cyril amarchand mangaldas

ahead of the curve

EYE ON INDIA

A Cyril Amarchand Mangaldas Thought Leadership Publication

5th EDITION

(Volume I)

I

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FOREWORD

While economies across the world were recovering from the deleterious impact of the COVID-19 Pandemic, the year 2022 brought its own set of crisis. Russia's invasion of Ukraine and the resultant economic contraction has had a significant negative impact across countries. From triggering food and fuel shortage, to creating an environment of uncertainty, the conflict has kept the world on edge ever since it started last year. This was accompanied by a 'cost-of-living crisis', following persistent and broadening inflationary pressures. While the inflation rates peaked towards the end of 2022, international financial organisations have predicted that they will remain elevated for a longer than expected period.

The year also saw a global banking crisis, leading to severe financial upheaval that affected the banking industry worldwide. The crisis was exacerbated by mounting debt levels and the inability of borrowers to repay loans due to the pandemic's adverse effects on business. The interconnectedness of the global financial sector led to the crisis having a domino effect on the financial health of all countries. The cumulative impact has led to spiralling of most countries into a global recession, which may potentially cause long-term harm to emerging-markets and developing countries.

Despite these global uncertainties, the Indian economy has continued to show resilience, and overtook the United Kingdom to become the fifth largest in the world. The overall growth remained robust throughout the year, with real GDP growing 7.7% year-on-year in the first three quarters of financial year 2022-23. This was underpinned by strong investment activity, bolstered by the government's capital expenditure push and a buoyant private consumption.

While the deal activity started off strong in the initial few months, almost in line with the trends of 2021, it tapered as the months progressed. Mergers and Acquisitions (**M&A**) held a major share of the deal value, reaching a record high of USD 107 billion, almost twice that of 2021.

The year saw some of the largest deals in the cement, aviation and the banking sectors. The start-up space continued to be active, and greatly

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contributed to the M&A activity. However, compared to 2021, there was a decline in the start-up deal activity. The Indian infrastructure and materials space, as well as the technology and financial services sectors, contributed significantly to the deal activity. Partly due to the launch of the National Single-Window System, a one-stop solution for approvals and clearances needed by investors, entrepreneurs, and businesses, the year witnessed the highest-ever FDI inflows of USD 84.8 billion.

With growth-rates across sectors now exceeding the pre-pandemic levels, I am excited to bring to you the next edition of 'Eye on India', and I am amazed, but not surprised, at the extent of India's growth and development. There is no denying that these are interesting times to be in India and we hope that our selection of essays will provide you with an equally interesting insight on these, and other issues of your interest. I look forward to your comments and suggestions as we continue to capture India's growth and journey through our thought leadership publications.

Cyril S. Shroff
Managing Partner
cyril.shroff@cyrilshroff.com
May 31, 2023

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01

INDIA'S
AMRIT KAAL

THE LAST OASIS OF HOPE IN THE GLOBAL MELTDOWN

India is emerging as a growth engine amid weak global economic outlook. As major economies around the world grapple with growing inflation, deal with the ripple effects of the Russia-Ukraine conflict and the lingering impact of the Covid-19 pandemic, India is expected to continue as one of the fastest growing major economies and emerge as a "bright spot" amidst uncertain global outlook. This phase of India's growth story is popularly dubbed as the *'Amrit Kaal'* (*a term from Vedic astrology that broadly translates to the beginning of a golden era*). There are several factors contributing to India's golden era and we outline some of the key drivers.

INDIA'S ECONOMIC AND GEO-POLITICAL LANDSCAPE

In recent years, India has made significant strides in several key areas leading to its economic growth, such as industrial development and technology innovation, making it an attractive destination for investors and businesses. India is the fifth-largest economy in the world[1] and is projected to continue to grow in the range of 5.8% to 6.3% in the financial year 2023-24[2]. It is also projected that the Indian economy will reach USD 26 trillion by 2047, with a six-fold increase in per capita income to USD 15,000[3]. Whilst there was a sharp decline in India's GDP in 2020 due to the Covid-19 pandemic, the Indian economy 'bounced back' in the year 2021.

1. Accessible here: https://www.weforum.org/agenda/2022/09/india-uk-fifth-largest-economy-world
2. Accessible here: https://www2.deloitte.com/us/en/insights/economy/asia-pacific/india-economic-outlook.html
3. Accessible here: https://www.ey.com/en_in/news/2023/01/ey-projects-india-to-become-a-us-dollor-26-trillion-economy-by-2047-with-a-six-fold-increase-in-per-capita-income-to-us-dollor-15000

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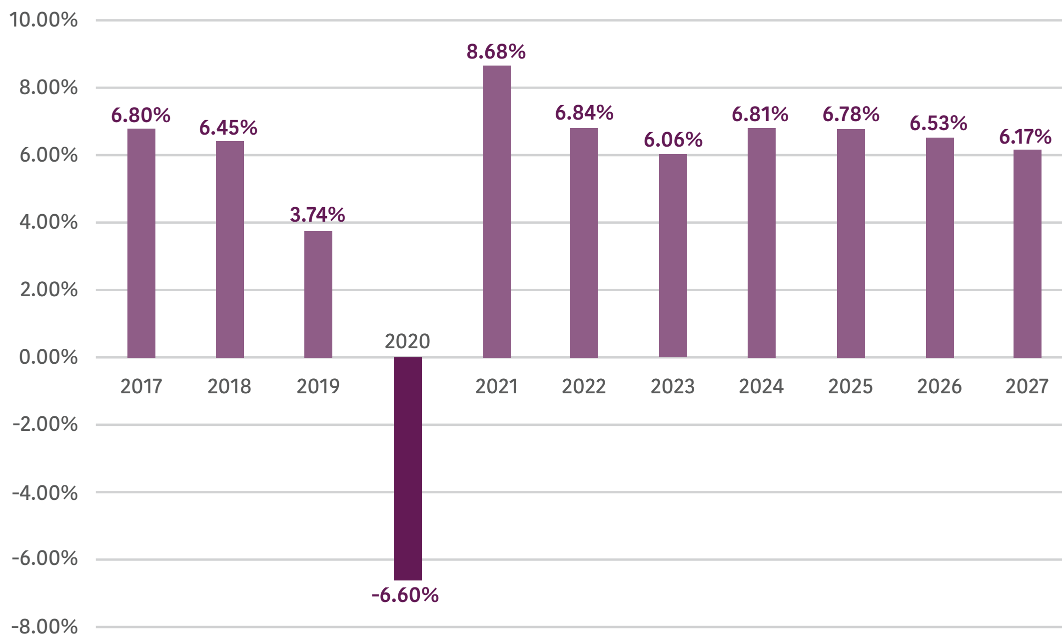
India's real GDP growth rate from 2017 to projections until 2027 is provided below[4]:



One of the primary reasons behind India's emergence as an economic powerhouse is its young and dynamic population. With a median age of just 28 years, India has a large and growing workforce that is increasingly skilled, educated, and digitally-savvy. This demographic advantage has helped fuel India's economic growth, creating a massive consumer market and a significant pool of human capital for global businesses to tap into.

On the political front, the strong leadership of Prime Minister Narendra Modi since 2014 has provided stability to the government's decision-making process and aided in the country's growth. The next general elections in India are slated to be held around May 2024. It is anticipated that the Bhartiya Janta Party under the leadership of Prime Minister Modi may continue to remain in power, which is likely to provide further impetus to the existing and proposed policies and initiatives of the government.

India's macroeconomic policies and reforms have also played a crucial role in its emergence as an economic powerhouse. Over the last two decades, India has undertaken several bold policy initiatives and economic reforms that have liberalised its economy, reduced time-consuming bureaucratic procedures, and improved ease of doing business in India. The government's pro-business policies, such as the 'Make in India' campaign and the Digital India programme, have helped create a favourable business environment for foreign investors and businesses, driving economic growth. India's industrial development has been another key driver of its emergence towards economic prosperity. India's ease of doing business has significantly improved, jumping from 63rd rank (out of 190 nations) in 2020[5] as per the World Bank Group's Doing Business 2020 to 37th rank (out of 63 nations) in 2022[6] as per the annual world competitiveness index of Institute of Management Development. All these drivers have led the country to be the sixth-largest manufacturing destination across the world, with a significant focus on high-tech industries such as IT, pharmaceuticals chemical, petrochemicals, automobiles, green energy, and biotechnology. A survey published by the European Union Chamber of Commerce in China during the Covid-19 pandemic estimates that around 23% of EU companies in China are planning to move out operations from China[7], creating further avenues for

4. Accessible here: https://www.statista.com/statistics/263617/gross-domestic-product-gdp-growth-rate-in-india/
5. Accessible here: https://www.worldbank.org/en/news/press-release/2019/10/24/doing-business-india-top-10-improver-business-climate-ranking
6. Accessible here: https://www.newindianexpress.com/opinions/2022/sep/07/transformation-in-ease-of-doing-business-environment-2495508.html
7. Accessible here: https://foreignpolicy.com/2023/01/04/china-corporations-geopolitics/

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The Indian economy is projected to reach USD 26 trillion by 2047, with a six-fold increase in per capita income to USD 15,000.

India to capitalise and emerge as a preferred global manufacturing hub. Some of the recent notable investments in manufacturing include, the world's largest semiconductor chip manufacturer, Foxconn, entering into joint venture with India's Vedanta Group to make semiconductors[8] in Gujarat; and technology major, Apple Inc., looking to shift a quarter of its global production to India, as part of its efforts to cut its manufacturing dependency on China.

In terms of healthcare, despite having a large domestic population, India initiated and focused on interventions to mitigate the impact of the Covid-19 pandemic, leading to protection of lives and livelihoods of not just its citizens, but also those across the world. India under its '*Maitri*' initiative supplied over 235 million Covid-19 vaccines across 98 countries. In January 2021, India launched the vaccine Maitri (Vaccine Friendship), which was a major diplomatic initiative to supply made-in-India vaccines to low-income and developing countries globally. Such initiatives and efforts have made India a fast-emerging and competitive destination in the pharmaceutical and healthcare space.

India is also taking big leaps in renewable energy, energy efficiency, sustainable transportation, and green technologies and has allocated INR 350 billion for priority capital investment to push energy transition and net-zero objectives. There has also been a 37% increase in budget allocation on capital expenditure, which is expected to ramp-up the virtuous cycle of business opportunities, development, investment and employment. In her 2023-24 budget announcement, finance minister Nirmala Sitharaman stated that "*our vision for the 'Amrit Kaal' includes a technology-driven and knowledge-based economy, with strong public finances and a robust financial sector. To achieve this 'jan-bhaagidari' (public participation) through 'sabka saath, sabka prayas' (efforts by all) is essential*"[9].

India's presidency of the G20 from December 1, 2022, to November 30, 2023 also gives India prominence on a global stage and gives the leadership an opportunity to promote this universal sense of one-ness.

REGULATORY AND POLICY REGIME

There has been significant progress in the regulatory regime in India across sectors. Key regulators such as the Reserve Bank of India (**RBI**), Ministry of Corporate Affairs (**MCA**) and the Securities and Exchange Board of India (**SEBI**) have been revamping the regulatory ecosystem, keeping up with the global trends in order to bring in new reforms and to provide a conducive regulatory environment for doing business in India. The government has taken several measures to improve the ease of doing business in the country, with the aim of attracting additional domestic and foreign investments and boosting economic growth, including:

a. Simplification of Indian regulatory framework for businesses by reducing the number of regulations, licenses, and permits required to start and operate a business, in addition to simplification of labour laws.

8. Accessible here: https://www.livemint.com/industry/manufacturing/vedanta-and-foxconn-to-form-jv-to-manufacture-semiconductors-11644848510887.html
9. Accessible here: https://indianexpress.com/article/explained/budget-sitharaman-what-is-amrit-kaal-8417380/

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b. The country is revamping its data privacy regime with the introduction of a new legislation that proposes to provide a data protection framework at par with global standards.

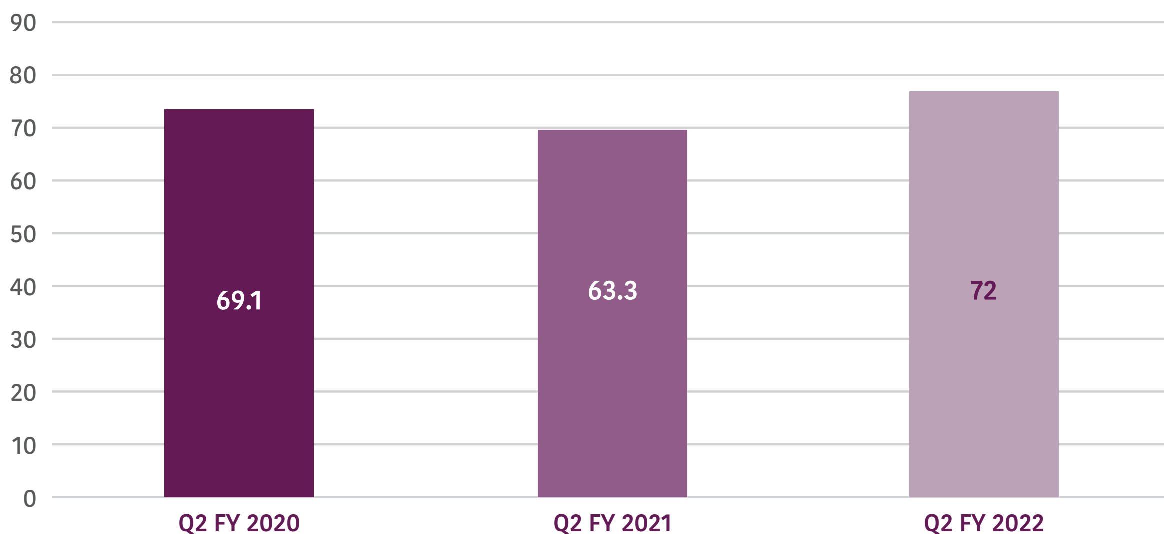
c. Digitisation of services through the launch of several online portals and digital platforms, such as the eBiz and the MCA21, to make it simpler for businesses to interact with the government and complete various compliance formalities.

d. Single-window clearance system in some States for businesses, which allows them to obtain all the necessary permits and licences for starting business under a single window.

e. Heavy investment in infrastructure development, including construction of new highways, airports, and ports, to improve logistics and connectivity and reduce the cost of doing business.

With active implementation of key initiatives such as the 'Atmanirbhar Abhyan', reckoning economy, infrastructure, system, vibrant demography, and demand as its five pillars, there is increased focus in making India self-reliant in every aspect. The National Education Policy also lays out the roadmap for India to become the next global knowledge hub. The recent introduction of the overseas investment regulations aims to relax and simplify the regulatory framework on overseas investments by Indian companies to allow more flexibility to Indian companies venturing overseas and expanding their global footprint.

The government has established special economic zones (**SEZs**) and industrial corridors to encourage the development of manufacturing clusters. The proposed Development of Enterprises and Services Hub (**DESH**) Bill, 2022 is likely to supersede the SEZ Act, 2005, aiming to promote SEZs and develop more inclusive economic hubs. The Indian government has been promoting the growth of the manufacturing sector as part of its economic development agenda. This push for manufacturing is primarily aimed at boosting employment generation, increasing exports, and promoting innovation and technology adoption in the country. Moreover, the government has introduced several other initiatives, such as the Production-Linked Incentive (**PLI**) scheme, to boost the domestic production of various products and promote exports. The PLI scheme offers financial incentives to manufacturers who produce goods locally, with the aim of increasing domestic production and reducing imports. Set out below is a graph evidencing the growth in the manufacturing sector in India since 2020, indicating significant development in the sector since the onset of Covid-19 pandemic.



