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ELP KNOWLEDGE SERIES

India Update

Part 4 of 2019

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FOREWORD

Dear Reader,

We welcome you to the latest edition of ELP Knowledge Series, a quarterly analysis of curated topics pertaining to critical legal and regulatory developments that can create risk for businesses in India.

In the last quarter, most notably, the Supreme Court of India has settled the corporate bankruptcy process in India through its landmark decision in the Essar Steel – Arcelor Mittal case. This judgment will definitely impact the non performing assets situation in the country.

Beyond this, consensus projections for India's growth are muted at around 5% (when compared to projections in the last decade). The Government has taken several steps to boost this and the Union Budget scheduled for February this year, holds great promise to large scale reforms that will further ease of doing business in India.

It is against this backdrop that this iteration of 'India Update – Part 4 of 2019' examines key judgments over the last quarter which will have a significant impact on doing business in India. Further, the judiciary, through decisive pronouncements provided an impetus to arbitration in India. To this end, our update examines a few key decisions of the Supreme Court in 2019 and how the same may be of relevance to stakeholders. The litigation section of this document also deals with tax decisions which highlight the current situation in India, post 2.5 years of GST being implemented.

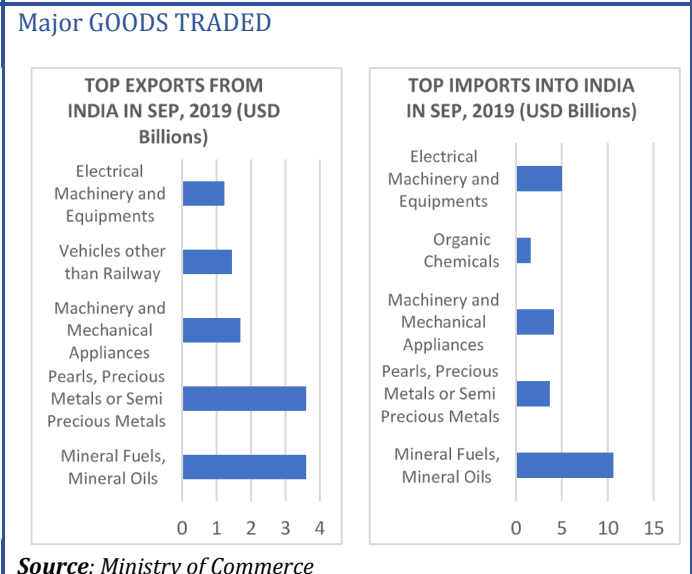
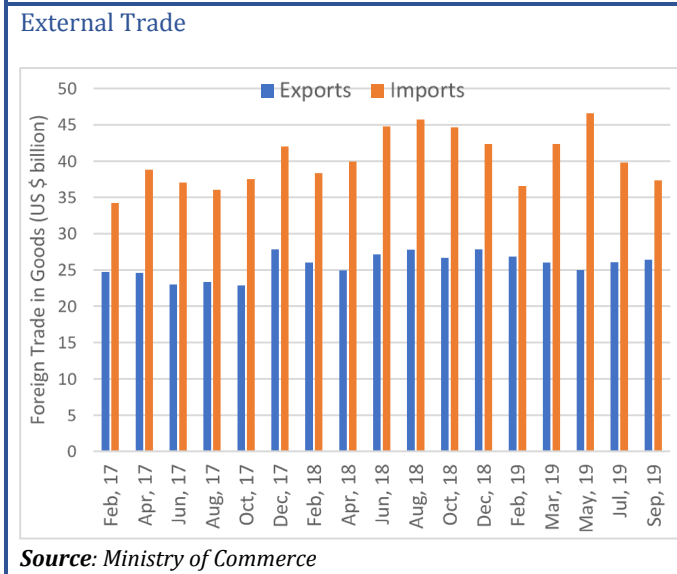
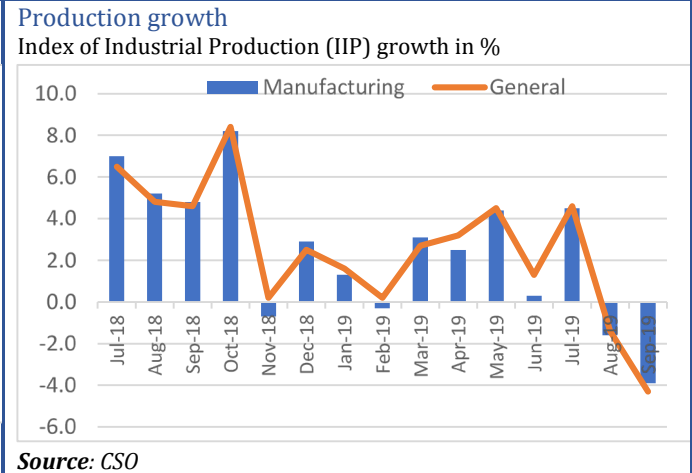
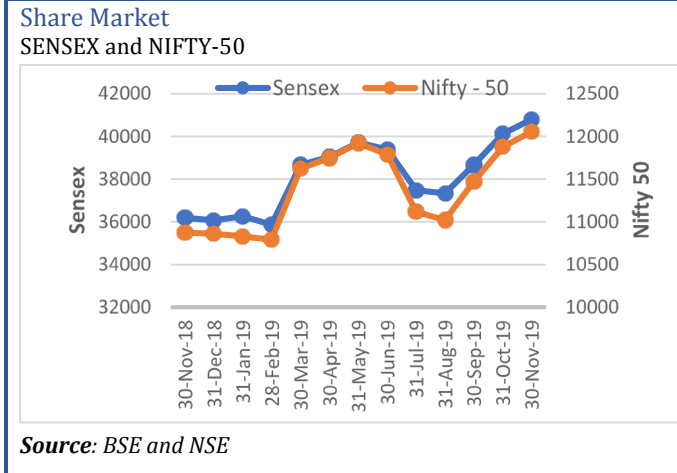
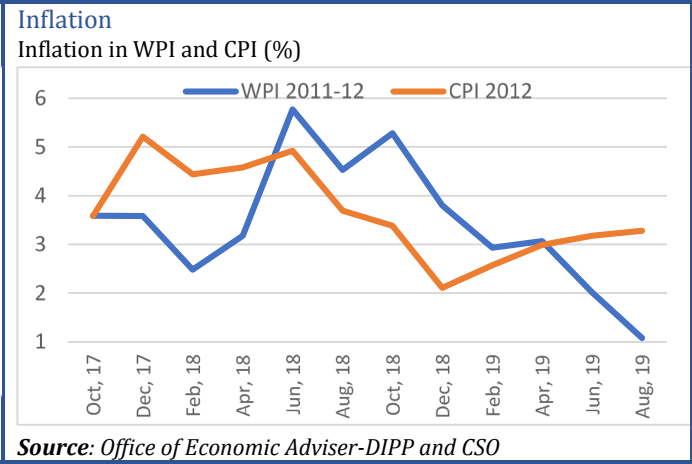
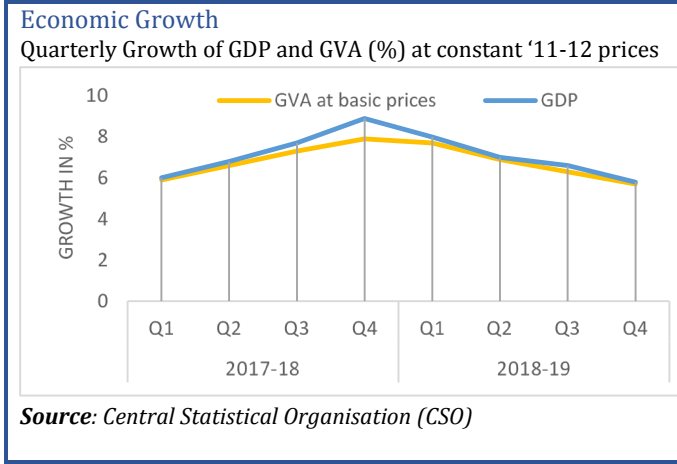
Many developments over the recent past – especially regarding compliances – be it India's evolving consumer protection regulations or Securities and Exchange Board of India's proposed framework for the issuance and listing of shares with superior or differential voting rights have also been analyzed in detail. Additionally, we have also added a section discussing the Open General Export License scheme for transfer of technology in India's defense and aerospace sector.

The update also discusses the interplay of Goods and Services Tax laws vis-à-vis Customs laws in India, sanctions being imposed by the United States and their consequent repercussions and competition law concerns permeating India's hospitality sector.

We hope you will find this information helpful. For any comments, clarification or further information, please connect with your point of contact at ELP or reach out to us at insights@elp-in.com.

Regards,
Team ELP

INDIAN ECONOMY - A SNAPSHOT



Tax Litigation: The Saga Continues

INTRODUCTION

'Litigation', said Ambrose Bierce, 'is a machine which you go into as a pig and come out of as a sausage'. A look at last year's Economic Survey will give us a sense of how many pigs are being turned into sausages in India. According to the recent Economic Survey 2019, close to INR 9.46 lakh crores is held up in tax litigation.

The Indirect Taxes in India included levy of Central Excise and Service Tax. The Hon'ble Finance Minister (FM) while presenting the Budget for the Fiscal year 2019-20 in her speech mentioned that currently INR 3.75 lakh crores is blocked in litigations in service tax and excise. The quantum of litigation that is pending in various appellate fora for excise and service tax could be imagined with the above statistic.

In order to allow the businesses to unload this baggage and be free from legacy litigations the FM introduced the 'Sabka Vikas (Legacy Dispute Resolution) Scheme, 2019' for excise and service tax matters. The scheme has been notified recently and at present not many taxpayers seem to have opted for the scheme considering there are certain grey areas which still leave the question open of whether a taxpayer is eligible to opt for the scheme or not.

Given the increasing indirect tax woes being faced by industry, the Government of India introduced Goods and Services Tax (GST) in the year 2017. Key objectives for the introduction of GST were to remove the cascading effect of taxes, and to allow seamless credit of the taxed paid.

Another aim to be achieved with the introduction of GST was to reduce litigation. For businesses to flourish, it is imperative for the tax environment to be conducive. One of the fears that haunts business entities doing business in/with India is the rampant litigation and the amount of time taken for litigation to conclude. GST as it is being perceived by industry, is falling short of success on a core parameter for judging tax reforms i.e. reduced litigation.

Looking back, over 2.5 years have passed since the introduction of GST and the given objective seems far from being achieved considering the large amount of writ petitions and advance ruling applications that are being filed every day.

A number of disputes have already arisen in relation to credit transitioned by the taxpayers into GST let alone the credit availed under GST. An overview of some burning issues in the GST regime, which affects businesses across India will reveal the criticality of GST disputes that haunts business entities today.

TRANSITIONAL CREDIT

Most disputes that have arisen are in relation to technical glitches being faced at the time of filing of the Form TRAN-1 for transition of the existing credit by the assessee. Writ Petitions were filed in the jurisdictional High Courts to address the difficulties being faced and many High Courts have entertained the writ petitions and granted relief to the taxpayers.

The other class of disputes that have arisen are in relation to the time-limit for claiming of transitional credit. The Gujarat High Court and Bombay High Court have expressed contrary views on the said issue. The Gujarat High Court following the ratio of the Supreme Court decisions in the erstwhile regime, held that the right to transitional credit is 'indefeasible' and the prescription of time-limit for claiming transitional credit is procedural in nature and not mandatory.¹

Apart from the above litigations which were more in nature of issues being faced during transitioning from old indirect tax regime into the new one, the other issues which challenge the jurisdiction of actions taken by the revenue are going ahead in full steam. Some of these are articulated below.

