entities do not have any indirect FDI if its holding company is Indian owned and controlled.
- Second, the usage of the term “equity participation” in Clause (v) of Paragraph 5.2.15.2.4 as compared to the usage of the term “direct or indirect equity participation” in the following Clause (ix) of Paragraph 5.2.15.2.4, begs the question as to what the correct position is.

¹ The FDI Policy defines a “group company” as “two or more enterprises which, directly or indirectly, are in a position to:

- (i) exercise twenty-six percent or more of voting rights in other enterprise; or
- (ii) appoint more than fifty percent of members of board of directors in the other enterprise.”



- Third, whether there is an ‘grandfathering’ for the existing structures – although It appears that since the Press Note comes into effect from a prospective date (1 February 2019), all E-Commerce Entities should comply with the provisions of the Press Note.
- Finally, the FDI Policy defines ‘capital instrument’ as referring to equity shares, CCPS, CCDs and warrants. It is therefore unclear whether the term “equity participation” refers solely to equity investments or whether it includes investments using other instruments (such as CCPS, CCDs or warrants) as well.

Applicability of 25% threshold now on seller entities

Earlier, the FDI Policy stipulated that an E-commerce Entity shall not permit more than 25% of the sales value on a financial year basis from one seller or its group companies (Earlier Condition). The Earlier Condition has been omitted and the Press Note states that an E-commerce Entity shall be deemed to control the inventory of a seller (which is prohibited by the FDI Policy) if more than 25% of the purchases of such seller are from the E-Commerce Entity or its group companies (New Condition).

Analysis: Sellers that predominantly procure products from an E-Commerce Entity (or any of its group companies) may seek to comply with the New Condition by procuring products directly from other wholesalers, distributors or manufacturers. This may mean that each of such sellers may be required to build additional channels / relationships such that they comply with the New Condition. This may also place significant compliance burden for E-Commerce Entities as any non-compliance by sellers may lead to a contravention of the FDI Policy / Foreign Exchange Management Act, 1999 by E-Commerce Entities. An unintended consequence of this rule could be that an Indian seller (without any foreign investment) that procures its products from the wholesale venture of any group entity of an E-commerce Entity will have to diversify its sourcing channels. This will likely impact their margins. Further, the Press Note does not clarify whether the 25% threshold is to be reckoned on the basis of transactions in a financial year or otherwise (though it is likely that it is to be reckoned on sales in a financial year, as had been specified in the Earlier Condition).

Market participants are predicting that this rule shall impact sales of products bearing private labels of E-commerce Entities as there are certain sellers that exclusively sell such products in the E-Commerce Marketplace.



No exclusivity

An E-commerce Entity cannot require any seller to sell its products exclusively on its E-Commerce Marketplace only.

More Stipulations to Ensure Level Playing Field for All Sellers

The FDI Policy now stipulates that if an E-commerce Entity or any entity in which the E-commerce Entity has “direct or indirect equity participation” or is under common control, provides any services (including logistics, warehousing, payments, etc), such services should be provided to sellers in a fair and non-discriminatory manner.

‘Cashback’ offers to buyers are required to be given on a fair and non-discriminatory basis.

Analysis: In spirit, an E-commerce Entity should endeavour to run the E-Commerce Marketplace as a ‘level playing field’ by not favouring any particular sellers and undertaking transactions on an arm’s’ length basis. Once the Reserve Bank of India issues the appropriate notification to incorporate the provisions of the Press Note to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017, any breach by an E-commerce Entity of such condition could be proceeded against as a breach of the provisions of the Foreign Exchange Management Act, 1999.

Report to the Reserve Bank of India

E-Commerce Entities are required to furnish a certificate along with the report of the statutory auditor to the effect that the E-Commerce Entity is in compliance with the provisions under the FDI Policy applicable to e-commerce sector.