Source: IBEF[10]

10. Accessible here: https://www.ibef.org/industry/manufacturing-sector-india

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There are various amendments proposed to the Banking Regulation Act, 1949, the Companies Act, 2013 and the Reserve of India Act, 1934 to improve bank governance, corporate compliance, and enhance investors' protection. The Income Tax Act, 1961 and the Companies Act, 2013 propose to decriminalise minor offences in order to promote ease of doing business. The Insolvency and Bankruptcy Code, 2016 now provides time bound effective mechanism for efficient resolution of bankruptcy cases. The Companies Act, 2013 was also amended to omit the requirement for minimum paid up share capital, prohibit public inspection of board resolutions filed in the Registrar of Companies, empower audit committee to give omnibus approvals for related party transactions on annual basis and such other consequential changes. A recent update by SEBI includes a new master circular for governing substantial acquisition of shares that provides ample clarity on the pricing formula for acquiring shares in an open offer. The GIFT City is one of the key initiatives by the government, which is being developed as a significant financial hub. In order to build a strong global connect and cater to the needs of the Indian economy and portray India on the world's map as a centre of financial excellence, the International Financial Services Centres Authority (**IFSCA**) was established as a regulator in GIFT City, Gandhinagar, Gujarat in 2019. With improved tax benefits, delegation of powers to the IFSCA and permitting acquisition financing by IFSC Banking Units, the GIFT City has emerged as a globally recognised financial services centre. In addition, with a view to ensure availability of talent with necessary knowledge and skills at the GIFT City, the IFSCA has also introduced regulations permitting the entry of foreign universities to set up branch campuses to provide courses related to finance and mathematics.

Over the past few years, the government of India has implemented several policy initiatives aimed at incentivising corporates and promoting a pro-business environment. These policy initiatives have provided an impetus to corporates in India. One of the most significant policy initiatives introduced by the Indian government is the 'Make in India' program aiming to encourage domestic and foreign companies to manufacture their products in India. It is a part of the government's larger plan to transform India into a global manufacturing hub. Under this program, the government has introduced several policy measures, including setting up SEZs, reducing bureaucratic red tape and providing financial incentives to companies such as: (a) lowering tax rates and tax holidays; (b) providing capital subsidies that can be used to purchase land, buildings, machinery, and (c) providing interest subsidies that can be used to lower companies' cost of borrowing, making it easier for them to do business in India. The government has also launched an online portal, called eBiz, which allows companies to apply for licences and permits online, thereby reducing the time and cost associated with regulatory compliance. Other key initiatives to promote corporates include the 'Digital India Program', 'National Optical Fiber Network', and 'the BharatNet project', aimed to transform India into a digitally empowered society and provide high-speed internet connectivity to remote areas of the country and promoting digital inclusion.

In addition to these initiatives, the Indian government has also introduced policies to promote innovation and entrepreneurship by way of 'The Start-up India' program that aims to create a conducive environment for start-ups to grow and thrive in India. India has become a hub of start-up activity, with a growing number of entrepreneurs launching businesses in a wide range of sectors. From technology to healthcare and beyond, the start-up ecosystem in India is booming, with a variety of emerging sectors offering huge potential for growth and investment. Overall, the total investments received by start-ups in India in 2022 was approximately USD 12.9 billion[11], a significant increase from the previous year. The graph below sets out the key sectors in which start-ups that have received the maximum investment in 2022.

Sector wise investment in start-ups in 2022

11. Statistics as per Venture Intelligence's Report titled 'Indian Private Equity & Venture Capital Report – 2022'

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With a thriving start-up ecosystem and a growing number of emerging sectors, India is quickly becoming a global leader in entrepreneurship and innovation. As investors continue to pour funds into these burgeoning sectors, it is clear that the future of Indian start-ups is bright and full of potential. Some key start-ups that made stock market debuts in 2022 include Delhivery and Tracxn Technologies.

FOREIGN INVESTMENT

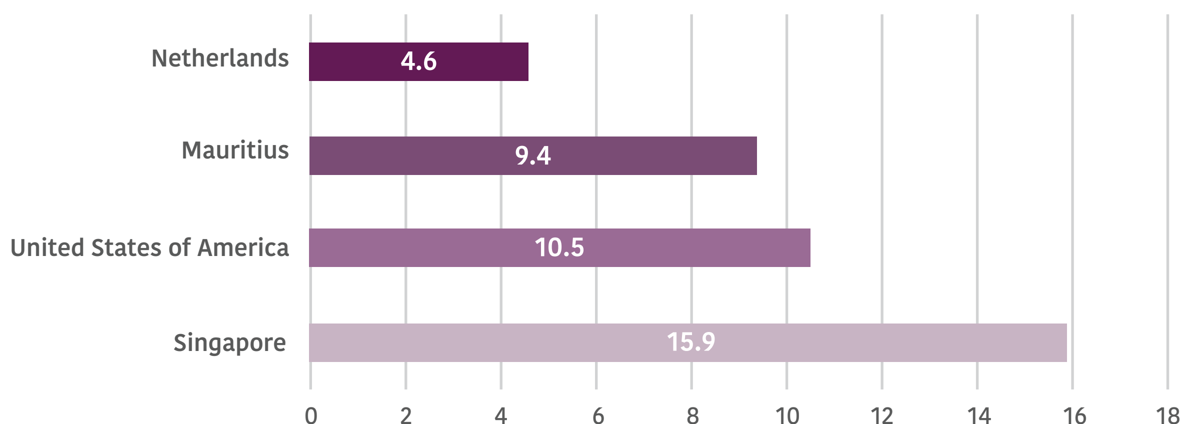
Equity based foreign investment in India is mostly routed as foreign direct investment (**FDI**), foreign portfolio investment, and foreign venture capital investments. The cumulative FDI inflows to India are set out in the table below:

Total FDI inflow (from April 2000 to December 2022)[12]:

Total FDI inflow (from April 2000 to December 2022)		In USD million
1.	Cumulative amount of FDI inflow (Equity inflow + 'Re-invested earnings' + 'Other capital')	USD 9,03,937 million
2.	Cumulative amount of FDI equity inflow (excluding, amount remitted through RBI's NRI Schemes)	USD 6,25,153 million

In terms of inflow of foreign investment in 2022, India has received approximately USD 58.8 billion FDI, in spite of headwinds in global and domestic economic environment[13]. The graph below sets out the country wise FDI inflow in India:

FDI flow in India: Country wise (in USD billion)



Source: RBI's annual report as on May 27, 2022[14]

12. Accessible here: https://dpiit.gov.in/sites/default/files/FDI Factsheet 3rd quarter 2022-23.pdf
13. Accessible here: https://m.rbi.org.in/scripts/AnnualReportPublications.aspx?Id=1365
14. Accessible here: https://m.rbi.org.in/scripts/AnnualReportPublications.aspx?Id=1365

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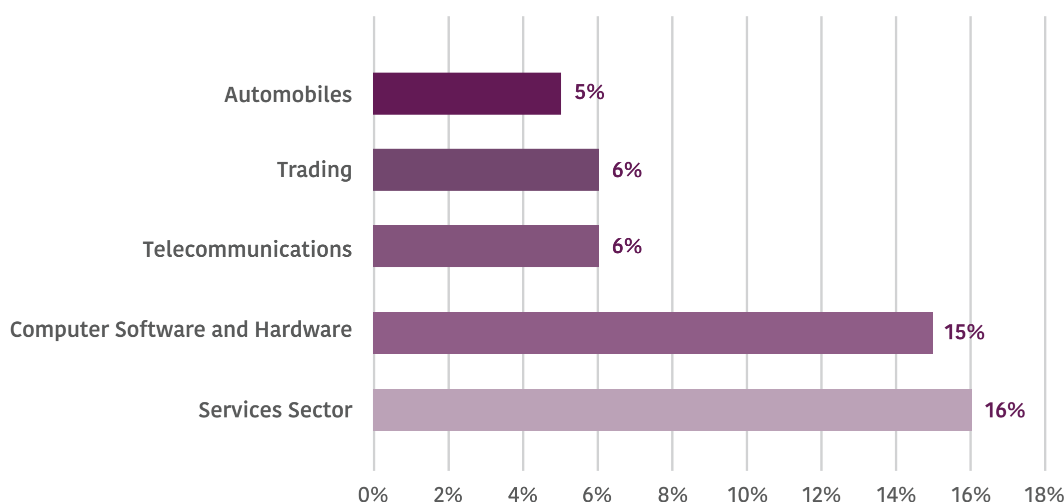
In terms of sector bifurcation, as on December 2022, the service sector (including financial, banking, insurance, non-financial/ business, outsourcing, research and development, courier, technology testing etc) received the maximum FDI equity inflow followed by computer software and hardware, telecommunications and trading.

Sectors attracting highest equity FDI inflow (% in terms of USD million)



Source: DPIIT[15]

There has been plethora of initiatives and reforms brought forward by the Indian government to boost overseas investment in India. Some key initiatives include: (i) amending the Foreign Exchange Management Act (**FEMA**), allowing up to 20% FDI in the insurance giant, Life Insurance Corporation of India, through the automatic route; (ii) promoting the telecom sector by allowing 100% FDI via the automatic route, compared to the previous 49%; and (iii) rolling out the new regime for overseas investment by India to boost foreign equity inflows, leading to development of technology know how, creating more jobs, bringing stability in the economy and such other benefits.

Outlook

A lookback on the past year evidences some major deals in the capital markets, including the largest initial public offering of equity shares in India by the country's largest government-owned insurance behemoth, the Life Insurance Corporation of India, for equity shares aggregating to approximately USD 2.7 billion. The M&A space also saw some record-breaking deals in sectors such as banking (HDFC Bank agreed to take over the biggest domestic mortgage lender), cement (Adani Group announced to acquire controlling stake in Holcim Ltd's businesses in India), and aviation (the TATA Group announced the merger of Vistara Airlines and Air India). Whilst a global slowdown is predicted for 2023, it is expected to be a pivotal year for India's stock market, leading to its enhanced presence in the global stage. Irrespective of the expected inflation, increased deficit, high interest rates, the current economic scenario is likely to boost the capital market sentiment with increased expenditure by the government on infrastructure, defence, real estate, etc., signalling resurgence of PLI-based investments, expansion of supply chain and a grand regain of the stock market post Covid-19.

While many developed countries are struggling to cope with the aftermath of the Covid-19 pandemic, India has been able to weather the storm and continue to grow. One of the key factors contributing to India's success is its robust domestic market, which is fuelled by the increasing purchasing power of a growing middle class. This has made India an attractive destination for foreign investors seeking to grow and expand their business operations in India. India's success has not gone unnoticed by the international community, with many experts now calling it the last oasis of hope in the global meltdown. While challenges remain, India has shown that with the right policies and investments, emerging economies can thrive even in the most challenging of times when other global economies are grappling with rising inflation, stagnant growth, and high unemployment rates.

15. Accessible here: https://dpiit.gov.in/sites/default/files/FDI Factsheet 3rd quarter 2022-23.pdf

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02

NEW OVERSEAS DIRECT INVESTEMENT REGIME

RE-KINDLING INDIA INC'S GLOBAL ASPIRATIONS

Introduction

Over the last two decades, India Inc has acquired a slew of foreign companies, across a variety of sectors, as a part of its strategy to expand footprint and establish Indian MNCs across the globe. Previously, it was unthinkable for any Indian company to acquire a company that is 5 times its size (*like Tata Steel's acquisition of Corus*) – and India Inc's risk appetite for overseas acquisitions is among the most interesting chapters of India's growth story, post the economic reforms of 1991.

The cumulative overseas direct investment (**ODI**) outflows for the April 2000 - January 2023 period stood at a staggering USD 289,033 million, a lion's share of which was received by financial services, insurance, manufacturing and hospitality sectors[1]. Further, as per publicly available data, ODI is mostly concentrated in Singapore, Mauritius, USA, Netherlands and the UK[2].

The key drivers for ODI include – (a) entry into new markets; (b) access to resources and new technologies; (c) economies of scale; and (d) diversification of business

1. ODI Factsheet, Department of Economic Affairs, Government of India, available at https://dea.gov.in/sites/default/files/Updated January 2023 factsheet.pdf
2. It is pertinent to note that countries like Singapore, Mauritius and Netherlands may only be intermediate destinations, and there is lack of conclusive empirical evidence on the final destinations for ODI.

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and expansion of the product mix. Availability of superior technologies as well as creation of synergies and economies of scale have greatly benefitted Indian consumers. As a result, they now have access to better quality products at competitive prices.

The period between 2005 and 2008, often referred to as the *golden period*, saw the highest outflow of ODI totalling approximately USD 60,000 Million. While Indian companies continue to make strategic overseas acquisitions, the ticket size of the ODIs witnessed a steady decline from the highs of the golden period. Even the outbound financial commitment, which stood USD 5,478.15 million in July 2011, more than halved in size to touch USD 2,047.79 million in December 2021.

It is worth noting that for many large corporate houses, their ODI deals have not proved to be particularly profitable. Over time this has contributed to a decline in the overall ticket size of ODI deals. Other factors responsible for the decline in ODI include – (a) the rise in protectionist legislations framed by various countries, with a view to safeguard the domestic industry; (b) existing geopolitical tensions; and (c) the current global economic slowdown.

In this backdrop, following an extensive consultation process that lasted for more than a year, the Ministry of Finance (**MoF**) and Reserve Bank of India (**RBI**) notified the new overseas investment (**OI**) regime on August 22, 2022 (**New Regime**), with a view to further liberalise the regulatory framework for OI, reduce the compliance burden and promote ease of doing business for India Inc.

The New Regime inter alia comprises the OI Rules, 2023[3] notified by the MoF (**Rules**), the OI Regulations, 2022[4] (**Regulations**) notified by the RBI and the Master Directions issued by the RBI to authorised persons. The New Regime supersedes the erstwhile regime under the FEMA 120[5] and the circulars and directions issued thereunder (**Old Regime**).

The New Regime can be broadly divided into three buckets i.e. equity, debt, and OI by resident individuals. In this blogpost, the authors discuss the key changes made under the New ODI Regime, from an equity perspective.

Grandfathering of Existing Investments

Rule 6 clarifies that any OI made in compliance with the Old Regime shall be deemed to be compliant with the New Regime. However, for an OI that was not in compliance with the Old Regime, there is no deeming provision stating that such investment shall be compliant with the New Regime.

Key Changes and its Implications

FOREIGN ENTITY

"***JV***" and "***WOS***" have now been replaced with '*Foreign Entity*' which inter alia means "*an entity formed or registered or incorporated outside India..*"[6] In a welcome move, the New Regime expands the meaning of 'Foreign Entity' and 'incorporation' of a Foreign Entity is not a mandatory requirement. This is relevant for LLPs in jurisdictions like the United States, which are registered but not incorporated.

INDIAN ENTITY

"*Indian Entity*"[7] includes companies, body corporates, LLPs and interestingly, even partnership firms registered under the Indian Partnership Act, 1932.

CONTROL

"Control" means the right to appoint majority of the directors or to control management or policy decisions exercisable by a person/ persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders' agreements/ voting agreements that entitle them to ten per cent or more of voting rights or in any other manner in the entity.[8]

As the Rules have introduced a new 10% voting rights test (**10% Test**), there is a material distinction between the tests for *control* under the Rules, and the

3. Foreign Exchange Management (Overseas Investment) Rules, 2022.
4. Foreign Exchange Management (Overseas Investment) Regulations, 2022.
5. Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004.
6. Rule 2(1)(h).
7. Rule 2(1)(j).
8. Rule 2(1)(c).

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applicable tests under Section 2(27) of the Companies Act, 2013 (**Companies Act**) and the takeover regulations. The 10% Test assumes relevance whilst determining whether the overseas entity would be regarded as a '*subsidiary' or a 'step-down subsidiary*' (**SDS**).

Under the Rules, a subsidiary is defined as an entity, in which a foreign entity has control. By virtue of the 10% Test, a Foreign Entity may be regarded as a subsidiary/ SDS even when it does not meet the 'subsidiary test' under Section 2(87) of the Companies Act.