There was a huge hue and cry amongst the business community when GST was introduced in relation to transition of Education Cess, Secondary/Higher Education Cess and Krishi

¹ i) Siddharth Enterprises [TS-684-HC-2019(Guj)-NT] and Filco Trade Centre Pvt. Ltd. [2018-TIOL-2861-HC-AHM-GST]

ii) JCB India Ltd. [2018-TIOL-23-HC-MUM-GST]

Kalyan Cess (**KKC**) into GST. Clarifications were issued by the CBIC vide FAQs that the said credit would not be allowed to be transitioned under GST. On challenge, Madras High Court allowed the writ petition and held that the transition of the said credit under GST is valid under law². It is yet to be seen how the other High Courts of the country interpret the provisions with regard to the given issue.

Considering the contrary views taken by the High Courts it appears that the said issues would be settled only by the Supreme Court which would entail costs for the taxpayers.

ADVANCE AUTHORIZATION – EXEMPTION FROM IGST – ‘PRE-IMPORT’ CONDITION

Investigations have been initiated by Directorate of Revenue Intelligence (**DRI**) against Advance Authorization (**AA**) holders for claiming exemption from Integrated Goods and Services Tax (**IGST**) post July 1, 2017 on imports against AA. Gujarat High Court struck down the pre-import condition inserted with effect from 13.10.2017 for claiming exemption from IGST and held it to be ultra vires³ while Madras High Court dismissed the Writ Petition and upheld the constitutional validity⁴.

Before the judgment was pronounced, the exemption notification was amended to remove the pre-import condition and to insert condition vi(a) and vi(b) whereby in case the export obligation has been fulfilled by the company and the duty free imports are made as replenishment, a bond is required to be submitted that the said imported goods would not be used in the manufacture of exempted or nil rated goods. While these conditions are trickily worded, in view of two conflicting decisions, the scope for litigation does not narrow and the DRI would continue investigating the matters for denial of exemption from IGST.

LEVY OF IGST ON OCEAN FREIGHT

Various Writ Petitions have been filed across the High Courts in the country, challenging the levy of IGST on the component of ocean freight on the ground that the importer of goods not being the ‘recipient of service’ cannot be deemed to be the person liable to pay IGST under ‘reverse charge mechanism’ and supply of service by a person in a non-taxable territory (**transporter**) to a person in a non-taxable territory (**exporter**) is beyond the jurisdiction of IGST.

The Gujarat High Court has heard the petitions at length and the judgment is awaited. No final judgment has been received on this issue from any other High Court.

COMPOSITION OF GST TRIBUNAL – UNCONSTITUTIONAL?

The Union Cabinet in January 2019 approved the proposal to set up a national bench of the GST Appellate Tribunal (**GSTAT**) in the capital city. The composition of GSTAT has come under criticism as there is a single judicial member with two technical members (each from Centre and State). Thus, the number of technical members would outnumber the judicial member which is certainly likely to result in an apparent imbalance in rendering justice and could undermine the impartiality of the GSTAT.

The Madras High Court allowed the writ petition challenging the constitution of the GSTAT and held that the number of expert members cannot exceed the number of judicial members on the bench. The other High Courts are yet to pass a judgment on the said issue.

While the number of appeals currently filed before the first appellate authority is insignificant the decision to constitute GST Tribunal will have a significant impact on the dispute redressal system. Another critical aspect of GST is the power to arrest for violation of GST laws.

² Sutherland Global Services Pvt. Ltd. [2019-TIOL-2516-HC-MAD-GST]

³ Maxim Tubes Company Pvt. Ltd. [TS-79-HC-2019(GUJ)-NT]

⁴ Vedanta Ltd [WP (MD) 18435 to 18438 of 2018]

ARREST UNDER GST

Under GST, the officers have been granted the power to arrest a person in case he has a reason to believe that the said person has committed any of the four types of offences listed below and the amount of tax evaded or input tax credit wrongly availed exceeds INR 5 crore (Imprisonment for 5 years with fine) or INR 2 crore (Imprisonment for 3 years with fine) viz.

- Supply of goods or services without issuance of invoice
- Issue of invoice or bill without the supply of goods or services leading to wrongful availment or utilization of credit
- Availment of input tax credit basis the above point
- Collecting the tax but not paying to the Government

The heinous offences of collecting but not paying the tax and issuance of fake invoices coupled with availment of credit basis the same are covered under the scope of arrest. These offences are non-bailable and cognizable.

The Government officials have been robust and swift in their approach to nab such taxpayers dealing in fake invoices or involved in huge tax evasions. The Writ Petition filed by one such taxpayer challenging the action of arrest was dismissed by the Telangana High Court and the said decision was upheld by the Supreme Court. The Bombay High Court however in a similar matter had directed the revenue not to take any coercive steps and continued such relief. The Supreme Court in the appeal filed against the said order held that since contrary views are being expressed by High Courts a larger bench will be constituted by the Supreme Court to clarify the issue. Also, the Apex Court made it clear that in future the High Courts must keep in mind that Supreme Court did not interfere with the order of the High Court of Telangana dismissing the petition.

While the final verdict of the Supreme Court in the above matter is pending, the taxpayers on such arrest proposals approach the High Court seeking bail under the provisions of Section 439 of Code of Criminal Procedure, 1973 and generally, on consideration of bail applications, the taxpayers have been allowed bail on a deposit of a huge sum with a condition for daily appearance before the police authorities. Recently, these conditions were imposed on an MNC executive on grant of bail in relation to case for default in payment of tax after collection of GST⁵.

.....AND THE SAGA CONTINUES

Considering the size of the Indian economy and the complex business models, disputes between the taxpayers and the tax authorities is inevitable. This saga of tax litigation seems to be continuing in the GST era too. While there is a shift in the model of levy of indirect taxation in India, whether that shift can be aligned in the way the Revenue

thinks while administering the law, is the moot question. It would be interesting to see, given the controversial rulings from various High Courts, how the GST laws will shape up and if the government and the judiciary will be able to address the challenges in a time-bound manner.

This article has been published in MoneyControl

⁵ Choi Yongsuk and Chae Jae Won [TS-612-HC-2019(MAD)-NT]

Lessons from 2019 for the Indian Arbitration Regime: A Commercial Viewpoint

INTRODUCTION

The year 2019 saw a second amendment to the Arbitration and Conciliation Act, 1996 (**Act**) and a plethora of important judgments⁶. Against this context, we seek to, analyze a few decisions that have commercial significance for stakeholders. Our objective is not to deal with every decision, but to focus on those with important takeaways for contracting parties.

CHECK THAT ARBITRATION AGREEMENT: APPOINTMENT RIGHTS

With the Arbitration and Conciliation (Amendment) Act, 2015, (**2015 Amendment Act**), the position regarding eligibility of an arbitrator and the grounds that give rise to justifiable doubts as to an arbitrator's impartiality and independence became clear with the insertion of the Fifth and the Seventh Schedule. Starting with *TRF Ltd. v. Energo Engineering Projects Ltd.*⁷ the Supreme Court interpreted the amended provisions to state that a person who is ineligible to be an arbitrator cannot naturally exercise the right to appoint an arbitrator. This was followed up by *Bharat Broadband Network Ltd. v. United Telecoms Ltd.*⁸ Recently, in *Perkins Eastman Architects DPC & Anr. v. HSCC (India) Ltd.*⁹ (**Perkins Eastman**) the Supreme Court went one step further to state that where only one party has a right to appoint a sole arbitrator, its choice will always have an element of exclusivity in determining or charting the course for dispute resolution, and therefore such party having an interest in the outcome or decision of the dispute must not have the power to appoint a sole arbitrator.

The above decisions give the necessary

ammunition, during contract negotiation, to parties, which otherwise would not have an equal bargaining power, in ensuring that the appointment procedure under the arbitration agreement is equitable.

Pertinently, arbitration clauses granting unilateral appointment rights have been held to be valid in various jurisdictions for the reason that when sophisticated commercial parties agree to such clauses, the courts shall endeavor to give full effect to them. However, in India, owing to the unique circumstances, more particularly those which prevail in Public Sector contracts there has been an urgent need to address this issue. While purists may argue that the decision of *Perkins Eastman* goes against the grain of party autonomy, however, the contra argument is that a purge is necessary to address the ills of unilateral appointments in India, especially where such appointments are often muddled in opaque processes. Against this background the decision comes as a huge relief to many who suffer arbitrator bias, both covert and otherwise, and can do precious little to challenge the status quo.

CHECK THAT ARBITRATION AGREEMENT: SCOPE

Contracting parties must also be alive to certain aspects that can alter the very scope of what may be referred to arbitration. This may not be a bone of contention at the stage of appointment of an arbitrator under section 11 of the Act. As clarified in *Mayavati Trading (P) Ltd. v. Pradyut Deb Burman*¹⁰ (**Mayavati Trading**) a court is now restricted to merely examining the existence and not the scope of the arbitration agreement. While this decision seems to be indirectly in conflict

⁶ *Ssangyong Engineering & Construction Co. Ltd. v. NHAI*, 2019 SCC Online SC 677; *Brahmani River Pellets Ltd. v. Kamachi Industries Ltd.*, 2019 SCC Online SC 929; *BGS SGS Soma JV v. NHPC Ltd.*, CA No. 9307 of 2019, Supreme Court, dated 10 December 2019; *Rashid Raza v Sadaf Akhtar*, (2019) 8 SCC 710; *Canara Nidhi Ltd. v. M. Shashikala*, (2019) 9 SCC 462; *Glencore International AG v. Dalmia Cement (Bharat) Ltd.*, 2019 SCC Online Del 9634; *WAPCOS Ltd. v. Salma Dam Joint Venture and Anr.*, 2019 SCC Online SC 1464; *M/s Uttarakhand Purv Sainik Kalyan Nigam Ltd. v. Northern Coal Field Ltd.*, SLP No. 11476 of 2018, Supreme Court, dated 27 November 2019.

⁷ (2017) 8 SCC 377.

⁸ (2019) 5 SCC 755.

⁹ Arbitration Application No. 32 of 2019, Supreme Court, dated 26 November 2019.

¹⁰ (2019) 8 SCC 714.

with *Oriental Insurance Co. Ltd. v. Narbheram Power and Steel (P) Ltd.*¹¹, it signals the correct approach towards the restricted scope of inquiry at the stage of appointment. Expectedly, section 11(6-A)¹² has also been omitted from the scheme of the Act vide the Arbitration and Conciliation (Amendment) Act, 2019 (**2019 Amendment Act**). As clarified in *Mayavati Trading*, the same doesn't amount to a resuscitation of the law prevalent prior to the 2015 Amendment Act wherein the court was empowered to go into certain preliminary issues at the time of appointing the arbitrator. Instead, the omission has been recommended¹³ because appointment of arbitrators is to be done institutionally, in which case the Supreme Court or the High Court under the old statutory regime are no longer required to appoint arbitrators and consequently to determine whether an arbitration agreement exists or not. It is pertinent to note that none of the amendments proposed to section 11 by the 2019 Amendment Act have been notified as on date.

Be that as it may, the question of what falls within the scope of an arbitration agreement and what are excepted matters assumes importance in a jurisdictional challenge before the arbitrator under section 16 of the Act as well as in an eventual challenge to the award under section 34 of the Act. Readers should be aware of the decision of the Supreme Court in *Mitra Guha Builders (India) Co. v. ONGC Ltd.*¹⁴ that excepted matters are precluded from being arbitrated. To prevent such a situation from presenting itself, contracting parties are advised to broaden the scope of the arbitration agreement such that at a later stage they are not forced to litigate on matters which may be beyond the scope of the arbitration agreement.

¹¹ (2018) 6 SCC 534.

¹² The said provisions reads as: "(6A) The Supreme Court or, as the case may be, the High Court, while considering any application under sub-section (4) or sub-section (5) or sub-section (6), shall, notwithstanding any judgment, decree or order of any Court, confine to the examination of the existence of an arbitration agreement".

¹³ In this regard it is important to point out that the said amendments have been carried out in furtherance of the recommendations made by Srikrishna Committee which stated: "In order to ensure speedy appointment of arbitrators, Section 11 may be amended to provide that the appointment of arbitrator(s) under the section shall only be done by arbitral institution(s) designated by the Supreme Court (in case of international commercial arbitrations) or the High Court (in case of all other arbitrations) for such purpose, without the Supreme Court or High Courts being required to determine the existence of an arbitration agreement."

