Between the lines...

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I. Delhi High Court rules on claim for damages vs. exercise of put option rights

The Hon'ble Delhi High Court in the case of ***Shakti Nath and Ors. vs. Alpha Tiger Cyprus Investments No. 3 Ltd. and Ors.*** (decided on February 9, 2017) has upheld the arbitral award, observing that none of the grounds under Section 34 of the Arbitration and Conciliation Act, 1996 (the **"Act"**) were attracted.

Background and submissions

The Petitioners had challenged a majority award being passed by the arbitral tribunal under Section 34 of the Act.

A plot of land was allotted by a development authority to M/s. Sarv Mangal Real Tech Private Limited (**"SMRTPL"**). In respect of the said plot of land, SMRTPL and Respondent No. 3, namely, IT Infrastructure Park Private Limited (**"ITIPPL"**) had entered into a co-development agreement for co-development of an SEZ. A sub-lease was granted for a portion of allotted land in favour of ITIPPL (**"Project Land"**).

A Share Holders Agreement (**"SHA"**) and a Share Subscription and Purchase Agreement (**"SSPA"**) came to be executed between the Petitioners and the Respondents concerning the Project Land. The Investors Respondent No. 1 and 2 (**"Investors"**) and the Petitioners held 50 percent stake each in ITIPPL. The Respondents were also interested in development of other projects, namely, the Technika Project and the Technova Project but had exited from these projects in 2010. The SHA and the SSPA were terminated and the Restated Share Holders Agreement (**"RSHA"**) and the Restated Share Subscription and Purchase Agreement (**"RSSPA"**) substituted the SHA and the SSPA.

Certain important clauses under the RSHA must be discussed here. Under the RSHA, the Petitioners 1 to 4 had agreed to arrange for a term loan facility of ₹113.50 Crores (**"Term Loan"**) for ITIPPL. The sum was to be utilized for the payment of remaining cost of land to development authority and to fund the first phase project construction. The Petitioners had

also agreed to execute a bank guarantee for the payment of remaining land cost to the development authority. The RSHA also contained put option rights. In the circumstances where conditions related to execution of the facility agreement and the release of the first instalment of the Term Loan facility were not fulfilled by a certain date, it was provided in the RSHA that the Investors, *"shall have the right, though not the obligation, to require the Promoters, to acquire all but not less than all of the shares held by the Investors (put option shares) and the Promoters shall be required to purchase such put option shares within 30 (thirty) business days of being required to do so by the Investors through notice in writing (Put Option Notice)."* Thus, an irrevocable obligation was imposed on the Petitioners promoters requiring them to purchase the put option shares and to pay the specified put option price to the Investors within 30 days of the put option notice.

Affirmative vote of at least one nominee director of the Investors was required for grant of the Term Loan facility and the execution of the facility agreement. Petitioners blamed the Respondents for failing to take adequate steps for execution of the facility agreement.

In the interim, the RSHA was amended by executing a Supplemental Agreement (**"SA"**). The Petitioners contended that the RSHA was substantially modified by the SA like certain provisions related to operation of designated bank account and regarding security for the Term Loan facility were altered.

In December 2009, the Petitioners, via an e-mail addressed to the Investors, purported to terminate, inter alia, the SHA, the SSPA, the RSHA and the RSSPA. The Respondents invoked arbitration and a request was made to the International Chamber of Commerce (**"ICC"**) for commencement of arbitration. The Parties nominated their nominee arbitrators. Thereafter, the chairman of the arbitral tribunal was to be appointed and the ICC repeatedly reminded both the parties of the requirement to nominate the chairman of the arbitral tribunal/third arbitrator. In the meanwhile, the Petitioners and the Respondents entered into settlement agreement on May 28, 2010 and requested the ICC to suspend the arbitration proceedings. However, the ICC confirmed the appointment of arbitrators nominated by each of the parties and the chairman of the arbitral tribunal came to be appointed.

The Petitioners challenged the appointment of nominee arbitrator of the Respondents and contended that the nominee arbitrator did not meet the special qualification to act as the arbitrator. This challenge was rejected by the ICC. In 2012, the Petitioners again made a failed attempt, to challenge the appointment of nominee arbitrator of the Respondents and also the appointment of the chairman of the arbitral tribunal. Further, a third application was filed by the Petitioners before the ICC Court which was also rejected.