ODI VS OPI

In a welcome change, there is now a clear segregation between an overseas direct investment (**ODI**) and an Overseas Portfolio Investment (**OPI**). An ODI inter alia includes[9]:

- Acquisition of unlisted equity capital of a foreign entity; or
- Subscription as a part of MoA of a foreign entity; or
- Investment in 10% or more of the paid-up equity capital of a listed foreign entity; or
- Investment with control where investment is less than 10% of paid-up equity capital of the listed foreign entity.

OPI is defined as investments other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC.[10]

OI ONLY IN "BONA FIDE BUSINESS ACTIVITIES"

"*Bona fide business activity*" means any business activity permissible under <u>any law</u> in force in India and the host country.[11] Further, the three no-go areas for ODI are (i) real estate activity; (ii) gambling; and (iii) dealing with financial products linked to the Indian Rupee, without specific RBI approval.

The Rules are silent on the test to be applied for determining whether a business activity is '*permissible*' in India. In India, certain business activities like multi brand retail, online gaming or sale of liquor may be legal only in certain States, and clarity is awaited on whether ODI can be made in such sectors.

9. Rule 2(1)(q).
10. Rule 2(1)(s).
11. Explanation to Rule 9(1).

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Cumulative ODI outflows for the April 2000-January 2023 period stood at a staggering USD 289,033 million.

CALCULATION OF TOTAL FINANCIAL COMMITMENT LIMIT (TFC LIMIT)

Whilst the TFC Limit has been retained at 400% of *net worth*,[12] the definition of 'net worth' has been aligned with Section 2(57) of the Companies Act and now includes security premium account, thereby potentially increasing the headroom available to the Indian Entity. However, the Indian Entity can no longer utilise the net worth of its subsidiary/ holding company, which could impact large conglomerates where subsidiaries are used to structure ODI.

The Rules provide that the TFC Limit should be determined *at the time of undertaking the financial commitment*.[13] Whilst the same wording was not present in the Old Regime, a conjoint reading of the Rules and the FEMA Master Directions on Reporting[14] suggests that the earlier ODIs would have to be computed at the old rate mentioned in the Form FC and the new ODIs would be worked out using the current exchange rate.

It is also pertinent to note that the TFC Limit only includes ODIs, and a separate limit of 50% of net worth has been provided for OPIs. Further, as a non-controlling investment of less than 10% in a listed foreign entity is treated as an OPI, it may not fall within the TFC Limit of 400% of net worth.

INOC REQUIREMENT

An NOC requirement[15] for making financial commitment has been introduced for any person resident in India who:

- Has an NPA account; or
- Is classified as a wilful defaulter; or
- Is under investigation by a financial service regulator or by investigative agencies in India, viz, CBI/ED/SFIO.

There is also a deemed approval provision if the agency fails to furnish the certificate within 60 days, which is a significant departure from the erstwhile regime of obtaining prior RBI approval in such situations.

PRICING GUIDELINES

Whilst India's foreign direct investment (**FDI**) regime has historically provided for elaborate pricing guidelines, the New Regime, has for the first time introduced pricing guidelines for ODI. The pricing for ODI should be on an arm's length basis, based on valuation undertaken as per any internationally accepted pricing methodology[16]. The AD banks are responsible for ensuring compliance with arm's length pricing requirements. It will be interesting to see the guidelines that may be framed by AD Banks in relation to arm's length pricing; and whether AD banks will insist on a valuation certificate from an investment banker or a chartered accountant before certifying compliance.

In this regard, it is relevant to note that an Indian Entity can lend or invest in any debt instruments issued by a Foreign Entity only if the rate of interest is charged on an arm's length basis.[17]

ODI IN FINANCIAL SERVICES ACTIVITY

In a significant change that will liberalise ODI in the financial services space, an Indian entity not engaged in financial services activity can now make ODI in a foreign entity engaged in financial services activity, except banking and insurance, provided certain eligibility conditions are met.[18] One of the conditions is that the Indian entity has reported net profit during the preceding three financial years; and the Covid-19 period i.e., FY 2020-21 and FY 2021-22 can be excluded while determining profitability.

Further, 'financial services activity' has been defined as an activity, which if carried out by an entity in India, requires registration with or is regulated by a financial services regulator in India.[19]

12. Rule 2(1)(p).
13. Para 3 of Schedule I.
14. Part VIII, FEMA Master Direction on Reporting, FED Master Direction No.18/2015-16, updated as on August 22, 2022.
15. Rule 10.
16. Rule 16.
17. "*Arm's length*" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.
18. *Schedule* 1, Para 2.
19. *Explanation to Schedule* 1, Para 3(2).

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ROUND TRIPPING (ODI-FDI STRUCTURES)

While the Old Regime did not explicitly mention round tripping in the text of the law, **FAQ No.64** of RBI's ODI FAQs effectively enacted substantive law by mandating prior RBI approval for round-tripping transactions (ODI-FDI structures).

Under the New Regime, ODI-FDI structures shall be permitted, subject to compliance with the layering restrictions set out under Rule 19(3), which provides that "no person resident in India shall make financial commitment in a foreign entity that has invested or invests into India, at the time of making such financial commitment or at any time thereafter, either directly or indirectly, resulting in a structure with more than two layers of subsidiaries." A plain reading of the Rules suggests that for computing the number of layers of 'subsidiaries', a foreign entity will be regarded as a 'subsidiary' even if the 10% test is independently met.

The key aspect to note here is that the New Regime removes the long-standing taboo surrounding round-tripping and ODI-FDI structures, and clearly recognises that in most cases, ODI-FDI structures are legitimate, and not necessarily devised in a manner that results in tax avoidance/evasion or siphoning of funds. While the Rules recognise that many ODI-FDI Structures are pursuant to legitimate commercial considerations, and may not always be abusive, greater clarity is awaited on how to compute the number of layers. Further, the RBI needs to clarify that when the ODI turns back into India as FDI under Rule 19(3), will it be seen as pure FDI from the compliance/ FOCC/ disinvestment perspective or will it be seen as an IOCC under the consolidated FDI Policy and the NDI Rules, 2019.

It is interesting to note that the Draft Rules had provided that ODI-FDI structures would be permitted subject to the ascertainment that the transaction was not designed for the purpose of tax avoidance/ tax evasion. While the regulatory intent is to prevent round-tripping and tax avoidance/ tax evasion, this subjective requirement has been omitted from the Rules – and the Rules prescribe an objective threshold based on the number of layers of subsidiaries.

For ODI-FDI Structures where it is not commercially feasible to comply with the layering restrictions (such as ODI-FDI structures in the infrastructure space), parties can approach the RBI for prior approval based on sound commercial justifications. All in all, legitimising ODI-FDI Structures will provide more flexibility to Indian as well as overseas investors in structuring their legitimate investments.

It is also expected that the RBI may soon come out with a slew of FAQs to clarify their position on all the contentious issues, from the standpoint of ensuring that the industry, AD banks and other stakeholders adopt a consistent view on key issues.

Nevertheless, there are many bright spots in the New Regime – that will surely act as an enabler for Indian companies to become global, and venture into new markets. Global economic meltdown due to inflation and war, may present good opportunities for Indian parties to acquire strategic assets at an attractive valuation, and expand their footprint.

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03

THE ROLE OF THE **JUDICIARY** IN INDIA'S ECONOMY

JUDICIARY VS EXECUTIVE

Introduction

The importance of a vibrant, inclusive, stable and growing economy cannot be stressed enough for any developing country. Every developing nation will strive to take all necessary steps to facilitate economic growth, and to stand tall amongst its peers.

It is well known that economic growth is nurtured and promoted by fostering a conducive business atmosphere, not only for local industries but also for attracting foreign investments to diversify the extant systems and practices. Foreign investment, however, is forward looking. It does not merely depend on prevailing policies but also on what investors predict will be the state of affairs in the coming future.

One major distinguishing feature that sets India apart from most other South-East Asian countries as a popular destination for foreign investments and economic growth is its strong commitment to Democracy, the Rule of Law as conceptualised under the Constitution, as well as the preservation of its sanctity by India's institutions.

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The Rule of Law, in its intrinsic sense, necessitates the formulation of equitable laws that apply equally to all, and their enforcement by Courts as per existing legal mechanisms. In the broader sense, the preservation of the Rule of Law is of paramount importance for economic growth, especially in the context of foreign investment. Foreign investment is largely dependent on several factors such as political stability, commitment to democratic principles and most importantly, the equitable mechanisms for legal redress and predictability of outcomes. It is in this domain that the Judiciary rises to the challenge as the key defender of the Rule of Law, thereby, playing a key role in the country's economic growth and development.

Globally, one of the most important facets of any Judicial system is the predictability of the outcome of a given *lis* based on adherence to the strict and settled legal principles and judicial discipline. On this count, we are fortunate that the Indian Courts, in most cases, render judgments in strict consonance with the aforesaid principles.

The political milieu of a given nation is often unpredictable, as it is contingent on the inclinations of the establishment in power. However, the Courts enforce strict adherence to democratic principles on a daily basis, within the realm of public law.

However, when it comes to certainty of laws, the Executive and Legislature often display a rather erratic approach and have on several occasions taken decisions which are contrary to the previously existent positions, thereby shaking the faith of businesses. Naturally such businesses repose even more faith in the Judiciary to remedy any wrongs.

It is mostly in situations where the Executive is either caught lacking, or is guilty of transgressing its authority, the presence of an independent Judiciary becomes imperative to keep the Government in check and uphold the Rule of Law in accordance with the principle of supremacy of the Constitution.

Unfortunately, it is this atmosphere that often sparks the age-old Executive vs. Judiciary debate, which really marks the antithesis for a constitutional democracy, when two of its primary organs contest each other, and in turn end up overstepping their boundaries.

Globally, one of the most important facets of any Judicial system is the predictability of the outcome of a given lis based on adherence to the strict and settled legal principles and judicial discipline.

Role of the Judiciary in the Economic

Courts in India have an exemplary track record when it comes to maintenance of the Rule of Law and the preservation of fundamental rights of the citizenry at large. The Courts have also shown a great deal of respect for the principle of comity of Courts, and have positively contributed to the development of jurisprudence on various subjects through landmark judgments. Many such judgments have been relied on in several other jurisdictions, primarily in the realm of constitutional law.

The right to freedom of speech, a fundamental right, is part of the basic structure of the Indian Constitution, and its importance is well established as a *sine qua non* of any healthy and functional democracy. In India, this right has been enshrined under Article 19(1)(a) and the Preamble of the Constitution of India. The Supreme Court of India has notably asserted that freedom of speech implicitly contains the right to freedom of press, whose stature has been further elevated, often being regarded as the Fourth Pillar of our Democracy. Right to press encompasses within itself the right and corresponding duty to report matters of national interest[1]. As expounded by Courts time and again, freedom of press is of paramount importance to instil within the citizenry a feeling of participation in the working of a democracy. However, this multi-faceted right has time and again been subject to several impediments, as is evidenced by the recent trend of instituting civil and criminal proceedings, even in relation to the bona fide exercise of such right. This has not passed muster with Courts, who have for instance even adopted the doctrine of 'chilling effect'

1. Indian Express v. Union of India, (1985) 1 SCC 641
2. Wieman v. Updegraff, 344 U.S. 183 (1952)

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from the United States of America[2]. Applying this doctrine, Courts have opined that such obstructions to the rightful exercise of freedom of speech by not only the press, but also the citizenry at large, has a chilling effect on others who intend to publish information relevant to the public[3]. The Supreme Court has further exemplified this right in its landmark decision, striking down a draconian penal provision contained under the Information Technology Act 2000[4], which made it a punishable offence for any person to send "offensive information" using a computer/ electronic device[5]. The Court found the vaguely worded Section to be arbitrary, excessive, and disproportionate as it would adversely affect even a protected/ innocent speech, rendering it ultra vires the Constitution. Notably, this decision of the Supreme Court has been relied on even by the Court of Appeal of Singapore[6].

Further, the Supreme Court has also vociferously supported and developed environmental jurisprudence, from the initial conceptualising of Green Benches and to having taken several significant steps towards the protection of the environment, with the application and development of principles such as polluter pays, precautionary principle, public trust doctrine, etc., many of which are now even statutorily recognised.

On one end of the spectrum, we have seen the Supreme Court bear vigil as a principal defender of the environment, with the Court refusing to interfere with the closure of factories as was seen in the case of Vedanta's Sterlite copper smelting unit in Tamil Nadu[7]. On the other end, the Court has adopted a lenient approach in certain exceptional cases, for instance, where it permitted the grant of ex post facto environment clearance, (*Pahwa Plastics case*)[8].

The Courts, unfortunately, face a difficult situation in such environment-sensitive cases. Their decisions calling for the closure of recalcitrant industries is termed as a bane for the economy, while relaxing the prevailing environment norms is considered retrograde in terms of preservation of the environment. The Courts have a commendable track record in dealing with cases affecting the environment, constantly

3. Mohammed Zubair vs. State of NCT of Delhi and Ors. AIR 2022 SC 3649
4. Shreya Singhal v. Union of India, AIR 2015 SC 1523
5. Section 66A, Information Technology Act, 2000
6. The Online Citizen Pte Ltd. vs. Attorney-General and Ors., [2021] SGCA 96
7. The Tamil Nadu Pollution Control Board vs. Sterlite Industries (I) Ltd (Sterlite Copper Plant Case), AIR 2019 SC 1074.
8. Pahwa Plastics Pvt. Ltd. & Anr. v. Dastak NGO & Ors., 2022 SCC OnLine SC 362.

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striving to balance sustainable development and conservation --- a task that originally lies with the Policy makers.

A few illustrations to buttress the role of Courts in the everyday lives of the citizens can be witnessed, for instance, in the celebrated *Aadhaar Case*, where the Supreme Court recognised the right to privacy as a fundamental right under the ambit of Article 21 of the Constitution, available against both, State and Non-State actors[9]. This right is facing numerous challenges, with the latest being the controversy over WhatsApp's newly updated privacy guidelines, which permits the free cross-platform messaging service to share user data with Facebook and its Group Companies[10], raising concerns about privacy infringement. Furthermore, there are ongoing concerns about possible violations of the citizens' privacy at the behest of the State under the guise of security, as witnessed in the *Pegasus Spyware Case*[11].

As far as the world of alternate dispute resolution is concerned, Courts have adopted a notable stance to promote such mechanisms, not only by delivering pro-arbitration judgments but also on the infrastructural front with the inauguration of several domestic and international arbitration and mediation centres in several cities, such as Hyderabad, Delhi, Mumbai, etc.

On the judicial front, we have seen some notable judgments being rendered by the Supreme Court as well as the High Courts, promoting alternative dispute mechanisms, permitting two Indian parties to choose a foreign seat for their arbitration[12], and also confirming the enforceability of an interim order of an India-seated emergency arbitrator award[13].

The development of the Insolvency & Bankruptcy Code 2016, had been a significant milestone, where Courts have delivered several landmark judgments preserving the sanctity of the Corporate Insolvency Resolution Process and furthering the objective of maximization of the value of assets of affected entities.

Pertinently, a large part of the jurisprudence in the realm of arbitration and insolvency law can be credited to the Retired Justice R.F. Nariman, whose judgments are populated with copious references to regulations, provisions, statutory forms, reports, and case law from foreign jurisprudence spanning several jurisdictions.

Courts have also delved into untraversed areas of law and policy, including the domain of cryptocurrency. For instance, the Supreme Court recently overturned an RBI circular that prohibited entities regulated by it from dealing in virtual currencies on the ground of proportionality[14]. In doing so, the Court has struck a balance by not imposing an outright blanket ban on the functioning of such entities, but has at the same time batted for the implementation of regulation of such currencies to protect public and private interests.