¹⁴ 2019 SCC Online SC 1442.

¹⁵ 2019 SCC Online SC 515.

¹⁶ (2011) 14 SCC 66.

¹⁷ The aforementioned powers of impounding and handing over of the insufficiently stamped instrument to relevant authorities are also possessed by the arbitrator as per the Supreme Court's decision in *SMS Tea Estates*.

¹⁸ Arbitration Application No. 261 of 2018, Bombay High Court, decision dated 22 November 2019.

STAMP THAT AGREEMENT

In *Garware Wall Ropes Ltd. v. Coastal Marine Constructions & Engineering Ltd.*¹⁵, the Supreme Court concurred with its decision in *SMS Tea Estates (P) Ltd. v. Chandmari Tea Co.*¹⁶ (**SMS Tea Estates**). The Supreme Court held that even post the 2015 Amendment Act, an arbitration agreement contained in a contract needs to be stamped in accordance with the relevant law. If the same is unstamped or inadequately stamped, the court¹⁷ would impound the instrument and hand it over to the relevant authority for adjudication of stamp duty and applicable penalty. The parties would then have to pay the stamp duty and applicable penalty, and only thereafter the court would act upon such agreement. This principle was further elucidated in *S. Satyanarayana & Co. v. West Quay Multiport Pvt. Ltd.*¹⁸ wherein a contract was executed outside Maharashtra, but the seat of arbitration was in Maharashtra. The Bombay High Court held that the contract, while stamped according to the law in Visakhapatnam, when brought into Maharashtra, needs to be stamped according to the law prevalent in Maharashtra in order for the court to act upon it.

Contracting parties need to now ensure that the contract containing the arbitration agreement is stamped adequately in accordance with the law prevalent in the jurisdiction where the arbitration agreement needs to be acted upon. To err on the side of caution if there are several jurisdictions where the contract is likely to be acted upon, it may be prudent to pay stamp duty in a jurisdiction where the stamp duty payable is the highest. This will address the requirement of paying differential stamp duty under circumstances where the instrument is required to be moved from one state to another.

ENFORCE THAT AWARD

Prior to the 2015 Amendment Act, the award debtor could by simply filing a challenge to the award get an automatic stay against the enforcement of the award. This meant that the award holder would never realize the amounts under the award until the challenge was finally decided. With the 2015 Amendment Act, the award holder is permitted to enforce the award and it is the award debtor that has to obtain a specific stay against enforcement. In such a case, the court may order the award debtor to deposit a part or whole of the award amount in court thereby securing the award holder. The question before the Supreme Court in *Hindustan Construction Company Limited & Anr. v. Union of India & Ors.*¹⁹ (HCC) was whether this benefit for the award holder could only be granted for arbitrations that had commenced after the 2015 Amendment Act came into force. Although the applicability of such a provision had been clarified by the *BCCI v. Kochi Cricket Pvt. Ltd.*²⁰ (BCCI) judgment to be retrospective in nature, the Arbitration and Conciliation (Amendment) Act, 2019 made the provision of the 2015 Amendment Act in this regard expressly prospective (by introducing section 87 in the Act). The constitutionality of this section 87 was successfully challenged in the HCC case. Stating that the automatic-stay of an award, as laid down previously by *National Aluminum Company Ltd. (NALCO) v. Pressteel & Fabrications (P) Ltd.*²¹; *National Buildings Construction Corporation Ltd. v. Lloyds Insulation India Ltd.*²² and *Fiza Developers and Inter-trade Pvt. Ltd. v. AMCI (India) Pvt. Ltd.*²³ was incorrect, it was further held by the Supreme Court that no automatic stay was ever contemplated even in the Act as it stood prior to the 2015 Amendment Act and thus, the amendments made by the 2015 Amendment Act being merely clarificatory in nature, ought to be applied retrospectively.

In light of the decision in HCC, even if there is a challenge to the award under section 34 of the Act pending in court (including in cases where the arbitral proceedings commenced prior to the 2015 Amendment Act), an application under section 36(2) of the Act can be filed by the award holder for vacation of the stay wherever such stay

had been granted automatically against the enforcement of the award. In such a scenario, the award debtor will be compelled to seek a stay against enforcement which might be made conditional on the whole or part of the awarded amount being deposited in the court. This amount, if ordered to be deposited, can then be withdrawn by the award holder by giving a bank guarantee of equivalent amount to the court. This would ensure that cash flows of an award holder are not affected. This is of particular importance in infrastructure projects where ongoing work is not impaired by the liquidity crunch that was otherwise being faced on account of pending disputes.

NO SPECIAL TREATMENT TO GOVERNMENT OR ITS AGENCIES

In *Pam Developments Pvt. Ltd. v. State of West Bengal*²⁴, the Government as an award debtor argued that it can be exempted from furnishing security/depositing the award amount on account of Order 27 Rule 8-A of the Code of Civil Procedure, 1908 (CPC). Relying upon section 36 of the Act and its interpretation, it was held by the Hon'ble Supreme Court that the provisions of CPC act as mere guiding principles in the scheme of the Act. In light of section 18 of the Act²⁵, it was also held by the court that the Act neither made any distinction nor afforded any differential treatment to the Government as an award debtor when compared to private parties. The Government, like any ordinary award debtor, will have to deposit the award amount in court if it wishes to challenge the award and seek a stay against enforcement. Thus, if a party secures an arbitral award against the government/Public Sector Undertaking (PSU), it can now rightfully claim the awarded amount to be deposited in the court when the government/PSU desires to challenge the arbitral award.

PARTING THOUGHTS

The judiciary, through decisive pronouncements, has undoubtedly tried its best to set things right for arbitration in India. While the commercial impact of various decisions of the Supreme Court can be debated, one has to appreciate the fact that the judiciary's approach in 2019 towards arbitration in India seems to be more commercially astute, which bodes well for 2020.

¹⁹ WP (Civil) No. 1074 of 2019.

²² (2005) 2 SCC 367.

²⁰ (2018) 6 SCC 287.

²³ (2009) 17 SCC 796.

²¹ (2004) 1 SCC 540.

²⁴ (2019) 8 SCC 112.

²⁵ The said provision reads as: "18. Equal treatment of parties.—The parties shall be treated with equality and each party shall be given a full opportunity to present his case."

Case Study: IBC – Essar Steel – Arcelor Mittal Judgment

BACKGROUND

As recommended by the Oversight Committee, the Reserve Bank of India issued a press release dated June 13, 2017 identifying 12 large stressed accounts (totalling about 25% of the then gross non-performing assets of the banking system in India) for immediate reference under the insolvency and Bankruptcy Code, 2016 (**Code** or **IBC** or **IBC Code**), Essar Steel India Limited (**ESIL**) being one of them.

Pursuant to the above, the lenders' of ESIL initiated the corporate insolvency resolution process (**CIRP**) for ESIL. As part of the CIRP, the resolution professional invited plans and the committee of creditors (**CoC**) approved the resolution plan submitted by ArcelorMittal India Private Limited (**Arcelor**) (post judgment of Hon'ble Supreme Court dated October 4, 2018, reported as *Arcelor-Mittal India Private Limited v. Satish Kumar Gupta*²⁶, and post fulfilment of the conditions mentioned in the said judgment).

Several issues were contested before the Hon'ble Supreme Court of India (pursuant to the order dated July 4, 2019 passed by the Hon'ble National Company Law Appellate Tribunal (**NCLAT**)). The Hon'ble Supreme Court of India vide its order dated November 15, 2019 dealt with the following key issues:

KEY ISSUES

- Role of (i) the Resolution Professional; and (ii) the CoC that is constituted under the Code;
- Jurisdiction of the National Company Law Tribunal(**NCLT**) and the NCLAT, qua resolution plans that have been approved by the CoC;
- Treatment of secured and unsecured creditors - "the equality principle";
- Extinguishment of rights of creditors against guarantors;
- Undecided claims;

- Constitutional validity of Sections 4 and 6 of the Insolvency and Bankruptcy Code (Amendment) Act, 2019/CIRP relating to the mandatory time period of 330 (three hundred and thirty) days;
- Constitution of the Sub-Committee; and
- CoC does not act as a fiduciary.

FINDINGS OF THE HON'BLE SUPREME COURT

- **Role of the Resolution Professional and the CoC that is constituted under the Code**

Role of the Resolution Professional: The Hon'ble Supreme Court of India has again clarified that the resolution professional is a person who is not only to manage the affairs of the corporate debtor as a going concern from the stage of admission of an application (under Sections 7, 9 or 10 of the Code) till a resolution plan is approved by the NCLT, but is also the key person to collect, collate and finally admit claims of all creditors, which must then be examined for payment (in full or in part or not at all) by the resolution professional. He/she is also to appoint and convene meetings of the CoC, so that they may decide upon resolution plans based on the information memorandum (prepared by the resolution professional). The Hon'ble Supreme Court of India has also again clarified that the role of the resolution professional is not adjudicatory but administrative which was also earlier held in *ArcelorMittal India Private Limited v. Satish Kumar Gupta*²⁷.

Role of the CoC: The Hon'ble Supreme Court of India upheld the earlier judgements passed in various cases that it is the commercial wisdom of the CoC to decide as to whether or not to rehabilitate the corporate debtor by accepting a particular resolution plan. The CoC may approve a resolution plan by a vote of not less than 66% of voting share of the financial creditors, after considering its feasibility and viability.

²⁶ (2019) 2 SCC

²⁷ (2019) 2 SCC 1

“It is clear that since corporate resolution is ultimately in the hands of the majority vote of the Committee of Creditors, nothing can be done qua the management of the corporate debtor by the resolution professional which impacts major decisions to be made in the interregnum between the taking over of management of the corporate debtor and corporate resolution by the acceptance of a resolution plan by the requisite majority of the Committee of Creditors.”

Para 36, Page 55

- **Jurisdiction of the NCLT and the NCLAT, qua resolution plans that have been approved by the committee of creditors**
The Hon’ble Supreme Court of India has held that the limited judicial review of the NCLT has to be within the 4 corners of section 30(2) of the Code and with respect to NCLAT, it has to be within the parameters of section 32 read with section 61(3) of the Code. Therefore, such review can in no circumstance trespass upon a business decision of the majority of the CoC.

The Hon’ble Supreme Court of India has also held that the residual jurisdiction of the NCLT under Section 60(5)(c) of the Code cannot, in any manner, whittle down section 31(1) of the Code, by the investment of some discretionary or equity jurisdiction in the NCLT outside section 30(2) of the Code, while adjudicating a resolution plan.

“While the NCLT cannot interfere on merits with the commercial decision taken by the CoC, the limited judicial review available is to ensure that the CoC has taken into account the fact that the corporate debtor needs to keep going as a going concern during the insolvency resolution process; that it needs to maximise the value of its assets; and that the interests of all stakeholders including operational creditors have been taken care of. If the NCLT finds, on a given set of facts, that the aforesaid parameters have not been kept in view, it may send a resolution plan back to the CoC to re-submit it after satisfying the aforesaid parameters.”

- **Treatment of Secured and Unsecured creditors - “the equality principle”**

Hon’ble Supreme Court of India is of the view that if an “equality for all” approach, recognizing the rights of different classes of creditors as part of an insolvency resolution process is adopted, secured financial creditors will, in many cases, be incentivized to vote for liquidation rather than resolution, as they would have better rights if the corporate debtor is liquidated. This would defeat the objective of the Code which is resolution of distressed assets and only if the same is not possible, should liquidation follow.

The Hon’ble Supreme Court of India has held that the amended Regulation 38 of Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (**CIRP Regulations**) does not lead to the conclusion that financial creditors and operational creditors, or secured and unsecured creditors, must be paid the same amounts, percentage wise, under the resolution plan before it can pass muster. The Hon’ble Supreme Court of India held that the equal treatment means only equals need to be treated equally.