The Petitioners had pointed out that, as per the RSHA and the RSSPA, nominated arbitrators were required to have experience and understanding of Indian real estate laws, regulations and practices and minimum 5 years' experience in construction/management of projects similar to the project in this case. It was the case of the Petitioners that the chairman of the arbitral tribunal and the arbitrator nominated by the Respondents did not possess the above qualifications. It is worth noting here that the arbitrator nominated by the Petitioners also did not possess the above qualifications. However, the Petitioners justified this by contending that their nominee arbitrator had made disclosure with respect to the same to the ICC and there was no objection raised to the same.

The Petitioners also alleged that the Respondents were trying to enforce put option rights under the RSHA through the arbitral award. It was submitted that the arbitral tribunal did not consider the Reserve Bank of India Circular No. 4 of 2014 and the Foreign Exchange Management (Transfer or Issue of Security by a person resident outside India) (12th Amendment) Regulations, 2014 in this regard.

The Respondents contended that, in terms of Clause 18.3.2 of the RSHA, the Respondents had the option to either enforce the put option or alternatively claim damages for breach of contract under Section 73 of the Indian Contract Act, 1872 and in the instant case the Respondents were claiming damages.

Observations of the Court

The Court observed that the challenge by the Petitioners, to the appointment of the arbitrator nominated by the Respondents, was made beyond the 30 days period requirement as prescribed under the ICC Rules and was therefore time barred. The Court also noted that arbitrators nominated by both the parties did not meet the specified qualifications, clearly showing that they decided to waive the strict adherence to the qualifications. Also, the challenge by the Petitioners did not appear bona fide to the Court.

The Court further observed that the ICC Court was not required to give any reason for rejecting the challenge in terms of Article 7(4) of the ICC Rules[1] and the decision was final and binding on the parties.

With regard to the allegation on enforcement of put option rights through arbitral award, the Court observed at paragraph 59 of the judgment, *"The AT examined the Respondents' claim as one for damages. The directions issued by the AT did not touch on the aspect of exercise of put option by the Respondents. With the Respondents not exercising the option of the "put option" but claiming damages for breach of the contract under Section 73 of the ICA, the question of any violation of RBI Circular No. 4 of 2014 in relation to exercise of "put option" did not arise. There is, therefore, no merit in the contention of the Petitioner that the impugned Award, if implemented, would lead to violation of FEMA/ RBI guidelines or any of the circulars thereunder."*

Decision

The Court observed that the Respondents had made it clear to the arbitral tribunal that the relief they were seeking was not pursuant to the exercise of the put option but damages for breach of contract under Section 73 of the Indian Contract Act, 1872. Further, the right available to the Respondents under Clause 18.3.2 of the RSHA, that is claiming damages for breach of contract under Section 73 of the Indian Contract Act was ***"in addition to and not in substitution for"*** any remedy available to the Respondents in respect of an event as set out in Clause 18.3 of the RSHA. Hence, the award is not an attempt to enforce the put option.

The Court concluded that the arbitral tribunal was properly constituted and thus the challenged award was not invalid. The Court noted that no ground was made out by the Petitioners to demonstrate that the impugned arbitral

[1] The decisions of the Court as to the appointment, confirmation, challenge or replacement of an arbitrator shall be final and the reasons for such decisions shall not be communicated. (Article 7 (4) of the International Chamber of Commerce Rules)

award suffered from any legal anomaly attracting Section 34 of the Act. The Court, after taking note of certain decisions, noted that *"the threshold for a successful challenge to an Award in a petition under Section 34 of the Act is indeed very high and unless the reasoning in the impugned Award is so perverse as to shock the judicial conscience or lead to violation of Section 28 (3) of the Act, the Court would not like to interfere. In the present petition, none of the grounds under Section 34 of the Act stand attracted".* Finally, the arbitral award was upheld by the Court.

VA View

The Delhi High Court has upheld the arbitral award and rightly observed that as the Respondents enforced their rights to seek damages and not the put option right granted to the Respondents under the contract and as the right to seek damages was in addition to and not in substitution for the put option right, therefore the award was not an attempt to enforce the put option right.

II. *"Independence and impartiality of the arbitrator are the hallmarks of any arbitration proceedings"*- Supreme Court judgment in DMRC case

The Supreme Court of India in the case of ***Voestalpine Schienen GmbH vs. Delhi Metro Rail Corporation Limited*** (decided on February 10, 2017) has laid down important principles concerning the independence and impartiality of arbitrators.

Background and submissions

The Petitioner, an Austrian company, was awarded contract for supply of rails in 2013 by the Respondent. The Petitioner had delivered the rails at sea port in Mumbai on time. However, the inland transport from Mumbai to Delhi was delayed. The Petitioner contended that they were not at fault but the Respondent imposed liquidated damages for the same.