On the criminal law front, the higher Judiciary is normally considered the key guardian of civil liberties, simultaneously developing sound bail jurisprudence and ensuring that guilty parties are brought to task. It would be out of place to not mention however, that this track-record appears to have taken a hit with the recent decision of the Supreme Court in the case pertaining to a challenge to certain provisions of the Prevention of Money Laundering Act, 2002 (**PMLA**), namely those pertaining to the powers of arrest, emergency attachment, and most importantly the twin conditions imposed for granting bail under the PMLA. This decision had the effect of reversing the principle of 'innocent until proven guilty' by requiring the Judge(es) to be satisfied that there exist reasonable grounds for believing that an accused is not guilty before granting bail.

In a historic, yet severely criticised ruling[15], the Court held that the Enforcement Directorate did not possess police powers and, as a result, did not have to follow police procedure when conducting an inquiry. Consequently, the Court found that the ECIR, being an

Courts have recently delved into untraversed areas of law and policy, including the domain of cryptocurrency.

9. Justice K.S. Puttaswamy (Retd.) & Anr. v. Union of India and Others (2017) 10 SCC 1
10. Karmanya Singh Sareen v Union of India, SLP (C) 804/2017 (Supreme Court)
11. M.L. Sharma v. UOI., WP (Crl) 314 of 2021(Supreme Court).
12. Pasl Wind Solutions (P) Ltd. v. GE Power Conversion (India) (P) Ltd., (2021) 7 SCC 1
13. Amazon.Com NV Investment Holdings LLC v. Future Retail Ltd., (2022) 1 SCC 209
14. Internet and Mobile Association of India v. Reserve Bank of India (2020) 10 SCC 274.
15. Vijay Madanlal Choudhary v Union of India, SLP (Crl) No. 4634/2014 (Supreme Court)

internal document was not required to be disclosed to the accused. This finding, coupled with the Court upholding the onerous bail conditions imposed under the Act, make it virtually impossible for an accused to obtain bail. The accused will now be constrained to conduct a 'mini-trial' at the stage of bail itself, to convince a judge of not being guilty of the offence. This is further made difficult due to the non-supplying of the ECIR, as a consequence of which the accused may not even have a full picture of the allegations levelled against them.

Having stated thus, there still lies a ray of hope, with the Supreme Court agreeing to hear a review petition against the aforesaid decision, which is presently pending.

Keeping with the above illustrations, cases may also be considered where Courts have been rather circumspect in exercising their jurisdiction, especially where questions of economic and public policy arise. In this regard, it is pertinent to highlight the diktat of the Hon'ble Supreme Court in *Shivashakti Sugars Ltd. v. Shree Renuka Sugar Ltd.*[16], where the Court held that in a given case before it, Courts ought to favour a view that subserves the economic interest of the nation and must avoid outcomes that have a potential to create an adverse effect on employment, growth of infrastructure or economy or the revenue of the State.

This principle of judicial non-interference in Economic/ Financial Policy was most recently employed in the case before the Apex Court challenging the demonetisation of certain denominations of currency notes[17]. Although this decision by the Executive was largely viewed as a possibly bad policy decision, adversely affecting the economy, the Court refused to interfere with the same, opining that Constitutional Courts ought not to interfere with the financial and economic policy decisions of the Government, unless such decisions are in contravention of the settled legal and constitutional principles in addition to public interest.

It would be remiss to not point out that there are also several instances where the Courts have been accused of overstepping their jurisdiction, transcending constitutional limits, by pronouncing judgments in relation to aspects that end up having an adverse economic effect on the nation.

Such decisions of Courts, despite possessing the laudable intention of safeguarding public interests, have often disregarded the larger economic impact on various industries. A glimpse of this was observed when the Supreme Court cancelled the licenses of several telecommunication companies, opining that spectrum being a natural resource, ought to have been auctioned and could not have been allocated on a first-come-first-serve basis[18]. Undoubtedly, the Court's intent was to keep in check any arbitrary State action, and to ensure that any such activity must be in accordance with the provisions of the Constitution. However, in doing so, the Court seemingly failed to consider the economic ramifications of such a decision in terms of losses to the relevant stakeholders, loss of employment prospects, uncertainty among investors, etc. In a further setback to the telecom sector, the Supreme Court, in *Union of India v. Assn. of Unified Telecom Service Providers of India*[19] found that the period of 20 years sought to be granted by the Union of India to the Telecom Companies for payment of the Adjusted Gross Revenue Dues (**AGR Dues**) was far too excessive, and, therefore, directed the payment thereof within a period of 10 years instead. This put an enormous strain on such companies, many of whom are already undergoing corporate insolvency resolution process under the Insolvency & Bankruptcy Code, 2016.

Additionally, in 2014, the Supreme Court of India was once again the subject of discussion in the foreign press for having cancelled hundreds of coal licenses[20] awarded right from the year 1993, for being issued illegally[21]. Having its genesis in a Public Interest Litigation (**PIL**), as most of such cases often do, the present Petition was filed challenging the procedure in which allocation of coal licenses had been made to private companies, on the ground that such procedure lacked transparency, and was contrary to various statutory provisions. It cannot be doubted even for a second, that in cases of such breaches, the recalcitrant parties must bear proportionate consequences. However, while directing such a blanket cancellation of licenses without having gone into the merits of each individual case, the Court ought to have been mindful of the impact of such a decision, as well as its international perception by including prospective foreign investors.

16. (2017) 7 SCC 729.
17. Vivek Narayan Sharma v. UOI., (2023) 3 SCC 1.
18. Centre for Public Interest Litigation and Ors. vs. Union of India (UOI) and Ors.,(2012) 3 SCC 1.
19. (2020) 9 SCC 748.
20. Manohar Lal Sharma vs. The Principal Secretary, (2014) 9 SCC 516.
21. https://www.wsj.com/articles/indias-supreme-court-cancels-most-coal-licenses-given-since-1993-1411552912 ; https://www.bbc.com/news/world-asia-india-29339842

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To counter such adverse effects, what could perhaps be considered is the development of adequate infrastructure to aid judges in ascertaining the long-term economic ramifications of their decisions. A small glimpse of this can be observed in a similar initiative undertaken by Consumer Unity & Trust Society, Jaipur, which under the aegis of the Niti Aayog, published a report highlighting the adverse economic impact of just five judgments of the Supreme Court and NGT on the economy[22].

Its all about finding Balance

It is a settled principle that the formulation and implementation of policies are solely the domain of the Executive and Judicial intervention in any form is limited, save in certain exceptional cases.
The role of Courts cannot be undermined when it comes to economic growth, primarily to secure the constitutional objective of economic development and justice as contained under the Preamble, Part III, Part IV, etc. Drawing from this, Courts have on several occasions managed to successfully strike a balance between judicial restraint and exercising their powers to achieve socio-economic reform. One such example can be witnessed in the case where the Hon'ble Supreme Court intervened to encourage the use of CNG, citing its economic and environmental benefits over the traditional sources of power.

However, in cases where the Executive is found to be lacking, Courts have felt the need to step in and exercise their powers in areas not necessarily under their expertise. In a recent case for instance, the Supreme Court of India directed the formation of a High Powered Committee comprising the Prime Minister, the leader of the Opposition in the Lok Sabha and the Chief Justice of India for the purpose of making recommendations for the appointments of the Chief Election Commissioner and Election Commissioners, in contrast to the prior system where the Election Commissioners were appointed solely by the Executive[23]. The Court has thus, unceremoniously taken away the decision-making right that vested solely in the Executive, introducing a far more transparent system for such appointments in the interregnum, till the Legislature enacts appropriate law to such effect, thereby strengthening the principles of democracy.

The functioning of Courts in such a scenario, however, cannot be faulted owing to the concentration of power in institutions of the Government. Contemporary illustrations of such a tussle between the Executive and the Judiciary can be traced to the ongoing controversy regarding the appointment of judges. Although it must be admitted that nowhere in the world do judges appoint their own successors, however, the existing collegium system of appointments is the most befitting, keeping in mind the specific exigencies of the Country, without having to compromise on the principle independence of the Judiciary.

On a slightly different perspective, however, this principle exceedingly appears to be under jeopardy on account of several factors, which cast aspersions on the actual independence of the judges in deciding various issues, namely where the State is a party. This phenomenon has seen a steep rise with the appointment of judges in public posts after their retirement, with former Chief Justices and other

22. https://cuts-ccier.org/pdf/synthesis-report-on-economic-impact-of-select-sc-and-ngt-decisions.pdf
23. Anoop Baranwal v. UOI., WP (C) No. 104 of 2015 (Supreme Court)

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Judges being appointed in high ranking positions such as Members of Parliament, Governors of States, etc.

How can a balance be achieved? While educating Judges on fundamental economic concepts may be a limited strategy for the short run, institutionalizing the mechanism of expert committees, which can assist judges in taking into account a variety of viewpoints and gathering the necessary evidence, may be a more immediate, sustainable and practical strategy. In an attempt to better augment the use of such powers, there could perhaps be a detailed study undertaken into the social and economic impact of the Court's judgments, as was undertaken by Niti Aayog. The said report was able to highlight the impact of certain decisions, linking the same to loss of revenue, employment, investments, etc. Perhaps if the judges rendering the decisions in question were made aware of their possible ramifications, the directions passed therein may have been suitably modified to strike a balance between public and private interests.

A sound practice would, therefore, be to invest in better infrastructure to assist judges in ascertaining the impact of their decisions, which would only aid them in fine-tuning the grant of final reliefs, while upholding constitutional and statutory principles. Pertinently, Courts are now able to obtain expert opinions and obtain their attendance for the purpose of providing evidence under the Specific Relief Act 1963, Arbitration and Conciliation Act 1996, the Indian Evidence Act 1872, amongst others.

There are several precedents in which courts have appointed expert committees to assist them with adjudication, such as the case pertaining to the farmers' protest[24]; the case pertaining to the air pollution caused by stubble burning[25], the Pegasus Spyware case[26], etc. In complex cases, courts should use expert assistance more often and there is no reason for them not to.

The existing propensity to make well-balanced decisions will only be enhanced by expert assistance and swift technological advancements, in appropriate matters. This will allow peaceful coexistence of the environment, people and the economy.

Conclusion

It is an indisputable fact that a nation's judicial and legal system can remarkably affect its economic development and prowess. India is no exception to this rule. An efficacious Judicial system is of vital importance for a political economy that entails inclusive economic development. Constitutional principles and legal contracts are enforced through this mechanism.

In this regard, one of the key developments that needs to be factored in, is the certainty of laws, which is primarily, and rightfully the domain of the Executive. For instance, it is only when a foreign investor is certain that their Intellectual Property Rights will be protected and enforced, will they choose to enter into data transfer or technology sharing agreements with India; or where there will not be a sudden and erratic change of laws rendering their investments otiose. As already expounded above, when Executive power remains unchecked, it becomes necessary for the Judiciary to fill this void, and virtually play the role of the Opposition, of course in strict adherence to the principles of Rule of Law. However, a strong responsibility is cast on the Judiciary to not only uphold the democratic principles, but also instill faith in Industry and Commerce that their rights in contract and equity will be protected in the long run. One can always cite instances where the Judiciary may have ventured into domains not necessarily within their expertise. However, this can only be attributed to the inactivity and/ or complacency of the other organs of the Government, which in turn made such Judicial intervention necessary.

In conclusion, for a vibrant and enterprising future, all pillars of the Government have to necessarily act in synergy, and at the policy front make the country future-ready so as to not be left behind in a rapidly changing world, with several advancements in technology *vis-à-vis* law and policy.

On the judicial front, Courts are likely to soon be faced with several issues/ problems in relation to areas/ subjects that have not been delved into in the past, compelling them to modernise their jurisprudence. There is a large anticipation of litigation in areas such as Environment and Social Governance (**ESG**), Artificial Intelligence and especially the extension of public law to private entities who are increasingly performing State/ public functions. Therefore, Courts will essentially continue to play an important role when it comes to securing foreign investments through the legal principles that they set, while also ensuring that the public interest is safeguarded with dynamic principles of the Constitution.

24. Rakesh Vaishnav & Ors. v. Union of India & Ors., Writ Petition (C) No. 1118 of 2020, Supreme Court of India, Order dated 12.01.2021
25. M.C. Mehta v. Union of India, IA No. 127792 of 2017 in Writ Petition(C) No.13029 of 1985, Order dated 29.01.2018
26. Supra Note 11, Order dated 27.08.2021

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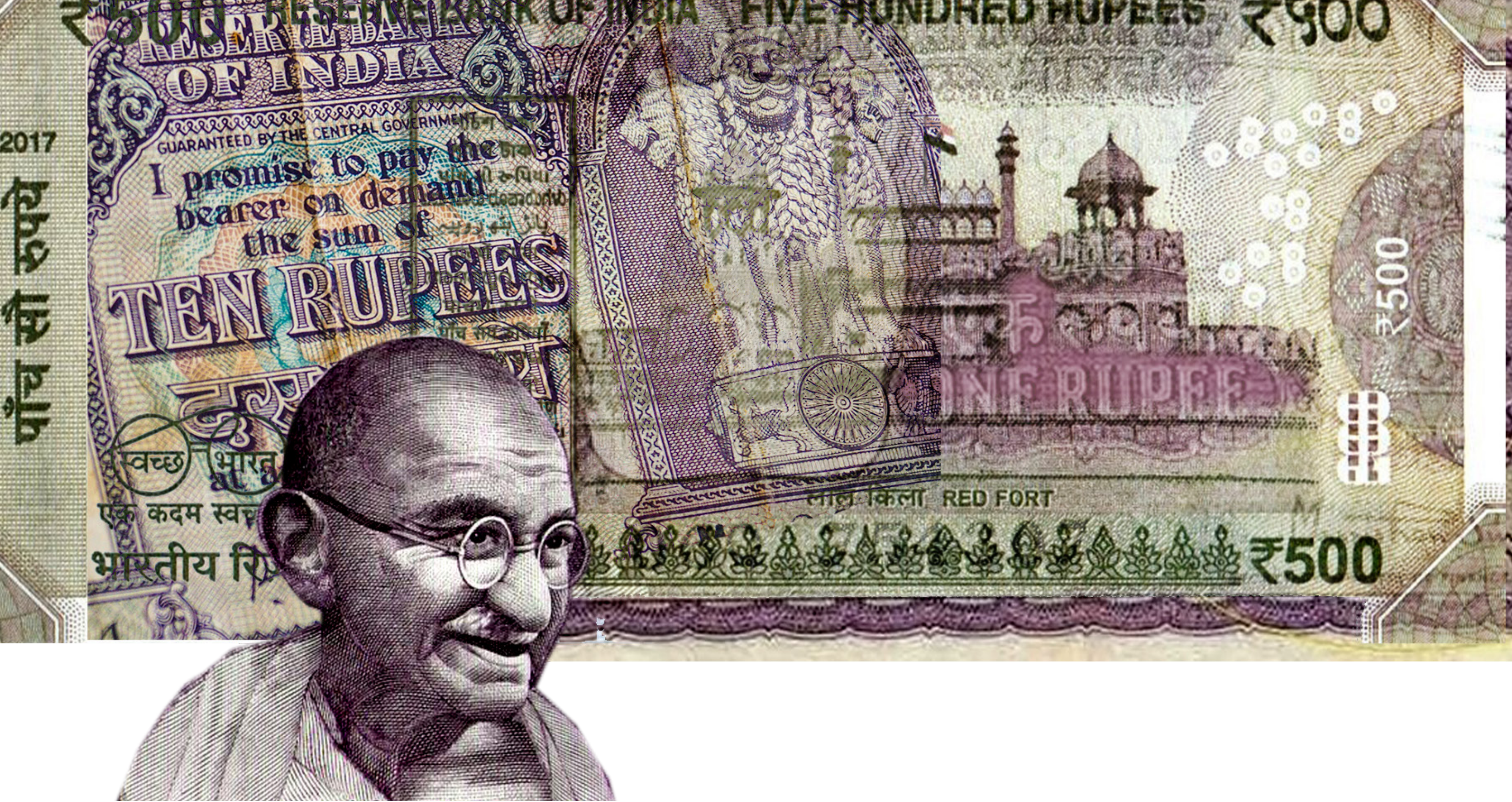
04

EMERGING TRENDS IN **FINTECH**



Introduction

The financial technology (**Fintech**) sector in India has seen unprecedented growth to become one of the largest fintech ecosystems in the world.[1] The development of a robust public digital infrastructure, increased private investment in this space, maturing of the startup environment and the government's push to digitise the economy have all contributed to this growth story. It is estimated that India's fintech market could grow to USD 1 trillion in AUM by 2030.[2]

Recent Developments

Financial inclusion has been a key objective of several fintech developments. Regulatory framework has evolved to bring greater clarity on activities at the edge of the regulatory perimeter, ease compliance and mitigate systemic risks. The following areas of fintech application saw renewed focus in the past year:

DIGITAL PAYMENTS

The receding of the pandemic and resurgence in consumer and industry demand, has supported the continued growth of digital payments. The total

1. https://cuts-ccier.org/pdf/synthesis-report-on-economic-impact-of-select-sc-and-ngt-decisions.pdf (last accessed on March 7, 2023).
2. Chiratae Ventures and EY, $1 trillion India FinTech Opportunity: Chiratae Ventures-EY Fintech Report, available at https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/financial-services/2022/ey-one-trillion-dollars-india-fintech-opportunity-chiratae-ventures-ey-fintech-report_v1.pdf (last accessed on March 7, 2023).