Therefore, so long as the provisions of the Code and the CIRP Regulations have been met, it is the commercial wisdom of the requisite majority of the CoC to negotiate and accept a resolution plan, which may involve differential payment to different classes of creditors, together with negotiating with a prospective resolution applicant for better or different terms which may also involve differences in distribution of amounts between different classes of creditors.

“Fair and equitable dealing of operational creditors rights under the Regulation 38 of CIRP Regulations involves the resolution plan stating as to how it has dealt with the interests of operational creditors, which is not the same thing as saying that they must be paid the same amount of their debt proportionately.”

Para 56, Page 96

- **Extinguishment of rights of Creditors against Guarantors**

The Hon'ble Supreme Court of India held that Section 31(1) of the Code makes it clear that once a resolution plan is approved by the CoC, it shall be binding on all stakeholders, including guarantors. This provision ensures that the successful resolution applicant starts conducting the business of the corporate debtor on a fresh slate, as it were. The Hon'ble Supreme Court of India observed as follows:

"In State Bank of India v. V. Ramakrishnan,²⁸ this Court relying upon Section 31 of the Code has held:

Section 31 of the Act was also strongly relied upon by the Respondents. This Section only states that once a Resolution Plan, as approved by the Committee of Creditors, takes effect, it shall be binding on the corporate debtor as well as the guarantor. This is for the reason that otherwise, Under Section 133 of the Indian Contract Act, 1872, any change made to the debt owed by the corporate debtor, without the surety's consent, would relieve the guarantor from payment. Section 31(1), in fact, makes it clear that the guarantor cannot escape payment as the Resolution Plan, which has been approved, may well include provisions as to payments to be made by such guarantor. This is perhaps the reason that Annexure VI(e) to Form 6 contained in the Rules and Regulation 36(2) referred to above, require information as to personal guarantees that have been given in relation to the debts of the corporate debtor. Far from supporting the stand of the Respondents, it is clear that in point of fact, Section 31 is one more factor in favour of a personal guarantor having to pay for debts due without any moratorium applying to save him."

Therefore, it is difficult to accept the argument that part of the resolution plan which states that the claims of the guarantor on account of subrogation shall be extinguished, cannot be applied to the guarantees furnished by the erstwhile directors of the corporate debtor. The judgment dated July 4, 2019 of the NCLAT is contrary to section 31(1) of the Code and the Hon'ble Supreme Court's judgment in *State Bank of India Vs. V. Ramakrishnan*.

²⁸ 2018 (9) SCALE 597

- **Undecided Claims**

All claims, therefore, must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor.

"A successful resolution applicant cannot suddenly be faced with "undecided" claims after the resolution plan submitted by him has been accepted as this would amount to a hydra head popping up which would throw into uncertainty amounts payable by a prospective resolution applicant who successfully take over the business of the corporate debtor."

Para 67, Page 113

- **Constitutional validity of Sections 4 and 6 of the Insolvency and Bankruptcy Code (Amendment) Act, 2019/CIRP relating to the mandatory time period of 330 days**

The Hon'ble Supreme Court of India held that time taken in legal proceedings cannot possibly harm a litigant if the Tribunal itself cannot take up the litigant's case within the requisite period for no fault of the litigant - a provision which mandatorily requires the CIRP to end by a certain date - without any exception thereto - may well be an excessive interference with a litigant's fundamental right to non-arbitrary treatment under Article 14 and therefore unreasonable restriction on a litigant's fundamental right to carry on business under Article 19(1)(g) of the Constitution of India.

However, the time taken in legal proceedings is certainly an important factor which causes delay, and which has made previous statutory experiments fail. While leaving the provision otherwise intact, the term "mandatorily" was struck down as being manifestly arbitrary under Article 14 of the Constitution of India and as being an unreasonable restriction on the litigant's right to carry on business under Article 19(1)(g) of the Constitution.

The effect of this declaration is that ordinarily the time taken in relation to the CIRP must be

completed within the outer limit of 330 days from the insolvency commencement date, including extensions and the time taken in legal proceedings. If the delay or a large part thereof is attributable to the tardy process of the NCLT and/or the NCLAT itself, it may be open in such cases for the NCLT and/or NCLAT to extend time beyond 330 days.

Therefore, it is only in exceptional cases that time can be extended, the general rule being that 330 days is the outer limit within which resolution of the stressed assets of the corporate debtor must take place beyond which it is to be driven into liquidation. All claims, therefore, must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor.

“A provision which mandatorily requires the CIRP to end by a certain date - without any exception thereto - may well be an excessive interference with a litigant’s fundamental right to non-arbitrary treatment under Article 14 and an excessive, arbitrary and therefore unreasonable restriction on a litigant’s fundamental right to carry on business under Article 19(1)(g) of the Constitution of India. This being the case, we would ordinarily have struck down the provision in its entirety. However, that would then throw the baby out with the bath water, inasmuch as the time taken in legal proceedings is certainly an important factor which causes delay, and which has made previous statutory experiments fail as we have seen from Madras Petrochem (supra).”

Para 79, Page 131

■ **Constitution of the Sub-Committee**

A sub-committee or core committee cannot be constituted under the Code. The CoC alone is to take all decisions by themselves. However, this does not mean that sub-committees cannot be appointed for the purpose of negotiating with resolution applicants, or for the purpose of performing other ministerial or administrative acts, provided such acts are in the ultimate analysis approved and ratified by the CoC.

■ **CoC does not act as a fiduciary**

The CoC does not act in any fiduciary capacity to any group of creditors. On the contrary, it is to take a business decision based upon ground realities by a majority, which then binds all stakeholders, including dissentient creditors.

CONCLUSION

The spirit of the law has been upheld. This is a landmark judgment, providing a clear and conclusive interpretation on the key issues mentioned above. This judgment sets a clear path ahead on the corporate insolvency resolution process in India and will aid in faster insolvency resolution for corporate debtors, increased recovery of debts of creditors and finally, greater confidence amongst bidders.

Industry strongly believes that this case will be a turning point for the number of cases reaching a successful CIRP (till date, only 15% of the cases have reached successful CIRP under IBC). There is a strong expectation on increased liquidity, (estimated close to INR 70,000-80,000 crores with Essar Steel and similar cases being resolved under IBC), relief for the banking sector, renewed investor confidence and increased investments from private equity investors/stressed asset funds.

SEBI Framework on Superior Voting Rights

INTRODUCTION

In a previous edition of 'India Update' (Part 2 of 2019), given the backdrop of a hostile takeover in India's IT sector, we had analyzed the law in respect of hostile takeovers in India. In our analysis, we had taken note of the increasing calls for permissibility of dual class share structures in India to enable promoters to retain control over their companies without impinging their ability to raise capital.

After considering public comments, the Securities and Exchange Board of India (**SEBI**), at its board meeting held on June 27, 2019 proposed a framework (**Framework**) for the issuance and listing of shares with superior or differential voting rights (**SR Shares**) by certain companies on the stock exchange.

The Framework was implemented on July 29, 2019 and SEBI notified amendments to various regulations, namely:

- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**Takeover Code**)
- SEBI (Buy-Back of Securities) Regulations, 2018
- SEBI (Delisting of Equity Shares) Regulations, 2009

THE CHEQUERED HISTORY OF DIFFERENTIAL VOTING RIGHTS IN INDIA

Green light under the Companies Act...

With effect from December 13, 2000, Section 86(a)(ii) of the Companies Act, 1956 permitted companies to issue shares with

differential voting rights as to dividend, voting or otherwise in accordance with the rules prescribed under the Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. Thereafter, a number of companies (including Tata Motors Limited and Gujarat NRE Coke Ltd) had issued shares with differential voting rights.

Section 43(a)(ii) of the Companies Act, 2013 (which supersedes the Companies Act, 1956), read with Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014 (SCAD Rules) permits companies to issue equity share capital with differential rights as to dividend, voting or otherwise, subject to certain conditions.

...But red light for listed companies

However, on July 21, 2009, the SEBI issued a circular²⁹ in terms of which it amended the Equity Listing Agreement to prohibit listed companies from issuing shares with superior rights as to voting or dividend vis-à-vis the rights on equity shares that are already listed. This closed the doors for listed companies from issuing any shares with differential voting rights.

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (which superseded and incorporated the corporate governance provisions of the Equity Listing Agreement) continued the restriction on the issuance of the differential voting rights by listed companies through Regulation 41(3).

However, the Framework has now enabled certain companies that have issued SR Shares to list their ordinary shares on the stock exchange.

²⁹ Circular SEBI/CFD/DIL/LA/2/2009/21/7

OVERVIEW OF THE FRAMEWORK

- An unlisted company which has issued SR Shares has now been permitted to list its ordinary shares on the stock exchange through an initial public offer (**IPO**).
- Certain key eligibility requirements for companies having SR Shares for an IPO are as follows:

Nature of Business	The company should be engaged in making intensive use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology for providing products, services or business platforms with substantial value addition.
Shareholding Criteria	The SR Shares should have been issued only to the promoters/founders, who hold an executive position in the company.
Net Worth Criteria	The holder of the SR Shares is not part of a promoter group whose collective net worth (excluding their investment in the company) is more than INR 500,00,00,000.
Voting Right Criteria	The SR Shares have voting rights in the ratio of minimum 2:1 to maximum 10:1 compared to ordinary shares.
Dividend	SR Shares are to be treated at par with ordinary equity shares in respect of dividends

- Corporate governance requirements in relation to listed companies having outstanding SR Shares:

Board of Directors	At least half of the board of directors shall comprise of independent directors
Audit Committee	Only comprise of independent directors
Other Committees	At least two thirds of the following committees shall comprise of independent directors: <ul style="list-style-type: none"> ▪ Nomination and remuneration committee; ▪ Stakeholders relationship committee; and ▪ Risk management committee.

- **Coat-tail provisions:** The SR Shares shall be treated as ordinary equity shares in terms of voting rights (i.e. one SR share shall only have one vote) in the following circumstances post-IPO:
 - appointment or removal of independent directors and/or auditor
 - where a promoter is willingly transferring control to another entity
 - related party transactions in terms of these regulations involving an SR shareholder
 - voluntary winding up of the listed entity
 - changes to the articles of association or memorandum of association of the listed entity, except any change affecting the SR equity share
 - initiation of a voluntary resolution process under the IBC Code
 - utilization of funds for purposes other than business

- substantial value transaction based on materiality threshold as specified under these regulations
- passing of special resolution in respect of delisting or buy-back of shares
- other circumstances or subject matter as may be specified by the Board, from time to time
- **Mandatory conversion into ordinary shares:** The SR Shares shall be converted into equity shares having same voting rights as that of ordinary shares on the 5th anniversary of listing of ordinary shares of the listed entity. However, the SR Shares may be valid for up to an additional 5 years, after a resolution to that effect has been passed, where the SR shareholders are not permitted to vote. Further, the holders of the SR Shares may convert their SR Shares into ordinary equity shares at any time prior to the period.
- **Automatic conversion into ordinary shares:** The SR Shares shall be compulsorily converted into equity shares having voting rights same as that of ordinary shares on the occurrence of any of the following events:
 - demise of the promoter(s) or founder holding such shares
 - an SR shareholder resigns from the executive position in the listed entity
 - merger or acquisition of the listed entity having SR shareholder/s, where the control would no longer remain with the SR shareholder/s
 - the SR equity shares are sold by an SR shareholder who continues to hold such shares after the lock-in period but prior to the lapse of validity of such SR equity shares
- **Exemption from open offer:** The conversion of SR Shares into ordinary shares is exempted from the requirement of making an open offer if such conversion triggers the thresholds specified in the Takeover Code.
- **Lock-in:** The SR Shares will be under lock-in until conversion into ordinary equity shares. In case of early conversion of the SR Shares to ordinary shares, the SR Shares shall continue to be under lock-in for 3 years after listing for SR Shares considered for minimum promoter contribution and for 1 year for SR Shares in excess of minimum promoter contribution. During the lock-in period, no transfer of SR Shares amongst the promoters is permitted.
- **Pledge not permitted:** No pledge or lien is permitted in respect of SR Shares.
- **Amendments to SCAD:** Following the implementation of the Framework, the Central Government has made the following changes in respect of companies proposing to issue shares with differential voting rights:
 - The requirement under Rule 4(1)(d) of SCAD which required a company having consistent track record of distributable profits for the last three years to be eligible to issue shares with differential voting rights has been omitted.
 - The requirement under Rule 4(1)(c) of SCAD which stipulated that shares with differential rights shall not exceed 26% of the total post-issue paid up equity share capital including equity shares with differential rights issued, at any point of time, has been increased to 74%.