The Petitioner alleged, inter alia, that the Respondent had wrongfully withheld money towards invoices raised for supply of rails and had illegally encashed performance bank guarantee. The Respondent also suspended business ties with the Petitioner for six months as it was not content with the performance of the Petitioner. However, the Delhi High Court had passed an order through which it had directed the Respondent to keep its decision of suspending business ties with the Petitioner in abeyance.

The Petitioner invoked the dispute resolution clause and attempts were made to resolve the dispute amicably. When the attempt to do so failed, arbitration clause was invoked. The arbitral tribunal was to comprise of three arbitrators. The procedure for constitution of the arbitral award was such that the Petitioner was required to pick its nominee arbitrator from the names of five persons chosen by the Respondent from the panel maintained by it. The Respondent was also required to choose its arbitrator from this list of five persons. The two arbitrators chosen by the parties were then required to choose the presiding arbitrator, again from the same list. Later, however, the Respondent had forwarded a new list to the Petitioner containing 31 names to choose and nominate its arbitrator from.

The Petitioner was aggrieved by this procedure as it was of the view that the panel maintained by the Respondent did not comprise of independent arbitrators. The panel of the Respondent consisted of serving or retired engineers of government departments or public sector undertakings.

The Petitioner relied upon the amendment made by the Arbitration and Conciliation (Amendment) Act, 2015 (the **"Amendment Act"**) to Section 12 of the Arbitration and Conciliation Act, 1996 (the **"Principal Act"**). According to the Petitioner, the panel maintained by the Respondent was not valid in view of the said amendment. The Petitioner picked a retired judge of the Supreme Court as a sole arbitrator and requested consent of the Respondent. The Respondent, however, refused consent for deviating from the procedure as contained in the arbitration clause and nominated an arbitrator from the said list of five persons. The Petitioner approached the Supreme Court in this case by filing petition under Section 11 of the Principal Act for constitution of arbitral tribunal by the Court.

The Respondent argued before the apex court that the petition was not maintainable as the agreement between the parties contained an arbitration clause prescribing the procedure for constitution of the arbitral tribunal. With regard to the submission by the Petitioner that the independence and impartiality of the arbitrators were compromised, the Respondent countered by submitting that no member of the panel was currently serving or was past employee with the Respondent nor any member of the panel had any direct or indirect connection with the Respondent. The Respondent also contended that due to technical issues involved in the matter and considering the nature of the dispute, the panel rightly comprised of retired government engineers who had adequate expertise to adjudicate the dispute between the parties.

The Petitioner stressed on the purpose behind the amendment brought by the Amendment Act to Section 12 of the Principal Act. Relevant provisions under the Principal Act, as amended by the Amendment Act, are below.

"12. Grounds for challenge

(1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing any circumstances,--

(a) such as the existence either direct or indirect, of any past or present relationship with or interest in any of the parties or in relation to the subject-matter in dispute, whether financial, business, professional or other kind, which is likely to give rise to justifiable doubts as to his independence or impartiality; and

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(5) Notwithstanding any prior agreement to the contrary, any person whose relationship, with the parties or counsel or the subject-matter of the dispute, falls under any of the categories specified in the Seventh Schedule shall be ineligible to be appointed as an arbitrator:

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THE SEVENTH SCHEDULE

Arbitrator's relationship with the parties or counsel

1. The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party.

2. The arbitrator currently represents or advises one of the parties or an affiliate of one of the parties.

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5. The arbitrator is a manager, director or part of the management, or has a similar controlling influence, in an affiliate of one of the parties if the affiliate is directly involved in the matters in dispute in the arbitration.

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12. The arbitrator is a manager, director or part of the management, or has a similar controlling influence in one of the parties.

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The spirit of the amendment, according to the Petitioner, was to ensure the independence of arbitrators and persons connected even remotely with any side were not to be appointed as arbitrators to adjudicate disputes between the parties. The Petitioner pointed out that the independence and neutrality of arbitrators were compromised due to presence of retired government engineers in the panel, creating apprehension of likelihood of bias.