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transaction value of UPI reached INR 125.94 lakh crore in 2022, a 74.83% increase from the previous year.[3] Recent developments in this space have sought to promote accessibility and efficiency. The UPI Lite feature introduced by NPCI in 2022 makes it easier to initiate certain low-value transactions. It also introduced offline functionality through a local wallet. The linkage of Rupay credit cards with UPI is also expected to increase merchant convenience and expand credit products to low coverage areas. The RBI also published a concept note on non-interest bearing tiered Central Bank Digital Currency (**e-Rupee**) that would serve as a more efficient complement to fiat money.[4] The first phased pilot for the proposed e-Rupee was launched in November 2022.[5]

PAYMENT AGGREGATORS AND PAYMENT GATEWAYS

The growth of e-commerce has been complemented by payment gateways and payment aggregators, which are key intermediaries for online payments. In February 2023, the RBI published the status of applications for payment aggregators, granting in-principle authorisation for several payment aggregator licences. Further, the RBI has also sought to overhaul the current framework for Online Payment Gateway Service Providers (**OPGSPs**) in the digital trade space by consulting on the draft Guidelines on 'Processing and Settlement of Small Value Export and Import related payments facilitated by Online Export-Import Facilitators'.[6] The draft guidelines rationalise the framework for remittances in relation to import and export of small value e-commerce products and would help enhance the participation of MSMEs in India's trade.

CREDIT DATA FRAMEWORK

Widening the pool of financial information providers to include GSTN,[7] SEBI[8] and IRDAI regulated entities led to significant expansion of the RBI Account Aggregator framework in 2022. The present work on development of the Open Credit Enablement Network (**OCEN**) as a public digital framework to connect borrowers, lenders, and loan service providers is a welcome initiative. OCEN could help optimise processes for supply of credit through digitisation and create an open marketplace, thereby increasing access to credit for small businesses. The RBI's revised eligibility criteria for access to credit bureau information to include unregulated entities has also helped Fintechs by granting them access to traditional data points to make credit decisions.[9]

DIGITAL LENDING

While Fintech firms have received payment bank licenses and small finance bank licenses, the RBI is yet to grant a full banking license to a fintech firm. In this regard, in July 2022, the NITI Aayog had proposed a differentiated licensing framework for digital banks.[10] Meanwhile, the chief mode of operation of digital lenders has been through collaboration with incumbent banks and NBFCs. Fintech firms rely on software to perform customer-facing functions and provide value added services such as facilitating account opening and issuing co-branded credit cards. Lending arrangements arising through such partnerships were sought to be regulated by the RBI through the Guidelines on Digital Lending in September 2022.[11] The Guidelines place the onus of compliance on regulated entities and impose requirements to ensure compliance by the lending service providers as well.

3. https://www.npci.org.in/what-we-do/upi/product-statistics (last accessed on March 1, 2023); https://inc42.com/features/record-breaking-numbers-upi-2022-hint-in-dia-maturing-digital-payments-ecosystem/#:~:text=their%20total%20value.-,At%20the%20end%20of%20the%20calendar%20year%202022%2C%20UPI%27s%20to-tal,of%20India%27s%20GDP%20in%20FY22. (last accessed on March 7, 2023).
4. RBI Concept Note on Central Bank Digital Currency (October 2022)
5. RBI Press Release, Operationalisation of Central Bank Digital Currency (e-Rupee pilot) (November 29, 2022), available at https://www.rbi.org.in/Scripts/BS_PressRe-leaseDisplay.aspx?prid=54773 (rbi.org.in) (last accessed on March 7, 2023).
6. Draft Guidelines on 'Processing and Settlement of Small Value Export and Import related payments facilitated by Online Export-Import Facilitators' available at https://www.rbi.org.in/scripts/FS_PressRelease.aspx?prid=53530&fn=5 (last accessed on March 7, 2023).
7. RBI, Inclusion of Goods and Service Tax Network (GSTN) as a Financial Information Provider under Account Aggregator Framework (November 23, 2022) available at https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12412&Mode=0 (last accessed on March 7, 2023).
8. SEBI Circular on Participation as Financial Information Providers in Account Aggregator Framework (August 19, 2022) available at https://www.sebi.gov.in/legal/cir-culars/aug-2022/participation-as-financial-information-providers-in-account-aggregator-framework_62157.html Eligibility criteria for entities to be categorised as Specified User under clause (j) of Regulation 3 of the Credit Information Companies (Amendment) Regulations, 2021, available at Eligibility05012022.pdf (rbi.org.in) (last accessed on March 2, 2023).
10. NITI Aayog, Digital Banks: A Proposal for Licensing and Regulatory Regime for India (July 2022), available at https://www.niti.gov.in/sites/default/files/2022-07/Digi-talBanking07202022_compressed.pdf (last accessed on March 1, 2023).
11. RBI Guidelines on Digital Lending (September 2, 2022), available at https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12382&Mode=0) (last accessed on March 7, 2023).

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Removing Barriers, Unlocking Potential

According to World Bank data, about 230 million Indians are unbanked.[12] Fintechs have the opportunity to complement traditional banks and facilitate the penetration of services such as credit or payments by virtue of their nimble, efficient, and data-driven approach. The Finance Minister has announced several measures in the Union Budget 2023-24 to expand credit and further financial inclusion. These include the creation of a national financial information registry to serve as a centralised repository of financial and ancillary information. Additionally, fiscal support for digital public infrastructure will also be continued.

The digital payments space is particularly ripe for further innovation due to significant growth potential in merchant payments. Promoting interoperability across platforms and increasing efficiency in cross-border digital payments could contribute to the RBI's aim of a 3x increase in digital payments as part of the RBI's Payments Vision 2025. Recent initiatives such as the interlinkage of India's UPI and Singapore's PayNow systems, NPCI permitting non-resident accounts from 10 countries to transact on UPI and RBI's consideration of wholesale CBDCs for cross-border settlement would boost the speed and cost-effectiveness of international payments and put the Indian fintech ecosystem at the forefront of global payments innovation.

The fintech sector, aided by a supportive policy and regulatory framework, could be central to financial inclusion and digitisation of the economy.

Thus, the fintech sector, aided by a supportive policy and regulatory framework, could be central to financial inclusion and digitisation of the economy.

CHALLENGES TO FUTURE GROWTH

While the fintech sector has made remarkable progress in the last few years, its continued growth is not devoid of challenges.

12. World Bank, The Global Findex Database 2021, available at https://www.worldbank.org/en/publication/globalfindex/Report (last accessed on March 1, 2023).

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REGULATORY ENVIRONMENT

One of the biggest challenges for the sector is the dynamic regulatory environment. The legal regime for Fintech firms is constantly evolving, which has a bearing on compliance costs, predictability of future growth and the feasibility of innovative business models. For instance, credit by fintech firms saw increased regulatory scrutiny in 2022 with the Digital Lending Guidelines, Credit and Debit Card-Issuance and Conduct Directions and the RBI's June 2022 letter prohibiting non-bank Prepaid Payment Instrument (PPI) issuers from loading their PPIs through credit lines. These interventions, while prescribing sound lending practices, prompted firms to review the feasibility of their business models, particularly in the digital lending space where contractual arrangements with customers had to be revisited. Similarly, both the Digital Lending Guidelines and the FAQs[13] that followed are silent on the permissibility of First Loss Default Guarantee (FLDG) arrangements and the related costs for consumers. The RBI Working Group's recommendation to prohibit such arrangements, which was under consideration by the RBI, has affected predictability on the feasibility of this lending segment.[14]

SUSTAINABILITY

Fintech firms are increasingly under pressure to design business models with strong unit economics and which demonstrate a clear profitability path. This has a direct interface with regulatory considerations as seen in the compliance costs related to data localisation mandates and the restrictions on certain BNPL products that relied on PPIs. Fintech innovation must focus on sustainable models that are proactively compliant, transparent, and anticipatory, given the stated regulatory policy.

CREATING A DIGITAL INDIA

Issues with establishing physical and digital infrastructure in remote areas can limit the reach of fintech firms. Lower levels of financial and digital literacy in certain segments of the population and the novel status of fintech business models and firms also contribute towards trust deficit, for instance in the case of high-value digital payments. Government initiatives such as the Pradhan Mantri Gramin Digital Saksharta Abhiyaan, which seeks to promote digital literacy, undertake skilling programmes and establish internet connectivity in remote locations have helped contribute toward bridging this digital divide. Such schemes also present an opportunity to fintech firms to partner with governments and non-government organisations as part of various schemes to offer financial services such as credit or payments to their beneficiaries. Firms can employ data from direct benefit transfer and other schemes to offer personalised products that can help drive small value, high volume business models.

EMERGING THEMES: TOWARDS GREATER CONVERGENCE

The fintech sector is constantly evolving to launch innovative business models in a data-driven and technology-intensive manner. Consequently, regulation is focused towards mitigating risks, enforcing compliance and protecting consumers. The present fintech environment has seen the following emerging themes, which we think we will be important going forward:

i. Democratising access

Fintech firms seek to provide a lost cost and efficient alternative to traditional financial services. Increased accessibility has enabled more users to avail financial services and participate in the financial markets. For instance, online brokers have enabled higher retail participation in India's securities market by designing lean, responsive and user-friendly interfaces, reducing transaction costs, providing vernacular access, and undertaking financial literacy initiatives. Similarly, fintech firms have expanded unsecured credit by utilising alternate data points such as social media activity, e-commerce purchases, PoS data and internet activity to assess creditworthiness.

ii. Heightened regulatory activity

Areas such as cryptocurrencies, which could do with greater regulatory certainty, have seen enforcement action in the recent past. The Enforcement Directorate has attached assets of crypto-exchanges and issued notices as part of FEMA and PMLA investigations. Another instance of proactive regulation has been by MeitY when it issued blocking orders against certain digital lending apps due to concerns that they were not regulated by the RBI. The ban was reversed in February 2023 post a MeitY review, through consultations with the RBI and on representations by industry players.[15]

13. https://www.worldbank.org/en/publication/globalfindex/Report)
14. RBI Report of the Working Group on Digital Lending including Lending through Online Platforms and Mobile Apps (November 18, 2021), available at https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1189 (last accessed on March 7, 2023).
15. https://www.livemint.com/news/india/meity-revokes-ban-orders-on-some-digital-lending-apps-11676019050662.html) (last accessed on March 7, 2023).

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iii. **Maturing ecosystem**

The slowdown in foreign funding in 2022 has nudged fintech firms towards developing robust business models and monetising their existing wide user-base through value-added services. Digital payments firms, which have lower scope for monetization on account of the RBI's zero MDR stance on UPI, have begun cross-selling services outside their primary business and moving up the value chain through lending, data management, and accounting functions.[16] E-commerce firms have also begun offering credit products to their captive user base. Further, focus on corporate governance norms in startups has increased, to improve investor transparency, undertake compliance, and manage conflicts of interest.

SETTING A PATH TO FUTURE ACTION

The Fintech sector is the key to realising India's economic ambitions. An appropriate legal, regulatory and policy framework can support the next stage of growth as set out below:

i. **Predictable and proportionate regulation**

There must be emphasis on scale-based regulation that assesses the financial impact of a business through its balance sheet, number of users, capital, etc. This should involve a combination of activities and entity-based regulation that are proportionate to the risks posed by any fintech business model. Further, regulatory rule-making should also focus on clarifying the roles of fintechs and incumbents with respect to collaborative business models. There should also be flexibility in pursuing legitimate business models within broad guardrails and light-touch supervision that protect consumers and promote transparency in conduct through periodic disclosures. For instance, the use of AI/ML based bots that undertake functions similar to regulated intermediaries present potential regulatory and supervisory challenges. Regulation of such applications must be sufficiently technology-neutral, fit for purpose, outcome focused and protect vulnerable consumers.

Specific compliance aspects cutting across fintech activities such as the cost of data storage or KYC requirements would benefit from greater harmonisation. For instance, the draft Digital Personal Data Protection Bill 2022 provides a mechanism for international data transfers while the RBI has stipulated data localisation norms for storage of payments data. The potential conflict between such requirements highlights the need for greater inter-regulatory coordination through MoUs and joint initiatives.

16. Boston Consulting Group and Matrix Partners India, State of the Fintech Union 2022 (August 2022), available at https://web-assets.bcg.com/7d/2f/002986714a27a0369a3f-85da6509/state-of-india-fintech-union-2022.pdf (bcg.com) (last accessed on March 2, 2023).

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ii. **Enhancing Present Regulatory Sandboxes:**

Existing regulatory sandboxes can be improved in line with global standards. For instance, the RBI's cohort-based sandbox scheme can transition to an always open model. Other changes that may be considered include more flexible durations and provision for structured and periodic feedback. Additionally, provisions should be made to facilitate regulated entities offering innovative services under a licence in a different jurisdiction to participate in the sandbox.

iii. **Formal mechanism to seek guidance**

Given the evolving and dynamic nature of fintech related regulations, the RBI and IRDAI should institutionalise a guidance mechanism on the lines of the SEBI Informal Guidance Scheme. This would give Fintechs the opportunity to seek clarity and guidance on interpretation of relevant regulations. While the RBI and IRDAI have been periodically publishing FAQs and clarifications, a mechanism where individual firms can raise queries related to their businesses and receive time-bound responses would be helpful in allowing fintechs to plan for compliance before experimenting with innovative models.

iv. **Greater industry collaboration**

Adopting a trust-based approach to regulation, the regulators could enhance engagement with industry participants and consult market players before prescribing regulations or undertaking more targeted regulatory interventions. This would allow the industry to take a more proactive role in compliance, respond to regulators' concerns, enhance transparency around their business models, identify issues and raise them in advance or communicate the estimated impact of a regulatory move. Such a collaborative approach would lead to more predictable regulations, bolster compliance and reduce the need for enforcement actions.

Regulators could also formalise self-regulatory approaches in certain businesses through representative industry bodies as has been proposed in the draft amendments to the Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021, for the online gaming industry. These self-regulatory organisations would work under the overall supervision of the relevant regulator and issue rules based on industry experiences and in response to new innovations. A trust-based model can help protect the interest of all stakeholders, ensure that the collective interest of keeping out the bad actors is met, and inspire greater consumer trust in their products and services.

Conclusion

The Indian fintech landscape has been recognised globally for its pace of innovation, scale of digital adoption and a largely facilitative regulatory environment. Emerging developments suggest that the sector is poised for exponential growth that could radically change and impact traditional business models. Increasing participation by fintechs in the economy holds the promise of democratising access to financial services and meeting India's digitisation goals. A predictable regulatory regime remains a major concern for the sector. In this context, regulatory activity has been focused on addressing gaps and clarifying the scope of different regulatory regimes. In light of this, supporting innovation while addressing risks in a commensurate manner would go a long way in boosting the growth of this sector.