OUR COMMENTS

The prohibition in relation to the creation of a pledge in respect of the SR Shares will likely dampen sentiments as it is standard for banks to require promoters to pledge their shares as security in order for the banks to extend working capital facilities to companies. Given that technology companies are, generally speaking, asset light, and the promoters are likely to be individuals without deep pockets (since the holders of SR Shares collectively should not have a collective net worth in excess of INR 500 crores), availing significant working capital facilities will likely prove to be a challenge for companies that have issued SR Shares.

However, the Framework for permitting issuance of SR Shares is a welcome step. This would enable promoters of professionally run technology companies retain control of their companies without inhibiting their ability to raise capital. Such dual class share structures have been adopted by a number of technology companies in western jurisdictions and the SEBI permitting Indian technology companies to issue SR Shares is a step in the right direction.

Sanctions, Exports Controls, CFIUS and ICTS

As an important foreign policy tool to tackle geopolitical challenges, the United States (US) continues to impose economic sanctions on various countries including Iran, Russia, North Korea and Syria (**sanctioned countries**), individuals and companies (**sanctioned persons**). Further, to increase national security, advance its foreign policy interests and economy, the US maintains various regulations (including export controls and foreign investment related laws and regulations) against US and non-US based companies.

Given the constantly changing nature of these regulations, their extraterritorial applicability and more critically, the impact of these regulations on businesses, it is important for international companies to keep abreast with any latest developments.

This article provides an insight on key regulations of the US which have a significant bearing on businesses globally.

PRIMARY AND SECONDARY SANCTIONS

Administered by: The Office of Foreign Assets Control, Department of Treasury, Department of State, Department of Commerce's Bureau of Industry and Security, Department of Defense and Department of Justice.³⁰

Primary Sanctions

Applicable to: Companies organized in the US, US citizens and permanent residents, and all persons located in the US, regardless of nationality.

Prohibition: Imposed by the US to prohibit the above from transacting with sanctioned countries or sanctioned persons. These US primary sanctions are generally in the form of asset freezes or trade embargoes.

Secondary Sanctions

Applicable to: Non-US individuals and companies to deter them from entering into certain transactions that are contrary to US national security and policy interests.

Prohibition/Restriction: More specifically, secondary sanctions (which are generally in the form of restriction/limitation to the US market or financial system) are imposed on non-US individuals and companies for their significant transactions with sanctioned countries or sanctioned persons.

Case Studies

Case Study 1: In the past, the US imposed secondary sanctions (such as denial of export licenses, prohibition of foreign exchange transactions with the US financial system, blocking of all property and interest in property within US, visa ban) on a Chinese company and its Director for engaging in significant transactions with a Russian sanctioned company. According to the US Department of State, the significant transactions between the Chinese company and Russian sanctioned company involved delivery of Su-35 combat aircraft in 2017 and S-400 surface-to-air missile related equipment in 2018 by the Russian company to the Chinese company.³¹

Case Study 2: An Indian company³², its subsidiaries and individuals were recently sanctioned for its involvement with an Iranian network that supplied oil to Syria in breach of US Sanctions laws³³. Consequently, all the property and interests of these Indian companies in the US or in control or possession of US persons were blocked. As a result, individuals or companies that engage in certain transactions with these designated companies may themselves be exposed to US sanctions laws.

³⁰ U.S. Sanctions on Russia, Congressional Research Service - Available at: <https://fas.org/spp/crs/row/R45415.pdf>

³¹ CAATSA Section 231: "Addition of 33 Entities and Individuals to the List of Specified Persons and Imposition of Sanctions on the Equipment Development Department" - Available at: <https://www.state.gov/caatsa-section-231-addition-of-33-entities-and-individuals-to-the-list-of-specified-persons-and-imposition-of-sanctions-on-the-equipment-development-department/>

³² US Department of Treasury Press release, "Treasury Designates Vast Iranian Petroleum Shipping Network That Supports IRGC-QF and Terror Proxies" - Available at: <https://home.treasury.gov/news/press-releases/sm767>

³³ Iran Sanctions, Congressional Research Service - Available at: <https://fas.org/spp/crs/mideast/RS20871.pdf>

BIS

Administered by: The US Bureau of Industry and Security (BIS), US Department of Commerce.

Applicable to: Non-US companies for acting contrary to US national security and foreign policy interests.

Prohibition/Restriction: The US maintains various lists/entity lists, whereby the US identifies certain foreign companies and its affiliates as posing a significant risk of involvement in activities contrary to US national security interests. Consequently, the exporters in the US and foreign re-exporters are required to apply for license for exporting, re-exporting or transferring any commodity, software or technology (collectively referred to as “items”) subject to the US Export Administration Regulations³⁴(**EAR**) to these listed companies.

Case Study

The US recently added numerous Chinese technology companies including China’s largest technology company (Huawei Technologies Co., Ltd. (Huawei) and its US affiliates³⁵) to the entity list, as according to the US, these Chinese companies were found to engage in certain activities contrary to US foreign policy or national security interests. With regard to Huawei, the US also acted on the basis of information that there were – violations of the International Emergency Economic Powers Act (**IEEPA**), conspiracy to violate IEEPA by providing prohibited financial services to Iran, and obstruction of justice in connection with the investigation of those alleged violations of US sanctions³⁶.

Various stakeholders have opined that the US has taken these steps to restrict and target

Chinese advances and capabilities in surveillance and artificial intelligence.

As a result, any exporter in the US or re-exporter who intends to transfer, export or re-export any item subject to EAR to the listed entities, such exporters or re-exporters will be required to secure an export license from BIS.

BIS

Administered by: The US Department of Treasury, Committee on Foreign Investment in the United States (**CFIUS**) under the Defense Production Act of 1959³⁷ (**Act of 1959**) has the power to review certain transactions involving foreign investments in the US (“covered transactions”³⁸) to determine the effect of such transactions on the national security of the US.

Applicable to: The US Department of Treasury has provided an illustrative list of transactions that have presented national security considerations for the US, whereby it has conducted a unilateral review of the covered transaction³⁹:

- A business - based out of the US which has government contracts/operations relevant to US national security or deals in certain advanced technologies or goods and services controlled for export
- Track record of the foreign person acquiring control of the US business, or the record of person’s country of origin
- Foreign government-controlled transaction⁴⁰

³⁴ Items subject to EAR include all items in US, all US origin items wherever located and non US items containing more than a de minimis level of US controlled content. (15 CFR § 734.3.)

³⁵ Huawei Entity List and Temporary General License Frequently Asked Questions (FAQs) - Available at: <https://www.bis.doc.gov/index.php/documents/pdfs/2447-huawei-entity-listing-faqs/file>

³⁶ Ibid.

³⁷ 50 U.S.C. 4565

³⁸ According to 31 CFR § 800.207, covered transaction means “any transaction that is proposed or pending after August 23, 1988, by or with any foreign person that could result in foreign control of any U.S. business, including such a transaction carried out through a joint venture”.

³⁹ CFIUS Reform: Guidance on National Security Considerations - Available at: https://www.treasury.gov/resource-center/international/foreign-investment/Documents/GuidanceSummary_12012008.pdf

⁴⁰ foreign government-controlled transaction is defined as “any covered transaction that could result in control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign government.” - Office of Investment Security: Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States - Available at: <https://www.federalregister.gov/documents/2008/12/08/E8-28791/office-of-investment-security-guidance-concerning-the-national-security-review-conducted-by-the>

Besides the power to review covered transactions, the CFIUS (pursuant to Foreign Investment Risk Review Modernization Act of 2018 (**FIRRMA**)) also has the power to review certain non-controlling investments made by foreign persons in US businesses involved in technologies related to specific industries⁴¹.

Further, the proposed CFIUS regulations to implement FIRRMA (which were recently published for comments) seeks to broaden the powers of the CFIUS to review certain foreign non-controlling investments (for example, supplies critical infrastructure or collects sensitive personal data of US citizens)⁴² and real estate transactions that previously fell outside CFIUS's jurisdiction. Further, the proposed CFIUS regulations provides for exclusion of certain investors from its jurisdiction provided they qualify certain criteria including that the foreign investor is a national of an excepted foreign state and is in compliance with certain law and regulations.⁴³

Consequently, companies that intend to invest in the US should keep themselves abreast with the key developments in this area – as their investments may be subject to mandatory review by the CFIUS. If faced with non-compliance, they may also face penalties for any violations of the US laws or national security considerations.

ICTS

Administered by: The US Department of Commerce, on November 26, 2019, issued “Securing the Information and Communications Technology and Services Supply Chain” - proposed rules that can potentially block or restrict transactions involving “information and communications technology and services” (**ICTS**)

from a “foreign adversary”.

Applicable to: Under the proposed rules, the Secretary of Commerce has been given the power to evaluate the effect – of any transaction i.e. acquisition, importation, transfer, installation, dealing in, or use of ICTS that has been developed, manufactured or supplied by persons owned by, controlled by, or subject to the jurisdiction or direction of “foreign adversary” – on the national security, foreign policy, and economy of the United States.⁴⁴ However, the following three conditions are required to exist for the Secretary of Commerce to exercise the aforesaid power of evaluation:

- Transaction is conducted by any person subject to US jurisdiction or involves property subject to US jurisdiction;
- Transaction involves any property in which any foreign country or foreign national has an interest; and
- Transaction was initiated, is pending, or will be completed after May 15, 2019.

Further, the power to determine who is a foreign adversary⁴⁵ has also been vested with the Secretary of Commerce in consultation with other relevant authorities under the proposed rules.

While the Department of Commerce has not identified any list of individuals or countries or countries that are foreign adversaries, various stakeholders opine that these proposed rules have been issued to target Chinese ICTS companies.

In any event, considering that the criteria to review a transaction under the proposed rules is open-ended, a wide range of transactions

⁴¹ Fact Sheet: Interim regulations for FIRRMA Pilot Program - Available at:

<https://home.treasury.gov/system/files/206/Fact-Sheet-FIRRMA-Pilot-Program.pdf>

⁴² “This new authority only applies to a non-controlling investment in a U.S. business that: • produces, designs, tests, manufactures, fabricates, or develops one or more **critical technologies**; • owns, operates, manufactures, supplies, or services **critical infrastructure**; or • maintains or collects **sensitive personal data** of U.S. citizens that may be exploited in a manner that threatens national security.” – Please see Fact Sheet: Proposed CFIUS Regulations to Implement FIRRMA - Available at:

<https://home.treasury.gov/system/files/206/Proposed-CFIUS-Regulations-FACT-SHEET.pdf>

⁴³ Proposed regulations implementing FIRRMA (September 2019) - Available at:

<https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius>

⁴⁴ According to the Department of Commerce's Press Release, the Secretary of Commerce will be empowered to assess ICTS transactions if such transactions pose undue risk to ICTS in the US, the critical digital infrastructure, digital economy, risk to national security, or security and safety of U.S. persons. Please see:

<https://www.commerce.gov/news/press-releases/2019/11/us-department-commerce-proposes-rule-securing-nations-information-and>

⁴⁵ The Executive Order dated May 15, 2019 (pursuant to which the Department of Commerce released proposed rules) defines foreign adversary as “any foreign government or foreign non-government person engaged in a long term pattern or serious instances of conduct significantly adverse to the national security of the United States or security and safety of United States persons”. Please see: <https://www.whitehouse.gov/presidential-actions/executive-order-securing-information-communications-technology-services-supply-chain/>

involving US and foreign companies operating in the ICTS sectors may be impacted.