Observations of the Court

The Court observed, with regard to the issue of deviation from the procedure for appointment of arbitrator mentioned in the arbitration clause, *"In such an eventuality, i.e., when the arbitration Clause finds foul with the amended provisions extracted above, the appointment of an arbitrator would be beyond pale of the arbitration agreement, empowering the court to appoint such arbitrator(s) as may be permissible. That would be the effect of non-obstante Clause contained in Sub-section (5) of Section 12 and the other party cannot insist on appointment of the arbitrator in terms of arbitration agreement."*

The Court pointed out that even prior to the amendment of Section 12, on many instances, arbitrators were appointed by the Courts in derogation to the agreed arbitration agreement between the parties to ensure their independence and impartiality. This was under the unamended Section 11(8) of the Principal Act, as below.

"(8) The Chief Justice or the person or institution designated by him, in appointing an arbitrator, shall have due regard to-

(a) any qualifications required of the arbitrator by the agreement of the parties; and

(b) other considerations as are likely to secure the appointment of an independent and impartial arbitrator."

However, the Court observed that no person on the panel of arbitrators maintained by the Respondent was covered by any item in the Seventh Schedule as added by the Amendment Act to the Principal Act. The Court was not convinced by the argument of the Petitioner that retired government officers were ineligible to act as arbitrators as

this intent was not captured anywhere in the Principal Act as amended. Rather, Court pointed out the benefit of having such people to arbitrate disputes of technical nature as they have the expertise to better adjudicate disputes of such nature.

The Court held, *"As already noted above, DMRC has now forwarded the list of all 31 persons on its panel thereby giving a very wide choice to the Petitioner to nominate its arbitrator. They are not the employees or ex-employees or in any way related to the DMRC. In any case, the persons who are ultimately picked up as arbitrators will have to disclose their interest in terms of amended provisions of Section 12 of the Act. We, therefore, do not find it to be a fit case for exercising our jurisdiction to appoint and constitute the arbitral tribunal."*

The Court made some important remarks on the arbitration agreement between the parties and the procedure contained therein for appointment of arbitrators, summarised below.

- The Court felt that there was limited choice for picking up arbitrators as all the three members of the arbitral tribunal had to be picked from the five persons picked by the Respondent from the panel maintained by it. Court also thought that such provision created doubt in the mind of the other party as party maintaining the panel could easily pick its favourites from the panel.
- The Court observed that freedom must be given to the parties and to the two appointed arbitrators (for appointment of presiding arbitrator) to nominate any person from the entire panel of arbitrators, and not just from the pool of five persons picked by the Respondent.
- The Court also remarked that the panel maintained by the Respondent should not only have serving or retired engineers of government departments or public sector undertakings but persons from varied fields.

Decision

The petition was dismissed and two weeks' time was granted to the Petitioner for nominating its arbitrator from a wider pool of 31 arbitrators as forwarded by the Respondent to the Petitioner. The Court further directed the Respondent to prepare a broad based panel in consonance with its directives within two months.

VA View

This is a very significant ruling coming from the apex court on the aspect of independence and impartiality of arbitrators. The Court has rightly remarked that the hallmarks of any arbitration proceedings are independence and impartiality of arbitrators.

The Court has laid down important principles to ensure the independence and impartiality of arbitrators. Further, it may be worth noting that the Court has also distinguished between independence and impartiality as two different concepts. According to the apex court, an arbitrator may be independent and yet, lack impartiality, or vice versa. Independence is more of an objective concept while impartiality is subjective.

This judgment is yet another valuable addition to a series of judgments delivered in the recent past by the Indian courts, which have been arbitration friendly and have sent right signals to foreign investors.

III. Pre-existing relationship of three years a strict requirement to avail open offer exemption for inter-se promoter transfer

The Securities and Exchange Board of India (**"SEBI"**), in an order passed on March 3, 2017 in relation to an application for exemption from making an open offer, denied to grant exemption for inter-se transfer among promoters. The application was made under Regulation 11 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**"Takeover Code"**) in the matter of proposed acquisition of shares and voting rights in Gokul Agro Resources Limited (**"Gokul Agro"**).

The proposed acquirer Mr. Kanubhai Jivatram Thakkar (**"Acquirer"**), managing director of Gokul Agro, was seeking exemption from making an open offer, as is required to be made under Regulation 3(2) of the Takeover Code, for the proposed indirect acquisition and control of the shareholding and voting rights in Gokul Agro.

Gokul Agro was incorporated as a subsidiary of Gokul Refoils & Solvents Limited (**"Gokul Refoils"**). A scheme of arrangement was entered into between Gokul Agro and Gokul Refoils for demerger of some undertakings of Gokul Refoils and transfer of the same to Gokul Agro. Pursuant to the same, Gokul Agro had allotted shares to the shareholders of Gokul Refoils.