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05

FUNDING AS THE **ACCELERATOR** TO INDIA'S GROWTH STORY

"Capital is the fuel that drives the engine of growth."

Despite the pandemic induced economic stress, the Indian economy has outperformed many others, as is evident by its 6.8% GDP growth in FY22, well above the global average of 3.4%.[1] This resilient and fast-paced growth is propelled by factors such as augmented capital expenditure (**capex**) by the Indian government and the presence of strongly capitalised banks that are poised to improve access to lending.[2] Capex has a well-known multiplier effect on economic growth. The capex allocation by the central government, which has been steadily increasing in recent budgets, has enabled a virtuous cycle of growth by crowding-in private investment.[3] As a result, there was a 13.5% jump in expected infrastructure investment by the private sector in FY22.[4] The surge in investment demand for infrastructure projects translated into a corresponding increase in credit demand, leading to an 11.1% YoY growth in India's lending market, which reached a size of INR 174.3 lakh crore during FY22.[5] Studies by the International Monetary Fund indicate that higher credit growth, arising from better capitalised banks with lower non-performing assets (**NPAs**) has a direct correlation with amplified GDP growth and economic development of India in the long run.[6]

1. See: https://pib.gov.in/PressReleasePage.aspx?PRID=1894932 (January 31, 2023); https://www.imf.org/en/Publications/WEO/Issues/2023/01/31/world-economic-outlook-update-january-2023 (January 2023).
2. See: https://pib.gov.in/PressReleasePage.aspx?PRID=1894932 (January 31, 2023)
3. See: https://pib.gov.in/PressReleasePage.aspx?PRID=1894932 (January 31, 2023).
4. See: https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/05_PCIG1808202225506D257434449CBC572C36BF13F073.PDF (August, 2022).
5. See: https://www.outlookindia.com/business/india-s-lending-market-grew-11-1-annually-in-fy-2022-says-credit-bureau-report-news-224599 (September 20, 2022).
6. See: https://www.imf.org/en/Publications/WP/Issues/2022/07/08/Financial-Sector-and-Economic-Growth-in-India-520580 (July 8, 2022).

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CREDIT EXPANSION AND REGULATORY REFORMS

In furtherance of a finance-led growth strategy, the Ministry of Finance (**MoF**) and the Reserve Bank of India (**RBI**) have engineered coordinated efforts towards calibrating regulatory reforms to fortify financial institutions and reduce NPAs. These measures are aimed at averting liquidity concerns and sustaining the momentum in infrastructure investment. One such reform has been the implementation of prudential norms on income recognition, asset classification, as well as the minimum capital adequacy requirements by the RBI, in line with the Basel III norms for scheduled commercial banks (**SCBs**).[7] SCBs are also required to maintain strict asset quality standards during the credit appraisal process, and conduct due diligence on the viability and bankability of infrastructure projects to ensure that the revenue streams from such projects are sufficient for complying with the debt servicing obligations.[8] The corrective actions taken by the RBI to adhere to these norms have created adequate buffers for banks against unforeseen contingencies. This is buttressed by the latest Financial Stability Report released by the RBI in December 2022, indicating that SCBs are well-capitalised and would be able to comply with the minimum capital requirements even under adverse stress scenarios.[9]

While banks form the core pillar of India's financial sector, India's growth story has also been driven by non-banking financial companies (**NBFCs**). NBFCs have seen significant traction in their outreach in the past two decades, with their contribution to the country's GDP increasing from a meagre 18% in 2002 to over 60% in 2020.[10] Such exponential growth also underscores the need for increased regulatory oversight of the NBFCs to safeguard the stability of the financial system. The systemic setbacks due to recent defaults by some NBFCs[11] have prompted the RBI to devise a scale-based regulatory approach, under which, the upper layer NBFCs are brought within the fold of adherence to capital adequacy and exposure norms on par with SCBs.[12] This will shore up the health of NBFCs and prevent spillover effects of an unfavourable economic environment.

Mandatory strengthening of provisions and capital buffers, while crucial for maintaining the durability of financial institutions, can also result in a degree of risk aversion among such institutions, dampening credit growth. To ensure liquidity from banks for infrastructure projects, the RBI has permitted partnership between SCBs and NBFCs, allowing the two to co-lend on the basis of an agreed master agreement for enhanced operational flexibility.[13] This is an improvement over the earlier scheme of co-origination of loans since it enables SCBs to leverage the market presence of NBFCs, while allowing NBFCs to access the larger fund reserves of banks, thereby augmenting credit access avenues for infrastructure financing. Banks can also have a higher exposure of up to 50% of its capital funds to a single borrower group, if the additional credit exposure is for infrastructure projects.[14] The infrastructure sector has additionally reaped the benefits of regular revision of the harmonised master list of infrastructure sub-sectors issued by the MoF (**Harmonised List**). With the inclusion of upcoming infrastructure projects such as energy storage systems and data centres in the Harmonised List[15], the borrowing options for such projects has been optimised, both domestically and through the external commercial borrowing route.

Offshore funding has emerged as an attractive alternative in India, and the MoF has liberalised infrastructure investment under the automatic route,[16] resulting in an influx of ~INR 2 trillion by foreign investors between April 2000 and December 2022.[17] Further, setting up of the National Bank for Financing Infrastructure Development (**NaBFID**), pursuant to announcement in the Union Budget for FY22[18], is expected to be a game-changer in addressing financing challenges faced by the infrastructure sector. As an ecosystem architect for infrastructure

7. Master Circular – Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances (April 1, 2023). See:https://rbidocs.rbi.org.in/rdocs/notification/PDFs/06MC01042023AEBE1CE5C60C4096875441C91F41553E.PDF.
8. Master Circular on Loans and Advances- Statutory and Other Restrictions, RBI (July 1, 2015).
9. See: https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/0FSRDECEMBER2022F93A2F188A394ACDB2FDDC2FCC0D07F0.PDF (December 2022).
10. See: https://m.rbi.org.in/scripts/BS_ViewBulletin.aspx?Id=21206 (August 18, 2022).
11. See: https://bfsi.economictimes.indiatimes.com/news/nbfc/how-the-ilfs-crisis-ravaged-indias-nbfc-sector-a-timeline/90541212 (March 31, 2022); https://www.businesstoday.in/top-story/story/rbi-introduces-new-nbfc-regulatory-framework-to-avoid-debacles-like-ilfs-dewan-housing-and-srei-group-310186-2021-10-22 (October 22, 2021).
12. Scale Based Regulation: A Revised Regulatory Framework for NBFCs, RBI (October 22, 2021). See: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12179&Mode=0.
13. Co-Lending by Banks and NBFCs to Priority Sector, RBI (November 05, 2020). See: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT6300DF94088B674E7FB6FC7EEC214B0200.PDF.
14. Master Circular – Exposure Norms, 2015, RBI.
15. See: https://egazette.nic.in/WriteReadData/2022/239561.pdf (October 11, 2022).
16. Consolidated FDI Policy, Department for Promotion of Industry and Internal Trade, Ministry of Commerce, Government of India. See: https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020.pdf.
17. See: https://dpiit.gov.in/sites/default/files/FDI_Factsheet_December_2022.pdf (December 2022).
18. Budget 2021-22, Ministry of Finance. See: https://www.indiabudget.gov.in/budget2021-22/doc/Budget_Speech.pdf (February 1, 2021).

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> Offshore funding has emerged as an attractive alternative in India, and the MoF has liberalised infrastructure investment under the automatic route.

financing, NaBFID will not only disburse term loans to infrastructure projects (which is projected to be ~INR 15,000 crore in the March quarter of FY23, with ~INR 50,000 crore as sanctions[19]), but it will also play a pivotal role in promoting the development of bonds and derivative markets.

With the widening range of funding avenues for infrastructure projects in India, vital support extended by new development finance institutions such as NaBFID and a surge in capex allocation by 37.4% in Union Budget 2023-24[20], the economy is primed for GDP growth north of 6% in the current fiscal year,[21] which bears a testament to the country's commitment to growth.

FINANCING THE GREEN REVOLUTION

India has set an ambitious target of becoming a US$ 5 trillion economy by FY25,[22] but its aspirations extend far beyond mere growth. The country intends to achieve 'sustainable' growth, in sync with the global efforts of transitioning to a greener earth.[23] As per estimates, to move the needle towards achieving its commitment of net-zero by 2070, India would need a total investment of US$ 10.1 trillion and the investment gap is currently, ~USD 3.5 trillion, which cannot be feasibly mustered through traditional sources.[24] To meet these challenges, Indian corporates have already begun embarking on a decarbonisation journey. The top 1000 listed companies (by market capitalisation) in India are required to comply with the mandatory business responsibility and sustainability reporting requirements, which has increased innovation in traditional business models to cater to green needs.[25]

Parallelly, there needs to be increased engagement with financial institutions to encourage sustainability-focused financing, and to develop a conducive ecosystem for corporates to access the bond market. An efficient bond market will de-risk bank balance

19. See: https://economictimes.indiatimes.com/markets/stocks/news/nabfid-plans-to-lend-rs-15000-cr-to-infra-projects-this-quarter/articleshow/96867172.cms (January 10, 2023).
20. See: Press Information Bureau (pib.gov.in) (February 1, 2023)
21. Economic Survey 2022-23, Ministry of Finance, Government of India. See: https://www.indiabudget.gov.in/economicsurvey/doc/eschapter/echap01.pdf. See also: https://www.imf.org/en/Countries/IND.
22. See: https://economictimes.indiatimes.com/news/economy/finance/india-to-be-usd-5-trillion-economy-by-fy2026-cea-anantha-nageswaran/articleshow/97500680.cms (January 31, 2023);
23. See: https://www.unep.org/resources/emissions-gap-report-2022 (October 27, 2022)
24. See: https://www.ceew.in/cef/solutions-factory/publications/investment-sizing-india-s-2070-net-zero-target (November 18, 2021).
25. Business responsibility and sustainability reporting by listed entities, SEBI (May 10, 2021). See: https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html

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sheets and offer a supplementary source of capital to finance the infrastructure sector. To attain this, the Securities and Exchange Board of India (**SEBI**) has updated its regulatory framework to permit issuance of 'green debt securities' (**GDS**) by introducing sub-categories of GDS such as blue bonds (for water management and marine sector), yellow bonds (for solar energy) and transition bonds, in line with the principles delineated by the International Organization of Securities Commissions.[26] As per SEBI's data, Indian corporates have issued GDS worth INR 4,539 crore between 2017 and September 2022.[27] Accompanied by the enhanced disclosure requirements and a guidance on avoiding green-washing, SEBI's robust framework on GDS is expected to provide an impetus for mobilisation of capital flow into green projects.[28] The inaugural sovereign green bonds issue in January this year will further accelerate the domestic sustainable debt market by providing a pricing reference for issuers.[29] The RBI has also given due consideration to the imperative of channelising funds towards green activities, and issued a 'Framework for acceptance of Green Deposits' on April 11, 2023 to stimulate deposits, proceeds of which are earmarked for eligible green projects.[30]

While expanding funding channels, it is imperative to bolster investor confidence in the sector being financed. This can be done by taking steps to eliminate infrastructure sector bottlenecks, such as delay in land acquisitions and obtaining clearances, by facilitating a single-window clearance system. The government has already made commendable efforts to harness the potential of green energy by enabling open access and banking of renewable energy for green hydrogen production, developing a 'green energy corridor' and implementing the production linked initiative schemes.[31] Simultaneously, introducing structural changes to improve financing conditions for project developers such as rationalising bank guarantee requirements by permitting letters of undertaking to be furnished *in lieu* of bank guarantee for bidding[32] or lowering credit risk rating of operational projects, could go a long way in increasing liquidity for infrastructure projects and supporting the green revolution.

UNLOCKING AVENUES FOR INFRA FINANCING THROUGH ASSET MONETISATION AND INVITS

Increased cashflows for infrastructure projects can be secured by not just developing a new investor base through development of bond markets, but also by asset monetisation or capital re-cycling. Asset monetisation was identified as a key pillar to ramp up the pace of sustainable infrastructure financing under the Union Budget 2021-22.[33] Accordingly, NITI Aayog laid out a national monetisation pipeline (**NMP**), having an average annual investment budget of INR 22 lakh crore, and estimating potential aggregate monetisation of INR 6 lakh crore over a four-year period from FY22 to FY25, through direct contractual models as well as structured financing models.[34]

Infrastructure investment trusts (**InvITs**) and real estate investment trusts (**REITs**) are essential drivers of monetisation through structured financing. Regulated by SEBI governance norms, these trusts provide a golden opportunity for investors to generate stable returns backed by high-quality assets. Indian road and highway concessions, renewable energy projects and transmission assets have already secured funding from international investment funds by reaping profits as high as 56% (India Grid Trust) and 83% (IRB InvIT) in 2021.[35] The RBI also enabled increased capital access for InvITs in 2021 by permitting FPIs to invest in debt securities issued by InvITs and REITs, pursuant to an amendment in the Foreign Exchange Management (Debt Instruments) Regulations, 2019.[36] By capitalising on asset monetisation and InvITs, India can spark a new wave of growth in the infrastructure sector, boosting economic development and unlocking new avenues for investors.

26. Board Meeting, SEBI (December 20, 2022). See: https://www.sebi.gov.in/media/press-releases/dec-2022/sebi-board-meeting_66407.html.
27. See: https://www.sebi.gov.in/statistics/greenbonds.html (September 14, 2022).
28. Revised Disclosure Requirements for Issuance and Listing of Greed Debt Securities, SEBI (February 06, 2023). See: https://www.sebi.gov.in/legal/circulars/feb-2023/revised-disclosure-requirements-for-issuance-and-listing-of-green-debt-securities_67837.html.
29. See: https://economictimes.indiatimes.com/markets/bonds/indias-sovereign-green-bonds-may-enhance-financing-capacity-fitch/articleshow/97797068.cms (February 10, 2023).
30. Framework for acceptance of Green Deposits (April 11, 2023), RBI (effective from June 01, 2023). See: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/CIRCULARGREENDEPOSITS55FFC86E3BD94C4A8BFF8946C6C282EA.PDF.
31. See: https://pib.gov.in/PressReleasePage.aspx?PRID=1885147 (December 20, 2022), read with Electricity (Promoting Renewable Energy Through Green Energy Open Access) Rules, 2022.
32. See: https://pib.gov.in/PressReleasePage.aspx?PRID=1651327 (September 04, 2020).
33. See: https://www.indiabudget.gov.in/budget2021-22/doc/Budget_Speech.pdf (February 1, 2021).
34. See: https://www.niti.gov.in/sites/default/files/2021-08/Vol_I_NATIONAL_MONETISATION_PIPELINE_23_Aug_2021.pdf and https://www.niti.gov.in/sites/default/files/2021-08/Vol_2_NATIONAL_MONETISATION_PIPELINE_23_Aug_2021.pdf (July-August 2021).
35. See: https://economictimes.indiatimes.com/markets/stocks/news/with-invits-get-returns-of-8-10-and-good-diversification/articleshow/85468305.cms (August 20, 2021); https://www.business-standard.com/article/markets/cppib-and-ontario-teachers-pension-plan-bag-nhai-s-maiden-invit-121110301236_1.html (November 3, 2021).
36. Foreign Exchange Management (Debt Instruments) (First Amendment) Regulations, 2021 (October 13, 2021). See: https://rbidocs.rbi.org.in/rdocs/content/pdfs/APDIR120_AN.pdf.