CONCLUSION

The current international business environment is getting increasingly unpredictable with geo-politics playing a far greater role. Businesses are vulnerable to far greater risks – risks of geopolitical changes, sanctions and protectionism.

It is important for international companies to understand the impact of the above challenges to remain sustainable and competitive. Companies must have robust compliance programs – including – monitoring investors, customers and procurement and supply backgrounds. For companies wanting to do business with the US, vigilance will be the new normal.

Consumer Protection Act, 2019: Changing Consumer Law Landscape in Changing Times

INTRODUCTION

The Consumer Protection Act, 2019 (**new CPA**) is set to replace the three-decade old 1986 enactment (**old CPA**). This has been introduced against the backdrop of various consumer-centric initiatives of this government and a spurt in consumer-centric actions/notices from the authorities. Given the above context, it will be pertinent for businesses having any B2C interface, to take note of the significant changes introduced under the new CPA, which this article attempts to discuss.

INTRODUCTION OF NEW CONCEPTS

■ Unfair Contract

- Unfair contract is widely defined to cover any contract having such terms which cause “*significant change in the rights of such consumer*”. It also specifically includes situations such as excessive security deposits/penalties, unilateral terminations and unreasonable charges being levied.
- While the Supreme Court has under the old CPA (in the matter of Pioneer Union) granted relief in case of one-sided contracts (between a builder and flat purchaser in that case), the new CPA provides for a separate cause of action in case of “unfair contract”. This clearly indicates the mindset of the government to regulate even contractual arrangements between private parties, in instances where one of the parties is a consumer and his/her rights are being impacted.

■ Product Liability

- Through this concept, liability is cast on the (original) product manufacturer (apart from the product seller and product service provider) in case of a manufacturing defect/design deficiency etc. Under the old CPA, actions are taken primarily against

traders or service providers – who typically would have an interface with the ultimate consumer.

Importantly, there is a “strict liability” being cast, where the product manufacturer/seller/service provider will be held liable even if he proves that he was not negligent or fraudulent in making express warranty of the product.

■ Misleading Advertisement

- As of today, advertisements are governed by the Advertising Standards Council of India (**ASCI**), which is a self-governing/non statutory body, and which has the authority to stop misleading advertisements. Under the new CPA, a separate body i.e. the Central Consumer Protection Authority (**CCPA**) has been given the statutory powers to issue specific orders in relation to misleading advertisements. [More details on the CCPA in the subsequent paragraph].
- The new CPA also casts liabilities on the endorsers of a misleading advertisement. For this reason, endorsers may now require back-to-back indemnity from the business/advertisers.

ESTABLISHMENT OF A CENTRAL CONSUMER PROTECTION AUTHORITY (CCPA)

- The new CPA recommends the establishment of a new authority called CCPA, which will be headquartered in New Delhi, though could have regional offices across the country.
- This body will perform multiple roles – it can investigate cases (equipped with its own investigation wing), pass necessary orders

against offenders and also advise as regards best practices.

- It is set up to look into three things specifically – enforcement of “consumer rights” (which is now a separately defined term), unfair trade practice (which is an omnibus concept covering wide nature of wrongful actions), and misleading advertisements (which has been discussed above).
- Importantly, the CCPA can take actions on its own, without a complaint being filed by any consumer, in case it feels that rights of consumers as a class/public interest is being impacted. Under the old CPA, there is no such regulator/body having the powers to take suo moto actions. Individual consumers have to fight their own battles, and many would shy away from incurring such additional costs. Now, the CCPA is set to fight battles on behalf of the consumers, and this would give an added reason for business to be cautious and compliant.
- While dealing with a particular issue, should it deem fit, the CCPA can also notify other regulators (e.g. Competition Commission of India, TRAI) who may also be concerned about the relevant issue. The new CPA specifically recognizes that action under the new CPA is additional to actions under other statutes.

CATCH-UP WITH TECHNOLOGY

- Keeping in mind the changing times, “consumer” is defined to specifically include instances of sale done online, or through direct marketing, tele-shopping etc.
- “Advertisement” is defined to include those made on the internet, websites, etc. and thus “misleading advertisement” would be understood accordingly.
- The concept of “unfair trade practice” now also includes sharing of personal data given in confidence by the customer and is perhaps the most direct legislation regulating this sphere of personal data as of now (since the Data Protection Bill is still in the bill form).

- Critically, the new CPA will also regulate “e-commerce” and “electronic service providers” (who advertise/promote sales of suppliers). However, the exact regulatory regime is unclear given that the relevant e-commerce rules have not yet been notified.

OTHER NOTEWORTHY CHANGES IN THE LITIGATION ROUTE

- A praiseworthy and welcome change is the introduction of mediation in the litigation route. The District Forums, before hearing the case (and if both parties agree), can suggest mediation, which can give an additional opportunity for parties to settle the case amicably.
- In the case of filing appeals, under the old CPA, the amount of pre-deposit to be made was capped to a nominal amount. Under the new CPA, however, it is fixed at 50% of the amounts awarded – this may result in significant increase in litigation costs.

CONCLUSION

The new CPA is no doubt a marked transformation from the old CPA and results in various areas of exposures for businesses to be prepared for. While the rules are yet to be notified which would hint on the exact extent of regulation – especially as regards the manner in which the CCPA will function and rules governing e-commerce entities – one can easily expect a rise in consumer protection related litigation, with the added possibility of multiple regulators being involved in a particular issue and with all modes of its operation (online/offline) being liable to questioning. Thus, it is crucial that businesses do a complete health-check of their contracts, offers, processes, advertisements etc. to ensure compliance under the new CPA and adequately justify the positions taken.

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Scrutiny of the Online Hotel Booking Sector by the Competition Regulator

India's e-commerce revenue is growing at an annual rate of 51% the highest in the world⁴⁶. A sector which has been part of this unprecedented growth is the online hospitality sector. According to a 2017 study, this sector is expected to grow to a USD 4 billion by economy 2020⁴⁷. However, growth always comes hand in hand with its own set of typical issues. Some of these issues have been raised before the Competition Commission of India (CCI), involving allegations against two key market players in the online hotel booking sector i.e. Oravel Stays Private Limited (OYO) and MakeMyTrip India Pvt. Ltd. (MMT), under two separate complaints.

Broadly, all market participants in the online hotel booking sector such as OYO, MMT, Yatra.com and Fab Hotels, are in effect providing intermediary services/platforms to two different set of consumers viz., the hotels that use their services to sell their rooms to the consumers and the ultimate consumers who use these platforms to book rooms at the partner hotels. This creates a dual sided market where the hotels as well as the ultimate consumers are availing the services of the intermediary platforms.

RKG HOSPITALITIES ALLEGING THAT OYO HAS ABUSED ITS DOMINANT POSITION

RKG Hospitalities Pvt. Ltd. (RKG), had alleged before the CCI that OYO abused its dominant position through its conduct. It was alleged that OYO had included and enforced terms and conditions in its agreement with RKG, which were one-sided, unfair and discriminatory. These practices allegedly included unilateral modification of structure of the hotel, disincentivizing hotels on the basis of performance, setting up exclusive signage of OYO on hotels and barring the hotel from engaging

with other online aggregators. The CCI *vide its prima facie* opinion⁴⁸ did not find OYO to be dominant, it however examined the allegations of abuses by OYO and concluded that the allegations were not made out.

■ Determining the relevant market of OYO

The CCI, while determining the relevant market for assessing the conduct of OYO observed, that OYO provided services to hotels including:

- Access to identifiable brand recognition;
- Access to existing distribution channels; and
- Access to a compelling customer base.

The CCI therefore identified the business model of OYO as a franchise model. Based on the specific features and types of services provided by OYO, the CCI identified the relevant market as the market for “franchising services for budget hotels in India”.

■ Determining the dominance of OYO

While assessing the dominance of OYO in the identified relevant market, the CCI noted that OYO was a leading player in the relevant market, with a significant market share in terms of number of hotels and rooms on its network. The CCI concluded that the relevant market for franchising services for budget hotels was an emerging sector where the competition dynamics were still unfolding. The CCI ultimately concluded that although OYO was a significant player in the relevant market, the deterministic assessment of market position of OYO was not possible.

Despite concluding that OYO was not a dominant in the relevant market, the CCI ventured into an assessment of the conduct complained of in terms of Section 4 of the Competition Act, 2002 and concluded that that allegations of abuse of dominance remained unsubstantiated.

⁴⁶ <https://www.ibef.org/industry/ecommerce.aspx>

⁴⁷ Demystifying The Indian Online Traveler, Hotels: A Four Billion Dollar Opportunity, BCG and GOOGLE, June 2017. Retrieved from: <https://media-publications.bcg.com/BCG-Google-Demystifying-the-Indian-online-traveler-jun-2017.pdf>, on 18 November 2019.

⁴⁸ RKG Hospitalities Pvt. Ltd. v. Oravel Stays Pvt. Ltd., Case No. 3 of 2019, decision dated 31 July 2019.

FHRAI'S CONTENTION AGAINST MMT AND OYO

A subsequent information was filed by Federation of Hotels & Restaurant Association of India (FHRAI), before the CCI where it was alleged that MMT and OYO had collectively and separately abused their dominant position by indulging in predatory pricing, charging exorbitant commissions and by resorting to misrepresentations. Additionally, it was alleged that the MMT and OYO had entered into an agreement which had resulted in the exclusion of OYO's competitors from listing on MMT. The CCI after reviewing the allegations, *prima facie* concluded⁴⁹ that the allegations of abuse of dominance against MMT and allegation of anti-competitive agreement between MMT and OYO required investigation.

■ Determining the relevant market

The CCI, in contrast to its earlier decision in the previous matter (described above), determined a broader relevant market in this matter. The CCI, based on the specific features and types of services provided by the intermediary platforms, concluded that market players like MMT only acted as an aggregator of hotels for convenience of customers. It therefore determined the relevant market as market for *"online intermediation services for booking of hotels in India"*.

■ Determining the dominance of MMT & OYO

Relying on the investor presentations made by MMT and Golbibo, the CCI observed that MMT held a 63% market share in the online intermediation market for booking of hotels. The CCI, while holding that the market share could not be the sole factor for assessment of dominance, concluded that *prima facie* MMT could be held to be in a dominant position in the relevant market. The CCI further attributed the long standing of MMT in the market for the above assessment.

In light of its *prima facie* determination, the CCI directed a detailed investigation into the alleged conduct of MMT. Its *prima facie* observations while assessing the allegations were:

- **Restrictions of room and price parity imposed by MMT over the hotels was of the broad category of Across Platform Parity Agreements (APPAs)** which could result in removal of incentives for platforms to compete on the commission charged from hotels.
- The allegation of **charging of excessive commission** from the hotels could not be determined at this stage as there was lack of clarity over market structure, entry conditions, cost structure of platforms, etc.
- The deep discounting allegation required investigation as it could not be considered as an introductory scheme or aimed at building its network (due to MMT's) long-standing presence in the market

While MMT was considered to be in a dominant position, the CCI (consistent with its *prima facie* findings in the previous case) did not find OYO to be dominant in the relevant market. The CCI noted that the market conditions did not appear to have changed since July 2019 to warrant a different delineation of relevant market.

■ Anti-competitive agreements amongst OYO and MMT

It was also alleged that the agreement between MMT and OYO, which in effect led to exclusive listing of OYO hotels on MMT in exclusion of its competitors amounted to an anticompetitive agreement. The CCI *prima facie* concluded that these allegations required a detailed investigation to ascertain if effects of the commercial agreement had caused exclusion of OYO's competitors from MMT's platform.

⁴⁹ Federation of Hotel & Restaurant Associations of India v. MakeMyTrip India Pvt. Ltd. and Ors., Case No. 14 of 2019, decision dated 28 October 2019.