72.52% of the equity shares and voting rights in Gokul Agro were held by the promoter group. The Acquirer individually held 20.74% equity shares and voting rights in Gokul Agro (the Acquirer acquired 4.93% of shares of Gokul Agro from a promoter under a block deal on stock exchange)and wanted to acquire further 31.34% shares from the promoter group shareholders.

Regulation 3 (2) of the Takeover Code, which contains the requirement of making an open offer, provides as under:

"Substantial acquisition of shares or voting rights –

3.(2) No acquirer, who together with persons acting in concert with him, has acquired and holds in accordance with these regulations shares or voting rights in a target company entitling them to exercise twenty-five per cent or more of the voting rights in the target company but less than the maximum permissible non-public shareholding, shall acquire within any financial year additional shares or voting rights in such target company entitling them to exercise more than five per cent of the voting rights, unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations:

Provided that such acquirer shall not be entitled to acquire or enter into any agreement to acquire shares or voting rights exceeding such number of shares as would take the aggregate shareholding pursuant to the acquisition above the maximum permissible non-public shareholding. XXXX"

Regulation 10(1)(a)(ii) of the Takeover Regulations, which provides exemption from obligation to make an open offer, is as below:

"General exemptions

10. (1) The following acquisitions shall be exempt from the obligation to make an open offer under regulation 3 and regulation 4 subject to fulfilment of the conditions stipulated therefor, —

(a) acquisition pursuant to inter se transfer of shares amongst qualifying persons, being,—

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*(ii) persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations **for not less than three years prior to the proposed acquisition;"***

The obligation to make an open offer was getting triggered under Regulation 3(2) of the Takeover Code as the Acquirer alongwith persons acting in concert were already holding shares and voting rights above 25% and therefore the further acquisition exceeding 5% attracted the obligation to make an open offer, unless the same was exempted.

The Acquirer thus sought an exemption under Regulation 10(1)(a)(ii) of the Takeover Code. The Acquirer put forth the argument that it was a proper case for granting exemption by submitting, with regard to the three years requirement, that promoters managed and controlled the business activities of Gokul Agro for more than 3 years though they could not meet the requirement of being named as promoters for a minimum period of 3 years. Hence, the Acquirer was of the view that *"looking through the substance of the transaction, the acquirer and transferors were in spirit and substance the Promoters of the business of the Target Company for a period exceeding 3 years."* The Acquirer pointed out that shares held by the promoters in Gokul Agro were out of shares held in Gokul Refoils for more than 8 years.

The Takeover Panel noted that the Takeover Code was very clear on the grant of exemption from making an open offer in case of an inter-se transfer among promoters. The Panel recommended that the application for grant of exemption must be rejected as the name of the promoters had to be disclosed for three years in order to avail the exemption.

SEBI cited the Report of the Takeover Regulations Advisory Committee (2010), in which it was observed, inter alia, *"In respect of inter–se transfers amongst certain 'qualifying parties' as listed and defined under the Takeover Regulations, the Committee recommends that, in order to curb the abuse of introduction of new entities as qualifying parties, in most cases a requirement of pre-existing relationship of at least three years has been prescribed".*

SEBI, while agreeing with the observations and findings of the Takeover Panel and the Takeover Regulations Advisory Committee, observed that the three years requirement is provided for in order to avail the exemption so as to avoid the misuse of the provision by introduction of new entities within the scope of definition of *'qualified persons'* under the Takeover Code.

Finally, SEBI rejected the application for exemption made by the Acquirer.

VA View

As observed by the Takeover Panel, the 1997 takeover code left much scope for interpretation but the 2011 code is rather strict and clear on the requirement to avail exemption in case of inter-se promoter transfers. The term *'qualifying promoters'* was used in the corresponding provision under the 1997 code, which as observed by the

Takeover Regulations Advisory Committee, lead to abuse by introduction of new entities as qualifying parties. Three year requirement was therefore prescribed under the 2011 code in order to address this loophole that existed under the earlier code and to make the requirement clearer and less susceptible to interpretation.

SEBI, in this order, has clearly indicated that the three years requirement under Regulation 10(1)(a)(ii) of the Takeover Code is to be strictly complied with in order to avail exemption from making an open offer in case of inter se transfer of shares amongst promoters.