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ROLE OF SECONDARY LOAN MARKETS AND INSOLVENCY FRAMEWORK

One of the typical challenges that an infrastructure boom brings with it, is the increase in potential stressed assets and NPAs. Prudential norms, as seen above, have played a crucial role in identifying stress in the banking and non-banking sectors at critical junctures. Further, taking cognizance of the stressed assets which fail to recover in a time-bound manner, the RBI has also adopted Prudential Framework for Resolution of Stressed Assets[37], the RBI (Transfer of Loan Exposures) Directions, 2021 and the RBI (Securitization of Standard Assets) Directions, 2021, which allow distressed assets to be managed by entities that are better equipped to facilitate faster recovery. With such framework, the RBI has proactively enabled banks and NBFCs to sell stressed assets to any class of entities (including corporates) that are permitted to take on loan exposures under their regulatory framework, thereby widening the spectrum of participants in the secondary loan market.[38] The price discovery process for transfer of stressed loan exposures has been streamlined, with swiss challenge mandatory for exposures above INR 100 crore.[39] Further, the marketability of different asset classes has been expanded by permitting tranching of securities depending upon the underlying credit risk, allowing each investor to share in the credit risk on the basis of its risk appetite.[40]

When coupled with the adoption of the Insolvency and Bankruptcy Code, 2016, wherein larger NPAs have been successfully fast-tracked for quicker resolution/ liquidation (even if the time taken was longer than initially anticipated), the toolkits with banks to deal with stressed assets, have already yielded impressive results. As per the Economic Survey 2022-23, the gross NPA ratio of banks plummeted to a seven-year low of 5% in 2022.[41] The paradigm shift in India's resolution philosophy and initiatives towards the development of a secondary market for loans will further augment market penetration and boost investor trust, resulting in increased business opportunities for investment in infrastructure.

Conclusion

As India's financial sector undergoes a massive metamorphosis, the government's initiatives and private sector investments are powering a promising era of sustained development. With the banking sector's alacrity in response to these developments and the introduction of new reforms, India's financial landscape is well-positioned to flourish in the *Amrit kaal*, paving the way for world-class infrastructure and fuelling India's growth story.

37. Dated June 7, 2019, as amended from time to time.
38. Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 (September 24, 2021). See: https://rbidocs.rbi.org.in/rdocs/notification/PDFs/86MDLOANEXPOSURESC6B1DFB428C349D885619396317F04DE.PDF.
39. Id.
40. Id.
41. See: https://www.pib.gov.in/PressReleseDetailm.aspx?PRID=1894929 (January 31, 2023).

06

RELATED PARTY TRANSACTIONS

DECODING THE NEW REGULATORY ARCHITECTURE

The regulatory architecture for related party transactions (**RPTs**) is founded on the principle of regulating contracts/ arrangements/ transactions that involve an actual or potential ***conflict of interest*** for a company. In this regard, an indicative guidance of the legislative intent may be taken from the definition of '*arm's length transaction*' under Section 188 of the Companies Act, 2013 (**Companies Act**) which highlights that an *arm's length transaction* is a transaction between two related parties, that is conducted as if they were unrelated, so that there is ***no conflict of interest***.

In India, regulating RPTs assumes relevance given that – (i) approximately 75% of listed companies are promoter owned/ controlled; and (ii) many business houses operate as conglomerates, with multiple domestic and overseas subsidiaries and associate companies. Therefore, prescribing a robust regulatory architecture for RPTs has been a top priority for the Securities and Exchange Board of India (**SEBI**) and the Ministry of Corporate Affairs (**MCA**).

It may be worthwhile to note that Section 188 of the Companies Act, 2013 (**Companies Act**) also provides a framework for the approval and disclosure of RPTs, which applies to both listed and unlisted companies.

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However, the RPT regulatory architecture for listed companies is significantly stricter.

Compared to the Companies Act, the regulatory regime under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**Listing Regulations**) encompasses a much broader definition of 'related party' and 'RPT' – to cover a wider gamut of transactions. Further, unlike the Companies Act, the Listing Regulations does not contain any exemption for RPTs that are entered into in the ordinary course of business, and undertaken on an arm's length basis.

On November 9, 2021, from the standpoint of strengthening the RPT regulatory architecture applicable to listed companies in India, SEBI notified far-reaching amendments that came into force on April 1, 2022. A year later, on April 1, 2023, some other key amendments (*such as the 'purpose and effect' test for transactions with unrelated third parties, the 10% shareholding test for 'related party' and the threshold for audit committee approval for subsidiary-level transactions*), came into force (**New RPT Regime**).

With its emphasis on RPT approval and disclosure, the New RPT Regime is both robust and forward-looking and perhaps prescribes one of the most comprehensive sets of standards across all jurisdictions.

While the New RPT Regime may have increased the compliance burden for India Inc, its provisions should be viewed and tested through the lens of safeguarding the interests of minority shareholders, and all other key stakeholders of a listed company.

In this article, the authors decode the key provisions of the New RPT Regime, and highlight its implications for India Inc.

RELATED PARTY

The definition of 'related party' under Regulation 2(1)(zb) of the Listing Regulations now covers any person/entity holding **10%** or more of the equity shares of the listed entity, either directly or on a beneficial interest basis (**10% Shareholding Test**).

It is pertinent to note that a person/ entity will be regarded as a 'related party' if the **10%** Shareholding Test is met <u>*at any time*</u> during the immediately preceding financial year. Hence, even if the threshold is exceeded for a limited period (or even for a single day) during that year, the person/ entity will be regarded as a 'related party'.

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Given that SEBI has also separately included 'promoter' and 'promoter entity' within the definition of 'related party' under Regulation 2(1)(zb) of the LODR, a separate shareholding-based threshold may, in certain situations, cast the net rather too wide. By virtue of the 10% Shareholding Test, even institutional investors holding a minority stake may be considered 'related parties', merely based on their shareholding threshold.

As no 'related party' can vote to approve an RPT (irrespective of whether it is a party to the transaction)[1], the 10% Shareholding Test may effectively disenfranchise minority shareholding from voting to approve an RPT. This may potentially lead to counter-intuitive results in certain situations, as the New RPT Regime is designed from the standpoint of safeguarding minority shareholders' interest.

By virtue of the 10% Shareholding Test, even institutional investors holding a minority stake may be considered 'related parties', merely based on their shareholding threshold.

RPTS – SCOPE AND AMBIT

The definition of RPTs previously covered any '*transfer of resources, services or obligations*' between a listed entity and a related party.[2]

This definition has now been broadened to cover all subsidiary-level transactions, including transactions between two foreign subsidiaries of the listed entity. If the value of such subsidiary-level RPTs exceeds the threshold of 10% of the annual standalone turnover of the subsidiary, then it will require approval of the audit committee of the listed entity. The audit committee is now required to review and examine a much larger gamut of transactions.

Further, SEBI has exempted certain corporate actions from the definition of RPT (such as rights issue, buyback, payment of dividend, etc.). The capital market regulator has also excluded acceptance of fixed deposits (on terms uniformly applicable to all shareholders) by a banking company/ NBFC from being a RPT.

However, as only a select set of corporate actions/ ordinary business transactions have been exempted, this has resulted in a situation where other common corporate actions/ ordinary business transactions unwittingly get covered under the definition of 'RPT'.

For instance, only acceptance of *fixed* deposits by banks/NBFCs has been exempted, which has prompted some listed banks to obtain shareholders' approval for accepting *current account* deposits of above INR 1000 crore from a related party.

PURPOSE AND EFFECT TEST

With effect from April 1, 2023, RPTs would encompass all such transactions undertaken between a listed entity or any of its subsidiaries on one hand and any other person or entity on the other hand, the ***purpose and effect*** of which is to benefit a related party of the listed entity or any of its subsidiaries (the **Purpose and Effect Test**). The Purpose and Effect Test, which has been borrowed from the UK Premium Listing Rules, also covers transactions where the counter party is not a 'related party' of the listed entity, bringing about a fundamental shift in the regulatory architecture.

It is relevant to note that under the UK Premium Listing Rules, the Purpose and Effect Test is not applicable for transactions undertaken in the ordinary course of business. However, a similar exemption has not been provided under the New RPT Regime.

SEBI has, as of date, not proposed any *bright line test* to aid in determining whether the 'purpose and effect' test has been satisfied in a given situation, and whether there is any 'benefit' to a related party.

While this test may seem onerous to implement, it should be viewed through the lens of safeguarding investor interest. It aims to curb transactions with third parties that are structured to benefit related parties, as well as transactions that are innovatively structured to avoid disclosures[3].

1. Regulation 23(4) of the Listing Regulations.
2. Regulation 2(1)(zc) of the Listing Regulations.
3. Report of the SEBI Working Group on Related Party Transactions, at Pages 8 and 13.

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The Purpose and Effect Test would require the compliance teams of listed companies to significantly revamp their internal processes and governance framework for identifying transactions with third parties that could result in a 'benefit' for a related party.

REVISED THRESHOLD – AUDIT COMMITTEE APPROVAL FOR SUBSIDIARY-LEVEL RPTS

It is relevant to note that prior to April 1, 2023, for subsidiary-level RPTs (*i.e. for RPTs where the subsidiary is a party but the listed entity is not a party*), prior audit committee approval was required if the value of the transaction exceeded 10% of the annual consolidated turnover of the listed entity, as per its last audited financial statements.

The threshold has now been revised to 10% of the annual standalone turnover of the subsidiary, as per the last audited financial statements of the subsidiary. Given the significant reduction in the threshold, the audit committee of the listed entity will now have to review a much wider range of subsidiary-level RPTs.

ONLY INDEPENDENT DIRECTORS ON THE AUDIT COMMITTEE CAN APPROVE RPTS

With effect from January 1, 2022, only the independent directors on the audit committee can approve RPTs. As independent directors are now solely responsible for RPT approvals, they are required to take all reasonable steps to ensure that the management team places all relevant details about the proposed RPT before the audit committee. These include details with respect to technical competence of the counter-party, key terms and conditions of the transaction (and whether there is any deviation from standard market terms for similar transactions), whether the pricing is based on an *arm's length basis*, etc.

Whilst the Listing Regulations does not contain any exemption for RPTs entered into in the ordinary course of business and on an arm's length basis, it is important for the independent directors on the audit committee to make this determination on a case-by-case basis, so as to evaluate whether the RPT is a legitimate business transaction, or whether the transaction is structured in a manner that impinges stakeholder interest.

Although the Listing Regulations do not provide any exemption for RPTs that are entered into in the *ordinary course of business* and on an *arm's length basis*, it is important to consider this factor when determining whether an RPT is being carried out on fair and just terms. This would serve as a guidepost for the audit committee (and specifically the independent directors) when evaluating whether the RPT is conducted on standard terms and conditions that do not result in any disproportionate economic benefit for a related party. Specifically, it is vital for the audit committee to obtain adequate justifications from the management, that the pricing for the RPT is arrived at on an arm's length basis.

Further, while only the independent directors on the audit committee can vote to approve a proposed RPT, the non-executive directors (including investor nominees on the audit committee, if any) can continue to play an important role and act as a sounding board – by assessing the merits/ demerits of the RPT, seeking additional information and justifications from the management team, and also by recording a dissent note, if they are uncomfortable with proposed terms.

MATERIALITY THRESHOLD FOR SHAREHOLDERS' APPROVAL

SEBI has revised the materiality threshold for obtaining shareholder approval to cover transactions that exceed **INR 1000 crore or 10%** of the annual consolidated turnover of the listed entity (as per the latest audited financial statements), whichever is lower. Further, SEBI has also clarified that a prior approval of the shareholders will be required, and an *ex post facto* approval of the shareholders will not be permissible.

Given that the absolute numerical threshold does not distinguish between the size of the company, scale of operations and value of its consolidated turnover, this has resulted in a situation where inter-connected business transactions between group companies (such as transactions between the holding company and its subsidiary, or transactions between two subsidiaries of the listed company) come within the purview of shareholders' approval.

Now, many large listed companies are obtaining prior shareholder approval even for legitimate business transactions that facilitate synergies and economies of scale for the listed entity. This raises the question of whether the New RPT Regime also

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regulates transactions in which the listed entity has no actual or potential conflict of interest? Further, has a balance been achieved between ease of doing business, and providing shareholders with a greater say with regard to potential RPTs?

DISCLOSURE REQUIREMENTS

SEBI issued a circular on November 22, 2021, applicable with effect from April 1, 2022, prescribing disclosures to be made (i) while placing a proposed RPT before an audit committee for prior approval; and (ii) in the explanatory statement of the notice sent to the shareholders for prior approval of an RPT. Interestingly, one such disclosure relates to the "justification for why the proposed transaction is in the interest of the listed entity". Further, a consolidated disclosure of all RPTs is required to be made to the stock exchanges on a half-yearly basis.[4]

In light of the extensive range of disclosures to be made and the newly broadened definition of RPTs, companies are now required to disclose a much wider array of details with regard to proposed RPTs – which enables investors/ shareholders to examine the nature, material terms and conditions, pricing aspects, etc.

As is evident from the approval and disclosure requirements discussed above, the New RPT Regime has been framed keeping in mind the lowest common denominator. While the New RPT Regime may undoubtedly increase the burden on the compliance teams of India Inc, one must not lose sight of the fact that the range of approvals and disclosures required would in turn benefit institutional and financial investors, and act as an enabler in safeguarding their investments.

Listed Companies would be well-advised to strengthen and periodically monitor their internal processes and frameworks for identification and disclosure of related parties and RPTs, determination of arm's length pricing and monitoring whether the transactions are within applicable materiality limits.

While India Inc has its task cut out, it is quite clear that RPT regulation has been placed at the forefront of the regulators' battle for better corporate governance.

4. Regulation 23(9) of the LODR Regulations.

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07

DO THE **RIGHT THING**

CORPORATE FOCUS ON ESG

The ever-increasing global population and their insatiable hunger for resources created an unsolvable equation for a planet that has only limited resources. By following a culture of use-and-throw for generations, we have over-extracted and over-polluted the planet. According to the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services' (**IPBES**) Global Assessment Report 2019, three-quarters of the land-based environment and about 66 percent of the marine environment have been significantly altered by human actions. Of the estimated 1.7 million species, nearly 1 million are threatened with extinction. We have polluted the land, oceans, and atmosphere of the planet. The unsustainable nature of our development model was evident many decades ago. The term sustainable development came into being in the 1970s itself. In 1983, the UN set up the World Commission on Environment and Development (also called the Brundtland Commission, after the chair, Gro Harlem Brundtland) focusing on environmental and developmental problems and solutions. The Commission's 1987 report 'Our Common Future' defined sustainability as "meeting the needs of the present without compromising the ability of future generations to meet their own needs." This remains the most quoted definition of sustainability.

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By this time, there were enough examples of long-term damage to the environment and society by the short-term focus on profits by corporates. Corporate sustainability emerged as a mark of ethical corporate behavior, with the idea of balancing long term environmental and social benefits with profits.

Although Climate change found only a passing mention in the 1987 Brundtland Report, the following year, in 1988, the UN set up the Intergovernmental Panel on Climate Change (**IPCC**) to address the urgent need for scientific understanding of climate change. Since then, it has produced a series of reports on the impacts and solutions related to climate change with the aim of informing policy makers and the public worldwide. In 1992, at the Rio Earth Summit, the UN Framework Convention on Climate Change (**UNFCCC**) was born. By this time, there was sufficient proof of climate change and the warning that it is accelerating. In 2005, the Kyoto Protocol, the first global pact to fight climate change, came into force. After 2012, Kyoto Protocol died a natural death. In 2015, the UNFCCC adopted the second global pact to fight climate change, the Paris Agreement, which aims to limit global warming to well below 2 degrees Celsius.

In 2000, the UN announced its Millennium Development Goals, a set of eight principles focused on social and environmental concerns. In 2015, under the 2030 Agenda for Sustainable Development, the MDGs gave way to a set f 17 new and renewed goals called the Sustainable Development Goals. These included social, environmental, and economic principles, together providing a 'shared blueprint for peace and prosperity for people and the planet, now and into the future.'