KEY TAKEAWAYS FROM THE CCI'S DECISIONS

- **CCI's evolving understanding of the tech based industries:** The CCI appears to be adopting a more conscious approach in cases involving online marketplaces. It appears to be guided by the realities and dynamics of technology driven sectors and industries and has been careful in its assessment of cases particularly dealing with dominance and abuse, even at the prima facie stage. This is evident from its observations for instance, in both Case 1 and Case 2 about the market position of OYO and its conduct, which led to rejection of the allegations in Case 1.
- **Market definition:** The observations made by the CCI in both the cases, with regard to the definition of the relevant market suggests that the CCI understands that there is a certain level of overlap between the services being offered by OYO and MMT. The CCI however, for the purposes of assessment of alleged conduct made a clear distinction between the two types of business models, without going into the discussions on the overlaps and its potential impact on assessment of conduct.
- **Unilateral rights and justifications:** In abuse of dominance cases as well as dealing with unilateral rights, the CCI has taken into account reasonable commercial justifications in its assessment, particularly with respect to the dynamism of the technology driven markets that are still emerging, such as that of OYO. For instance, in Case 1, the CCI considered the maintenance of standard benchmark quality and consumer satisfaction as reasonable justifications.
- **Deep discounting:** The CCI has considered the objectives for offering deep discounts and period of presence in the market of the player in the market, as relevant in assessment of this issue. While introductory offers or operational reasons such as network building might be justifiable in case of new entrants, it may not necessarily be justifiable in cases of established players. Additionally, the CCI has also considered factors such as the cost structure of the players and the hotels, prices charged by the hotels and discounts offered by the players, as relevant factors for assessment of the issue of deep discounting.
- **APPAs:** The treatment of such parity restrictions, also called retail Most Favored Nation (**MFN**) clauses would be analyzed based on the foreclosure effects, such as concentration or enhanced entry barriers to the detriment of the consumers. Additionally, while narrow restrictions might be permissible subject to other factors, broad or wide restrictions are more likely to be treated as anti-competitive by the CCI, subject to the market power and their impact under Section 3(4) and Section 4 of the Competition Act.
- **Excessive Commissions:** CCI has maintained its position regarding excessive pricing/commission with the view that there are no clear standards to determine what would be 'excessive' or 'fair'. The factors that are likely to play a role in assessment of such 'fair' price would be the market structure, the entry conditions and the cost structure of the platforms, etc. in the market.

CONCLUSION

The market assessment of the online hotel booking sector by CCI provides a useful (albeit limited) insight into the CCI's current thought process on these issues in the context of technology driven sectors.

Considering that these sectors are in their development phase in India and are being studied by the CCI separately,⁵⁰ the outcome of a thorough investigation and inquiry is likely to throw light on the approach that the CCI may adopt in the future and its likely impact on the competition and consumers.

This article has been published in cnbctv18.com

⁵⁰ CCI initiates market study on e-commerce, The Economic Times, 30 August 2019. Retrieved from: <https://economictimes.indiatimes.com/industry/services/retail/cci-initiates-market-study-on-e-commerce/articleshow/70908158.cms>, on 20 November 2019.

Interplay of Goods and Services Tax Laws vis-à-vis Customs Laws

INTRODUCTION

There is no doubt, the introduction of GST has allowed its effects to be felt in other laws, including the Customs Law. This article highlights, via illustrations, the strong interplay of GST and Customs in relation to international trade transactions.

VALUATION

As per the provisions of Section 14 of the Customs Act, 1962 (**Customs Act**) read with Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (**Customs Valuation Rules**), the value of the imported goods is the transaction value of such goods where the buyer and seller of the goods are not related and price is the sole consideration for the sale. Specific additions to the transaction value are prescribed under Rule 10 of the Customs Valuation Rules. Given that value of certain services is included in the transaction value of imported goods, there is double taxation per se in respect of those services wherein there is no exemption of IGST on the services which already form part of the transaction value of the imported goods.

Under the GST regime, certain instances of transactions where there is an element of double taxation are given below:

▪ Levy of IGST on ocean freight

One of the most contentious issues under the GST regime, which is affecting almost all importers across industries, is whether the importers are liable to pay IGST under Reverse Charge Mechanism (**RCM**) on ocean freight paid for services of transportation of goods up to customs station of clearance in India, provided

by a person located in a non-taxable territory. This is, even if such freight is a part of Cost Insurance & Freight (**CIF**) value of imported goods on which the applicable Customs duty along with IGST (as a component of Customs duty) is already paid. Various Advance Rulings have been pronounced clarifying that the importer is liable to pay IGST on RCM basis on ocean freight even if such freight is part of CIF value of imported goods⁵¹. While multiple writ petitions have been admitted across various High Courts in India challenging the levy of IGST on ocean freight under RCM inter alia on the ground that the same amounts to double taxation⁵², the final outcome of the petitions is still awaited.

▪ Double taxation of service imports in certain other cases

Valuation provisions under Customs require adding value of certain services on to the transaction value of imported goods for the purpose of payment of Customs duty. In line with the same, exemption from payment of IGST under RCM has been granted to royalty and license fee to the extent that the same is included in the value of goods imported on which IGST (as a component of Customs duty) is paid⁵³. However, no such exemption is currently available qua other services (such as commissions and brokerage, engineering, design work) which form a part of transaction value and wherein Customs duty and IGST (as a component of Customs duty) are already paid. This results in double taxation in respect of such services.

It is interesting to note that this double taxation goes against the fundamental principle of GST which is to curb cascading effect of taxes.

⁵¹ IN RE: E-DP Marketing Pvt Ltd. [2019 (26) G.S.T.L. 436 (A.A.R. - GST)]; IN RE: Chambal Fertilizers & Chemicals Ltd [2018 (17) G.S.T.L. 526 (A.A.R. - GST)]; IN RE: Bahl Paper Mills Ltd. [2018 (14) G.S.T.L. 306 (A.A.R. - GST)]

⁵² Mohit Minerals Pvt. Ltd. vs. Union of India [2018 (10) GSTL 424 (Guj.); Ghanshyamlal & Co. [TS-345-HC-2019(GUJ)-NT]; Indorama Industries [TS-361-HC-2019(HP)-NT]

⁵³ Notification No. 6/2018-Integrated Tax (Rate) dated January 25, 2018

SCOPE AND AMBIT OF 'EXPORT' IN THE CONTEXT OF DUTY-FREE SHOPS (DFS)

Under the erstwhile Value Added Tax and Central Sales Tax laws, the Hon'ble Supreme Court of India⁵⁴ had held that sale of goods by duty free shops at International Airports, which are undisputedly beyond the Customs frontier of India, cannot be subjected to the levy of Sales Tax.

Under the GST regime, the controversy started with an Advance Ruling pronounced by the Delhi AAR⁵⁵ wherein a view contrary to that of the apex Court was taken thereby holding that supplies made by a DFS to outbound passengers is amenable to GST as export under GST takes place only when goods cross territorial waters/airspace of India and not merely on crossing customs barriers. A similar view was also adopted by the Bombay High Court⁵⁶ and Madhya Pradesh High Court⁵⁷. However, a similar issue also came up for consideration before the Allahabad High Court⁵⁸ wherein it was held that sales made by DFS constitute as exports as the goods are taken outside India and will not attract GST.

Given the conflicting judgments, recently, the Government of India granted exemption⁵⁹ to any supply of goods by a retail outlet established in the departure area of an international airport, beyond the immigration counters, to an outgoing international tourist, from IGST. Interestingly, the exemption from payment of IGST indicates that the Government considers the supply to be otherwise, amenable to GST. This fact has also been categorically mentioned in a Circular⁶⁰. Further, the exemption has only been granted to supplies that take place from the departure area and that too to 'outgoing international tourists'.

The term 'outgoing international tourist' has been defined to mean a person not normally resident in India who enters India for a stay of not more than 6 months for legitimate non-immigrant purposes. A natural conclusion to this would be that no exemption will be available to an Indian resident purchasing goods from such retail outlets. This is for the simple reason that they cannot be called as persons who are not normally residents.

The limited exemption is expected to bring additional responsibility on the DFS since they will now be required to maintain a separate record of sales to 'outgoing international tourists' and also cast a responsibility upon DFS to scrutinize if the passenger qualifies for an exemption or not.

CLASSIFICATION

In any indirect tax, classification of goods is very vital. The same has wide implications particularly in the case of a multi rate tax structure like GST. Customs adopt the global classification of goods, based on the Harmonized System of Nomenclature (**HSN**) read along with General Rules of Interpretation. The rate Notification of goods under GST regime also adopts the classification, rules of interpretation, section notes and chapter notes as specified under the Customs Tariff Act, 1975. However, certain anomalies in classification are observed with respect to 'goods' and 'services'. For example – any Intellectual Property Right (temporary transfer) imported into India over a physical medium is considered as goods for the purposes of Customs whereas under the GST, by virtue of Entry 5(c) of Schedule II of the Central GST Act, 2017 the same is classified as service. This may lead to issues in future if there is a difference in the IGST rate, double taxation, availment of any exemption benefit restricted to goods etc.

There is no doubt, given so much ambiguity, that GST and customs laws need to align. Amongst other things it will reduce expensive and long drawn litigation. This is where regulators will need to step in.

Uncertainty in taxation laws, especially interplay between different tax laws and consequently long drawn out litigation, is a pain point with corporate India. Clarity on issues, consistency of implementing regulations and continuous dialogue between government and businesses is the need of the hour.

⁵⁴ Hotel Ashoka v. Assistant Commissioner of Commercial Taxes — 2012 (276) E.L.T. 433 (S.C.)

⁵⁵ IN RE: Rod Retail Pvt. Ltd. [2018 (12) GSTL 206 (AAR – GST)]

⁵⁶ A-1 Cuisines Pvt. Ltd. vs. Union of India [2019 (22) GSTL 326 (Bom.)]

⁵⁷ Vasu Consulting Pvt. Ltd. vs. Union of India [2019 (22) GSTL 163 (MP)].

⁵⁸ Atin Krishna vs. Union of India [2019 (25) GSTL 390 (All.)]

⁵⁹ Notification No. 11/2019 - Integrated Tax (Rate) dated June 29, 2019

⁶⁰ No.106/25/2019-GST dated June 29, 2019

Implications of the WTO Panel's Decision: India – Export Related Measures (DS541)

BACKGROUND

On October 31, 2019, a WTO Panel issued its report in the dispute India – Export Related Measures (DS541), finding that a number of incentives provided by the Indian Government, under various export promotion schemes, violated certain WTO disciplines. The complaint which was initiated against India by the United States challenged the following schemes:

- Export Oriented Units and Sector-Specific Schemes (**EOU/EHTP/BTP**)
- Merchandise Exports from India Scheme (**MEIS**)
- Export Promotion Capital Goods (**EPCG**) Scheme
- Special Economic Zones (**SEZ**) Scheme
- Duty Free Imports for Exporter Scheme (**DFIS**)

Depending upon the scheme in question, an eligible participant, may be entitled to the following incentives:

- Exemptions from customs duties on importation of various goods (including raw materials and capital goods)
- Exemption from central excise duty payable on “excisable goods”, IGST and compensation cess
- Duty credit scrips adjustable against customs duties, central excise duties and certain other charges owed to the Indian Government
- Deduction of export earnings from corporate income taxes

The United States challenged the above incentives as ‘prohibited export subsidies’ under Article 3.1(a) and Article 3.2 of the WTO Agreement on Subsidies and Countervailing Measures (**ASCM**).

KEY LEGAL PROVISIONS AT ISSUE IN THE DISPUTE

This dispute examined whether the incentives provided by India’s export promotion schemes were prohibited under the WTO framework and if so, whether they could be covered by any of the exceptions as claimed by India under the ASCM. Separately the dispute also examined whether India, as a developing country, could avail of special benefits under the ASCM to protect its export promotion schemes.

A subsidy under the ASCM refers to a financial contribution by a government or public body that confers a benefit. Subsidies that are contingent, in law or in fact, on export performance are ‘prohibited’ under the ASCM.