IV. FIPB abolished- Government to release new framework soon

Background

The liberalisation of the Indian economy in 1991, which opened the floodgates of foreign investments into the Indian economy, gave birth to an inter-ministerial body called the Foreign Investment Promotion Board (**"FIPB"**). FIPB, a single window clearance for foreign investments coming into the country, was given the primary charge of processing the foreign direct investment (**"FDI"**) proposals for investment in sectors under the Government approval route. Functioning under the Prime Minister's Office in its initial years of establishment, the FIPB came under the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry in 1996 and Department of Economic Affairs, Ministry of Finance from 2003 onwards. Proposals that require Government approval under the FDI policy are processed through the FIPB. However, it is to be noted that for proposals with total foreign equity inflow of more than ₹5000 crores, the FIPB recommendations are placed for consideration of the Cabinet Committee on Economic Affairs.

Budget proposal

Hon'ble Mr. Arun Jaitley, the Union Minister of Finance, in his budget speech delivered on February 1, 2017, announced that the nearly 25 years old FIPB will be abolished in 2017-18.

The Government had given signals of its intent to phase out the FIPB in 2016 as more and more sectors were coming under the automatic route pursuant to the liberalisation of FDI policy (92 per cent of FDI falling under the automatic route) and all the activities had moved online raising doubts over the utility of FIPB.

Further developments

As per reports, the mandate to prepare a standard operating procedure for all the ministries in order to facilitate expeditious approval of the FDI proposals, is given to the Reserve Bank of India. In a significant change to the practice of approving FDI proposals, regulators or ministries for a particular sector will now take charge of approving the FDI proposals for such sector. Needless to add that such sector must fall within the approval route.

As per recent reports, a draft cabinet note for consultation has been circulated by the Department of Economic

Affairs, Ministry of Finance indicating that sectoral ministries and regulators are set to take over the functions of FIPB soon. New framework is being worked upon and is expected to be released soon.

VA View

The role of the FIPB was on the decline in the recent years after the Government of India went on the FDI liberalisation spree, giving a constant push to its *'ease of doing business'* agenda and a major fillip to foreign investments. Several sectors have been put under the automatic route from the approval route and Government is considering proposals to further liberalise the FDI policy regime.

However, this move has triggered some concerns as well. Some reports suggest that it may be mulled that all sectors, currently under the government route, are put under the automatic route. However, this speculation is rather unrealistic, considering that some sectors of national and strategic importance cannot be allowed to have 100% FDI without appropriate checks. Ministries and other relevant authorities are most likely to be given the charge for their respective sectors. However, this move may have its own pitfalls due to excessive segregation and lack of experience in handling FDI proposals.

With the new framework being awaited, only time will tell whether this step by the Government will give a boost to foreign investments or will only complicate the approval regime for sectors under the government route.

V. FDI in LLPs further liberalized

The Reserve Bank of India issued the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Second Amendment) Regulations, 2017 on March 3, 2017 (the **"Amendment Regulations"**), amending the Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000 (**"FEMA 20"**) which came into force on March 3, 2017.

Foreign direct investment (**"FDI"**) in limited liability partnership (**"LLP"**) was liberalized through Press Note No. 12 (2015 Series) issued by the Department of Industrial Policy and Promotion dated November 24, 2015. 100% FDI was permitted under the automatic route in LLPs operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions.

The Amendment Regulations have introduced certain amendments to FEMA 20, inter alia, substituting Schedule 9 of FEMA 20. Important takeaways from the amendment:

- **Availing External Commercial Borrowings ("ECBs"):**

Earlier, Schedule 9 of FEMA 20 contained the provision disallowing LLPs from availing ECBs. Now, this prohibition is deleted and LLPs are permitted to avail ECBs.

- **Conversion of company into LLP under automatic route:**

If a company having foreign investment is engaged in a sector in which 100% FDI under the automatic route is

allowed and no FDI linked performance conditions exist, such company can now be converted into an LLP under the automatic route. Requirement of government approval now longer exists for conversion of such companies into LLP.

- **Requirements with respect to Designated Partner:**

Prior to the amendment, in case of LLP with FDI having a body corporate as a designated partner, only company registered in India under the Companies Act could act as the designated partner. Further, the designated partner had to satisfy the definition of *"person resident in India"* as prescribed under the Foreign Exchange Management Act, 1999.

The above stipulations are now done away with and only the applicable provisions of the LLP Act, 2008 need to be complied with in this regard.

VA View

This recent amendment is a step in the right direction and has broadened the scope of fund raising for LLPs as now LLPs are permitted to raise resources by way of ECBs.

Earlier, the designated partners were responsible for compliance with the FDI conditions. However, this requirement is omitted under the Amendment Regulations which raises concern and a clarification from the Reserve Bank of India would be in order.

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