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GUIDELINES FOR FOREIGN DIRECT INVESTMENT IN E-COMMERCE

The petition filed by the Footwear Manufacturers & Retailers Association before the High Court of Delhi (the “**High Court**”) last year, alleging violation by the e-commerce players of the regime governing foreign direct investments (the “**FDI**”) in India (the “**FDI Policy**”) and the subsequent order of the High Court directing investigation into the matter has spooked foreign investors and the industry players in this sector.

To bolster the confidence of foreign investors and the industry players, the Department of Industrial Policy & Promotion (the “**DIPP**”) has released Press Note 3 (2016 Series) dated March 29, 2016 (the “**Press Note**”) ¹, which lays down regulatory boundaries of the FDI in the e-commerce sector with immediate effect.

Prior to the Press Note, under the FDI Policy, e-commerce activities were defined as “the activity of buying and selling by a company through the e-commerce platform”, and 100% FDI was allowed subject to specified conditions in Business to Business (“**B2B**”) e-commerce. As regards e-commerce in the retail trading, i.e., Business to Customer (“**B2C**”) trading, the Press Note also reiterates and clarifies the following specific exceptions/conditions of FDI in the B2C trading:

1. A manufacturer is permitted to sell its products manufactured in India through wholesale and/or retail, including through e-commerce without Government approval. An Indian manufacturer being the investee company and the owner of the brand is permitted to sell its own products in any manner, i.e., wholesale, retail, including through e-commerce platforms. Such Indian manufacturer should be the owner of the Indian brand and should manufacture in India, in terms of value, at least 70% of its products in house, and source, at most 30% from the Indian manufacturers.
2. Subject to the provisions of the FDI Policy, the FDI in single brand retail trade is permitted up to 49% under the automatic route and beyond 49% under Government route. A single brand retail trading entity operating through brick and mortar store, is also permitted to undertake retail trading through e-commerce subject to conditions imposed under the FDI Policy.

In an attempt to validate and clarify that the marketplace model of e-commerce is permissible under the FDI Policy and the conditions to be adhered to by entities operating under such models, the Press Note provides the following:

1. Marketplace model means providing of an information technology platform (“**Marketplace**”) by an e-commerce entity to facilitate sales between the vendors and sellers. 100% FDI through automatic route is expressly permitted in e-commerce companies operating under the Marketplace model subject to the conditions stipulated in the Press Note which are elaborated below.

¹ A copy of the Press Note is available at http://dipp.nic.in/English/acts_rules/Press_Notes/pn3_2016.pdf

2. An e-commerce entity engaged in Marketplace model is prohibited from: (a) having ownership of any inventory; (b) permitting more than 25% of the sales through one vendor or their group companies; (c) directly or indirectly influencing the price of goods or services, and is required to maintain a level playing field. The Marketplace entity can provide support services like warehousing, logistics, call centre, order fulfilment, payment collection etc. to sellers. However, warranty/guarantee for goods/services and post sales responsibility including delivery of goods and customer satisfaction shall vest with the sellers.
3. B2B e-commerce shall be governed by the guidelines on cash and carry wholesale trading under the FDI Policy.
4. Sale of services through e-commerce platform will be under automatic route subject to other conditions in FDI Policy and applicable law.

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The Press Note provides the much awaited clarity, among other issues, on the terms 'e-commerce' and 'marketplace model' by providing definitions in this regard. It has also spelt out clearly that 100% FDI under the automatic route is permitted in a Marketplace entity, which at no point shall have ownership of the inventory. As a result, e-commerce companies deploying a combination of Marketplace and a B2B inventory-based model will have to restructure their business. Overall, this is definitely a good step and the regulator needs to be lauded for taking such a bold step, especially when (a) there are conflicting interests and lobbying; and (b) the matter is pending before the courts. The devil, as they say, is in the detail. Following are our comments / issues / concerns / questions, but this should not take away from what we have stated above.

The restriction on Marketplace entities stating that not more than 25% sales on their platform can be from one vendor or its group entities will definitely impact the business model of some players. Marketplaces that have (a) a fewer number of vendors; and (b) one or two dominant vendors (including its subsidiaries or group entities) will be particularly hit by this condition. These entities will need to get more vendors on board their Marketplace. Apart from this, the restriction may also become a practical obstruction as the mechanism for computing and monitoring the threshold has not been provided for in the Press Note. Assuming (this is a logical assumption to make) that this has to be computed for a particular cycle (which should be one year), satisfying the requirement could pose some practical but not insurmountable hurdles.

Separately, it is interesting to note that the Press Note allows Marketplace entities to provide support services like warehousing, logistics, call centre, order fulfilment, payment collection etc. to sellers whilst specifying that post sales, delivery of goods to customers will be the responsibility of the sellers. It appears that the regulator is trying to convey that while there is no restriction in Marketplace entities providing ancillary services like delivery of goods, the primary responsibility should lie with the seller as if it had outsourced the function to any other third party. To this extent, the Marketplace entities will need to ensure that the end responsibility with respect to the delivery of goods and post sales services lies with the vendors and that the contractual obligations are in line with the essence of the Press Note.

Further the definition of an e-commerce entity which provides that it is a company or an office or agency owned and controlled by a non-resident creates an anomaly with the FDI principles. It seems to suggest that FDI upto 49% without control being exercised is permitted in e-commerce companies which could not have been the intention. A clarification or a change in wording in this regard would be helpful.

It is not clear why e-commerce services are now included in this definition. Services generally were always under the automatic route under the FDI Policy and this is also clarified in the Press Note at the end. Therefore adding services within the ambit of this Press Note seems to us to serve no meaningful purpose but only obfuscates and raises several questions about online services currently being provided by a host of entities. It may have been preferable to leave out e-commerce services from the ambit of this Press Note apart from clarifying that the e-commerce entity may provide support services.

Finally, the Press Note states that the Marketplace entity will not directly or indirectly influence the price of the goods or services and shall maintain a level playing field. This poses multiple problems / questions:

- a) Given the fact that anti-competitive practices are regulated under competition law, the intent of bringing this within DIPP's realm is debatable. Influencing price is not necessarily bad. One must remember that consumers benefit from a reduction in price. Having said that, there is substantial jurisprudence in competition law around what is permissible and what is not. Dealing with the issue in one sentence, in our view, is not appropriate. This should have been left to the competition regulator.
- b) What does level playing field mean? This is highly subjective and can become a matter of clever drafting and structuring. Further, certain kinds of vendors / territories may need special support and help. Marketplaces, as they evolve, will go deeper into items that are not mainstream and require significant marketing and support. This clarification might come in the way of such activities.
- c) Purely Indian marketplaces with no FDI are exempt from this requirement. Unfair practices are harmful, irrespective of the person or entity propagating them. Does this give an unfair advantage to an "Indian" marketplace with no FDI?
- d) The FDI Policy in general covers sectors, capitalisation and other high-level issues. This Press Note goes into detail and legislates on business models. How will this be regulated? Who will examine and determine whether there is a violation? What is the consequence of this violation? How can foreign investors ensure that companies comply with these requirements? Will "small" violations / infractions make the company non-compliant?
- e) What is "an inventory of services"? Will aggregators / facilitators of services be governed by this restriction? It would be very odd, for example, if there is no uniformity in the taxi service rates, fees for beauty related services or for plumbing services offered on a services Marketplace.

Author - Srinivas Katta, Aakash Dasgupta and Ankita Gupta

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