However, footnote 1 to the ASCM provides a carve-out from the definition of a subsidy. It states that a measure is not a subsidy if it provides exemption or remission of duties or taxes (on an exported product) not in excess of duties and taxes actually accrued, or those levied on like products for domestic consumption. Read with Annex I of the ASCM, the following exemptions on certain taxes, if not in excess of those levied on good for domestic consumption, may not be considered export subsidies:

- Exemption or remission of “indirect taxes” with respect to production and distribution of exported products [Annex I(g)]
- Exemption, remission or deferral of prior-stage cumulative “indirect taxes” on goods and services used the production of exported products [Annex I(h)]
- Remission or drawback of “import charges” on imported “inputs” consumed in the production of the exported products [Annex I(i)]

KEY FINDINGS OF THE PANEL

Special and differential treatment for developing countries

Annex VII of the ASCM allows certain developing countries, including India, to maintain export subsidies, provided that the per capita income of these countries does not cross 1000 USD for three consecutive years. The ASCM does not expressly provide for treatment of these countries once they cross the said threshold. Notably, Article 27.2(b) of the ASCM provides for a phase out period of 8 years from entry into force of the WTO agreement for 'other' developing countries (i.e. developing countries that are not listed in Annex VII) to discontinue prohibited 'export subsidies'.

India crossed this threshold in 2016, however India argued before the Panel that it was still entitled to maintain its export subsidies because it was entitled to the 8 year phase out period (from the date of graduation from Annex VII) like the other developing countries.

The Panel however rejected India's argument as a textual interpretation of Article 27.2 read with Annex VII did not support India's claims⁶¹.

Customs Duty Exemptions on Capital Goods

In examining whether the customs duty exemptions provided on the import of various goods under the EPCG, EOU and DFIS Schemes were export subsidies, the Panel considered whether they were covered under the exception in Annex I(i) of the ASCM.

The Panel found that the import duty exemptions on capital goods did not meet the conditions of Annex I(i) as capital goods do not constitute inputs consumed in the production process as they are not physically incorporated in the goods or services they are

used to produce nor are they physically present in the final product.⁶² Furthermore, the Panel found that these exemptions were prohibited export subsidies as they were export contingent.

However, the duty exemptions on raw materials under the EOU/EHTP/BTP and DFIS Schemes were found to be within the scope of Annex I(i) since they constituted inputs.

Central Excise, IGST and Compensation Cess Exemptions

India argued that the exemption from central excise duties under the EOU/EHTP//BTPs scheme met the conditions of footnote 1 read together with Annex I(h) as exemptions remission or deferral of prior-stage indirect taxes levied on inputs.

The Panel noted that the exemption applied to procurement of "excisable goods" were in the nature of inputs and hence these exemptions (which were not in excess of those levied upon goods for home market consumption) were not prohibited export subsidies.

Separately, the exemption from certain other indirect taxes namely, IGST and compensation cess under the EOU/EHTP/BTP and EPCG Scheme were not examined by the Panel because they were not elaborated upon by the United States.⁶³

Duty Credit Scrips

India argued that the scrips issued under the MEIS constituted refunds for past payments of indirect taxes, under footnote 1 read together with Annexes I(g) and I(h). The US argued that there was no connection with the taxes actually paid and the value of the scrips.⁶⁴

⁶¹ Para 7.37 of Panel Report.

⁶² Para. 7.202 of Panel Report.

⁶³ Footnote nos. 304 and 373 of Panel Report.

⁶⁴ Para. 7.277 of Panel Report.

The Panel rejected India's arguments noting that, as per the Foreign Trade Policy, duty credit scrips were granted as a "reward" for exports.⁶⁵ The Panel further noted that the basis for calculating the reward was the free on board value of past exports of notified goods to notified markets which was then multiplied by a variable applicable rate of reward for each product-country combination. This did not indicate that indirect taxes paid in connection with the exported products were the basis of the award of MEIS scrips.⁶⁶ Furthermore, the Panel found the scheme to be a prohibited subsidy as it was export contingent.

The SEZ Scheme

India did not claim the exceptions under footnote 1 read with annex 1 with respect to the exemptions provided under the SEZ Scheme. The Panel found the benefits provided under the scheme with respect to exemptions on import duties and IGST and deductions from corporate income tax, to be entirely inconsistent with the ASCM as they were export contingent.⁶⁷

CONCLUSION: IMPLICATIONS OF THE PANEL'S FINDINGS

With India choosing to appeal the report of the Panel and the current impasse surrounding the functioning of the Appellate Body, it is unclear as to when and how this report will be adopted. That said, the findings of the Panel in this case may have implications on the WTO-consistency of several export promotion schemes maintained by several Members of the WTO. Given this context,

key implications of the Panel's decision are provided below:

- The Panel's clarification regarding special and differential treatment makes it clear that developing countries listed in Annex VII will be subject to the prohibitions of Article 3 of the ASCM immediately after they graduate from Annex VII.
- Export Promotion Schemes that provide exemptions from import charges on import of capital goods cannot be protected under the exceptions to the ASCM. However, the Panel did not examine whether exemptions on indirect taxes levied on the import of capital goods could possibly be covered under Annex I(g).
- The Panel's findings regarding the SEZ Scheme may have implications on similar Export Processing Zones existing in several other countries that provide fiscal benefits to entities operating from such Export Processing Zones.

Finally, it is possible to structure export subsidies so that they are compatible with WTO rules and governments may consider rejigging their Export Promotion Schemes based on the needs of the businesses and industry. In fact, the Government of India (**GoI**) has proposed to replace the MEIS by another scheme namely, Remission of Duties or Taxes on Export Product which aims to offer refund of certain non-creditable indirect taxes levied at the central and state levels.⁶⁸ Similarly, the GoI had also constituted a committee headed by Mr. Baba Kalyani to review the special economic zones policy of India. The committee has submitted its report to the GoI (not yet available in public domain).⁶⁹ It is unclear if the committee has investigated the WTO issues while formulating the report. Given that the GoI appears to be keen in reforming its export promotion policies, it would be useful for businesses to make sound representations to the GoI for formulating WTO-compliant policies.

⁶⁵ Para.7.272 of Panel Report.

⁶⁶ Para. 7.281 of Panel Report.

⁶⁷ Para.7.351 of the Panel Report.

⁶⁸ <https://www.thehindubusinessline.com/economy/policy/centre-considers-option-of-continuing-popular-meis-scheme-for-entire-fiscal/article29758344.ece>

⁶⁹ <https://pib.gov.in/Pressreleaseshare.aspx?PRID=1555650>

Open General Export Licenses

In lieu of the Government's mandate to ensure ease of doing business, the Department of Defence Production (DDP) has published two notifications dated October 21, 2019 for the issuance of an Open General Export License (OGEL) for the intra company transfer of technology as well as export of spare parts and components.

These notifications have been introduced with a view to reduce the bureaucracy and red-tapism plaguing the defence industry and to ensure that exports of defence related goods occur in a much faster time frame. Companies having offices abroad as well as in India will view this as a welcome break from the task of constantly seeking approvals and licenses from the various Ministries and Departments of the Indian Government.

INTRA-COMPANY TRANSFER OF TECHNOLOGY

The OGEL for transfer of technology only applies to those companies having a foreign parent company, with a subsidiary in India. Such transfer of technology shall be from the Indian subsidiary to either the foreign parent company and/or subsidiaries of the foreign parent company, provided it fulfils the following criteria:

- The items/software/technology to be exported by Indian subsidiary, have been imported from the country of the parent company or from subsidiaries of the parent company abroad.
- The items/software/technology to be exported is based on a Master Service Agreement/Contract between the parent company and the Indian subsidiary for carrying out certain services including design/encryption/research/development/delivery/validation/testing. Provided, such items/software/technology should not undergo change in functionality and classification.
- The applicant exporter declares that the exported items would only be used for the purposes for which it is intended by the parent company and/or its subsidiaries.

CONDITIONS FOR GRANT OF OGEL

While the first notification provides for the intra-company transfer of technology, the second notification addresses the export of spare parts and components by an Indian entity. While the items eligible under these two OGELs may be different, the DDP has provided similar conditions that the companies must comply with:

- The applicant exporter should have a valid Import Export Certificate
- The applicant exporter should have established an appropriate/certified Internal Compliance Program (ICP) or Export Compliance Programme of its own, or should be compliant with an ICP of its subsidiary/principal abroad to which the items will be exported
- The exporter agrees to receive an on-site inspection by DDP or its authorized representative, whenever desired for the auditing/verification of ICP
- Submission of annual report to Export Promotion Cell of DDP every year, in respect of the exports made against a specific OGEL
- The exporter shall submit a declaration to the effect that they have internal controls in place to prevent transfer of goods to countries/entities facing UNSC sanctions or arms embargo
- The countries to whom export of such items would be permitted are Belgium, France, Germany, Japan, South Africa, Spain, Sweden, UK, USA, Canada, Italy, Poland and Mexico

ITEMS/ SOFTWARE/TECHNOLOGY TRANSFERABLE UNDER THESE LICENSES

For intra-company transfer of technology:

SCOMET List Classification	
6A021 & 6A022	<ul style="list-style-type: none"> ▪ Technologies or software related to items listed in 6A010 of Munitions List except complete aircraft or complete unmanned aerial vehicles (UAVs) and any components specially designed or modified for UAVs. ▪ Technologies or software related to items listed in category 6A005 of Munitions List. ▪ Technologies or software related to items listed in category 6A013 of Munitions List.

For export of spare parts and components:

SCOMET List Classification	
6A003a & 6A003c	Components of ammunition & fuse setting device without energetic and explosive material.
6A005	All goods under this category. (<i>Firing Control & related alerting and warning equipment and related system</i>)
6A010	All goods under this category except complete aircraft or complete UAVs and any components specially designed or modified for UAVs
6A013	All goods under this category (<i>Body protective items</i>)

ACTIONS TO BE TAKEN

India's inspiration for introduction of such OGEL appears similar in approach to a move by the European Union (**EU**) in 2012 whereby individual licenses by different European countries were replaced by a general license for intra-EU transfer of defence equipment. The European defence market being fragmented and differing on national approaches caused many problems for the European defence industry in general, and for small and medium-sized enterprises in particular. For example, national systems to control the transfer of defence equipment did not distinguish between exports to non-EU countries and transfers between EU countries. Different national licensing regimes also imposed burdensome administrative procedures, while hampering the security of supply between EU countries.

*The Transfer Directive 2009/43/EC*⁷⁰ diminished these obstacles, progressing towards a genuine European market for defence equipment, without sacrificing EU countries' control over their essential defence and security interests. It introduced a new licensing system namely general, global and individual licenses, differentiating between each of them and it encouraged EU countries to replace, as far as possible, the use of individual licenses with general licenses for unproblematic

⁷⁰ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02009L0043-20160928>

intra-EU transfers. Additionally, general licences were to be applied where the transfer of defence-related products were simply made for the purposes of demonstration, evaluation, exhibition or for the purpose of maintenance & repair, where the recipient of the license is the original supplier of the products.

This established licensing system aims at rendering individual licenses as the exception. EU countries continue to remain free to determine the products eligible for the different types of licenses and to fix the terms and conditions of such licenses. This has allowed for a smooth exchange of defence related products amongst the EU countries without the administrative hassle of each individual export.

STEPS IN THE RIGHT DIRECTION

With one fell swoop, the Government has addressed the concerns of the defence industry regarding the amount of paperwork, time and approvals required for a simple transfer of spares, components or technology from one subsidiary to another. These notifications serve to ensure that a company looking to transfer technology to one of its branches or provide defence items for overhaul and repairs to the parent company can now jump

ahead of the queue and obtain their export license rather than get bogged down by the excessive licenses and submissions previously required. Similar to the move by the EU few years ago, the Government has vide these two notifications ensured ease of doing business in India while also furthering their goal of making India a defence manufacturing hub.

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