Since 2015, sustainability has been running on the twin engines of the Paris Agreement and the UN SDGs. Sustainability was rechristened as ESG in a 2014 UNGC report titled 'Who Cares Wins – Connecting Financial Markets to a Changing World.' The Report, the result of a joint initiative by some of the largest global financial institutions and the UNGC, took the form of recommendations by the financial industry to better integrate environmental, social and governance issues in analysis, asset management and securities brokerage. The Report, for the first time, used the term ESG to represent Environmental, Social, and Governance (issues). Since then, the terms 'sustainability' and 'ESG' are used interchangeably, although they may not have the same meaning for everyone.

Despite the global disruptions and trauma of the pandemic, companies and investors accelerated their

Corporate sustainability emerged as a mark of ethical corporate behavior, with the idea of balancing long term environmental and social benefits with profits.

adoption of ESG principles during 2020 and 2021. Stakeholder awareness and scrutiny of corporate action, new regulations, and a deepening investor stewardship helped shape the EGS landscape post-pandemic. The UN Principles of Responsible Investing (**PRI**) saw significant jump in signatories during the pandemic years. BlackRock, Vanguard, and State Street, the world's three largest asset managers, committed to actively engage with their investee companies on ESG. The EU launched Taxonomy Regulations for sustainable activities and Sustainable Financial Disclosure Regulations (**SFDR**), while US SEC convened to discuss climate change disclosures in financial reports. Global climate commitments accelerated through the pandemic years and, by COP26 in Glasgow at the end of 2021, more than 130 countries covering more than 70 percent of global emissions were committed to net zero.

Year 2022 turned out to be a mixed bag. The Ukraine war has strained the energy security of many European nations. Europe has blinked its eyes on coal, oil, gas, and nuclear power. For the first time, ESG funds have taken a hit worse than the wider market. Oil companies across the world raked in record profits. A combination of these factors has given rise to an increasing anti-ESG sentiment, especially in the US. The proponents of anti-ESG or anti-woke capitalism argue that ESG factors are clouding asset managers' focus and that ESG rules are distracting them from their primary responsibility of delivering profits to investors. At the same time, ESG regulations continued to proliferate across the world, including in India. The EU notified the Corporate Sustainability Reporting Directive (**CSRD**), replacing and expanding the scope of the older Non-Financial Reporting Directive (**NFRD**). Climate action commitments continued to zoom during this period to cover 83 percent of global emissions and 91 percent of global GDP. A recent analysis of the world's largest publicly traded companies found that more than one-third have set net zero emission goals,

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representing a significant shift towards sustainability in the corporate sector. The year also witnessed high regulatory scrutiny over ‘green washing’, mostly by ESG funds, as well as rapidly increasing number of climate litigations.

Since 2015, India positioned itself as a climate leader; India announced its ambitious climate goals, including one of the most ambitious Nationally Determined Contributions (**NDCs**) to the Paris Agreement and a pledge to become Net Zero by 2070. India has embraced ESG through its large-scale social development programs aligned to the UN SDGs and commitment to renewable energy and green transition.

ESG Among India Inc.

Leading Indian corporates have been on their sustainability journey for over a decade. Today, some of them are among the global leaders in ESG. More than 40 Indian companies started voluntary disclosures on sustainability by 2010 or earlier. Today, of the 500 companies that are reporting as mandated by SEBI, more than 70 follow the reporting standard of the Global Reporting Initiative (**GRI**), a voluntary standard for ESG reporting. Seventy-four Indian companies have joined the Taskforce on Climate-related Financial Disclosures (**TCFD**) framework. Indian companies have stepped up their climate action in line with India’s NDCs and net zero goal - 121 Indian companies have already validated or are committed to Science Based Targets and 47 companies are committed to net zero.

Sustainable Finance in India

Sustainable finance includes ESG funds, green bonds, social bonds, green loans, and others. Indian corporates and institutions have raised a total of USD 18.1 billion in green bonds, as of 2021, including domestic and overseas. There are ten ESG funds active with a cumulative AUM of 10,452 Crore Rupees. In early 2023, GoI issued USD 2 billion worth of sovereign green bonds and SBI raised USD 1 billion ESG loan.

ESG FUNDS

10 ESG Funds that include one ETF, with a total AUM of INR 10452 Cr.

Name of Fund	AUM (In Cr. INR)
Aditya Birla Sun Life ESG Fund (G)	835.333
Axis ESG Equity Fund (G)	1537.181
ICICI Prudential ESG Fund (G)	1263.365
Invesco India ESG Equity Fund (G)	626.078
Kotak ESG Opportunities Fund (G)	1195.381
Mirae Asset Nifty 100 ESG Sector Leaders Fund of Fund (G)	123.691
Quant ESG Equity Fund	155
Quantum India ESG Equity Fund (G)	61.894
SBI Magnum Equity ESG Fund (G)	4509.484
Mirae Asset Nifty 100 ESG Sector Leaders ETF	145.16
Total	**10452.567**

ESG BONDS

Year	USD (Billions)
2015	1.2
2016	1.6
2017	4.3
2018	0.7
2019	3.1
2020	1.1
2021	6.1
2022	NA
2023 (India sovereign GB)	2
2023 (ESG loan)	1

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ESG Regulations in India

2009

Ministry of Corporate Affairs released the Corporate Social Responsibility Voluntary Guidelines

2011

Ministry of Corporate Affairs released the National Voluntary Guidelines (**NVGs**) on Social, Environmental, and Economic, Responsibilities of Businesses

2012

Stock Exchange Board of India (**SEBI**) mandated that a Business Responsibility Report (**BRR**) prepared in line with the NVGs be included in annual reports of the top 100 listed companies by market capitalisation

2013

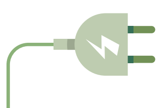
The Companies Act 2013 was the pioneer in embedding stakeholderism as a legal mandate, setting a global precedent by integrating stakeholder interests with corporate decision-making. Section 166(2) of the Companies Act, 2013, describes the duty of a director as “A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interest of the company, its employees, the shareholders, the community and for the protection of environment.”

2015

SEBI extended the BRR mandate to top 500 listed companies by market capitalisation

2019

Ministry of Corporate Affairs released the National Guidelines on Responsible Business Conduct (**NGRBC**)



2021

RBI Green Finance in India: The Progress and Challenge white paper

Securities Exchange Board of India (**SEBI**) mandated that (starting fin year 2022-23) Business Responsibility and Sustainability Report (**BRSR**) based on the NGRBC be included in the annual reports of the top 1000 listed companies by market capitalization, by amending regulation 34 (2) (f) of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015 (**LODR Regulations**).

2021

NCS Regulation 2(1)(q) defined green debt security as: "green debt security" means a debt security issued for raising funds that are to be utilized for project(s) and/or asset(s) falling under any of the following categories, subject to the conditions as may be specified by the Board from time to time:

i. Renewable and sustainable energy including wind, solar, bioenergy, other sources of energy which use clean technology,

ii. Clean transportation including mass/public transportation,

iii. Sustainable water management including clean and/or drinking water, water recycling,

iv. Climate change adaptation,

v. Energy efficiency including efficient and green buildings,

vi. Sustainable waste management including recycling, waste to energy, efficient disposal of wastage,

vii. Sustainable land use including sustainable forestry and agriculture, afforestation,

viii. Biodiversity conservation, or

ix. A category as may be specified by the Board, from time to time.

2022

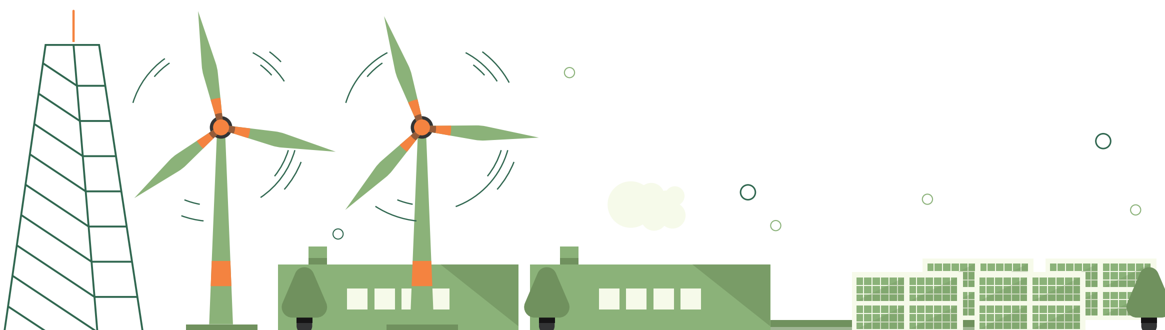
RBI released a 'Discussion Paper on Climate Risk and Sustainable Finance,' raising important questions on regulatory policy for climate change

2023

SEBI issued operational guidelines for Green Bonds – applicable to all issuances from April 1, 2023

SEBI issued a consultation paper on ESG disclosures, ratings, and investing

SEBI issued a consultation paper on regulatory framework for ESG Rating Providers (**ERPs**) in securities market



The Road Ahead

India presents the biggest ESG opportunity as well as challenge to the world. With the largest population in the world along with low per-capita income & energy consumption, severe environmental pollution & degradation, inequality, and poor wealth distribution - all reflective of a sub-optimal quality of life - India clearly represents the biggest growth opportunity of the century. As India's GDP grows, the country faces a huge challenge to make the growth equitable, inclusive, and low-carbon. As one of the most vulnerable countries to climate change, India needs to build resilience across its food, water, energy, and financial systems. In many ways, ESG is likely to play out in its full scale and potential in India.

Like many other jurisdictions, India also will see increasing regulatory push for detailed ESG disclosures. The disclosure details will continue to evolve and will incorporate new topics such as climate risk (as per the framework of the Taskforce on Climate-related Financial Disclosures or TCFD) and bio-diversity risks (as per the framework of the Taskforce on Nature-related Financial Disclosures or TNFD). With SEBI's focus on eliminating green washing by improving ESG disclosure scope and quality and enhancing reliability through third-party assurance, companies are likely to make BRSR their default ESG report. This will be further encouraged by SEBI's proposal to base ESG ratings of Indian companies on their BRSR disclosures.

It is widely accepted that green washing is rampant in the ESG space around the world, and India is no exception. Regulatory investigations and fines as well as lawsuits based on green washing allegations have been reported globally, signaling greater scrutiny of companies' environmental claims. Similarly, India has seen its fair share of climate litigations in a world where climate litigations, especially of the polluter-pays kind, have been steadily increasing. With ESG funds and sustainable finance set to play a bigger role in the Indian investment space in an era of mandatory disclosures and heightened scrutiny, activist organisations eying to set examples could be targeting Indian corporates.

Later in 2023, the world will see the first cross-border carbon tax come into force through the Carbon Border Adjustment Mechanism (**CBAM**) of the EU. That may be the beginning of a new era in global trade. While it may not impact all goods immediately, the writing is clearly on the wall for the future of world trade. The EU CBAM may lead to a carbon pricing mechanism in India, either in the form of a compliance carbon market or a carbon tax.

Company boards must navigate these new and emerging risks and realign their business strategies to succeed. In an era where stakeholders are expecting and demanding the boards to take a planet-friendly and people-friendly approach to business, the directors are clearly under the spotlight more than ever before. Cases filed by activist organisations, holding directors responsible for lack of appropriate action or inadequate action, are clearly driving that point home.

Half a century of globalisation has led to an unprecedented integration of supply chains across the world.. Today, supply chain disruptions caused by climate events and/or violation of human rights or labor rights are among the biggest risks facing companies. At the same time, the dependent-relationship and influence that big corporations have on their suppliers represent a big opportunity to drive ESG action such as emission reduction and renewable energy transition. ESG will become increasingly important to the SME sector because of supply chain focus. Realising this, SEBI has already proposed the inclusion of mandatory supply chain reporting for the top 250 listed companies by 2024-25.

Estimates show that India needs investments of more than USD 10 trillion by 2030 for its transition toward net zero. That translates to nearly USD 150 billion very year. Building climate resilience (climate adaptation measures) will require additional financing. A large portion of this investment is expected from outside. While India has accessed some investment through overseas green bonds, enhancing the flow of such capital requires structural alignment internally. A taxonomy framework customised to India, but largely aligned to the EU and other taxonomies is needed to channel global ESG finance to India. On the other hand, SEBI has already released a discussion paper on disclosure requirements and third-party assurance for ESG funds as well as investee companies.

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If ESG is woke today, it must be because it represents some real and serious risks to businesses and economies. In a world that is grappling with a grinding war, sticky inflation, and slow growth, ESG momentum may temporarily slip. However, the ecosystem participants, including corporates, investors, and regulators have crossed the point of no return on ESG transition. India is poised to quickly catch up with other leading geographies in ESG adoption, given the accelerated regulatory push to create a nuanced ESG culture.

Estimates show that India needs investments of more than USD 10 trillion by 2030 for its transition toward net zero

08

EVOLUTION OF THE **LABOUR REGIME**

A NEW LABOUR LAW REGIME IN INDIA

The past few years have been witness to the Indian legal landscape undergoing numerous changes – the labour law regime being no exception. We are witnessing evolving legislations and workforce engagement models, with increasing complexities and new intricacies resulting from such changes. Ranging from the now familiar Labour Codes that are sought to be introduced by the Government of India, the introduction of new laws to promote diversity and inclusion at workplace, the shift of the legislature towards ease of doing business for corporates, the inescapable spurt of hybrid working models, propelled by a global pandemic, the boom of the gig economy, to inevitable complications arising out of innovative engagement structures such as moonlighting, one cannot overlook the continual evolution of the labour law regime in India.

Through this article, we seek to provide readers with an insight into some of the significant themes and topical issues emerging from the changes to India's labour law landscape.

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Labour Codes – Paving the way for Harmonisation of Central Labour Legislations

One would be amiss to examine India's labour landscape evolution without considering the four landmark Labour Codes that have been passed by Parliament, namely: (a) the Code on Wages, 2019 (**Wages Code**), (b) the Occupational Safety, Health and Working Conditions Code, 2020 (**OSH Code**), (c) the Code on Social Security, 2020 (**SS Code**), and (d) the Industrial Relations Code, 2020 (**IR Code**, and collectively, the **Labour Codes**).

While these Labour Codes received Presidential assent in 2019-20, they are yet to be notified and come into force. Once notified, these Labour Codes will repeal and consolidate India's vast array of over 25 Central labour legislations, with far-reaching objectives to harmonise definitions and streamline compliances under the current labour laws.

One of the significant features of the Labour Codes is the harmonisation of definitions of key terms such as 'employer', 'employee', 'worker', 'wages' and 'appropriate government', which currently vary across the different extant laws, resulting in difficulties while assessing applicability and implementing the laws.

Notably, the newly proposed definition of the term 'wages', which has been made uniform across the Labour Codes, will have an impact on remuneration structures of employees, as well as their social security and terminal benefits – necessitating employers to review their compensation structures to ensure continued competitive advantage while being in compliance with the new laws.

Another noteworthy change, introduced under the OSH Code, is the introduction of a prohibition of engagement of contract labour in the core activities of an establishment. While at present, only few States have notified this prohibition, the Central OSH Code may impact an employer's ability to engage contract labour or outsource activities that qualify as 'core activities'. Having said that, the OSH Code provides some clarity on the ambit of who would constitute contract labour, as compared to the existing law, potentially providing employers the flexibility to have in place service provision arrangements to engage personnel who are regularly employed by a contractor, without attracting the realm of compliances associated with the engagement of contract labour.

"One of the significant features of the Labour Codes is the harmonisation of definitions of key terms such as 'employer', 'employee', 'worker', 'wages' and 'appropriate government'."

Another move under the Labour Codes towards protection of workers' interests is the statutory recognition of fixed-term employment under the IR Code and the SS Code, under which fixed-term employees will be entitled to parity in wages, working conditions, social security, gratuity and other benefits as provided to full-time employees, on a pro-rata basis.

Codifying the learnings from the COVID-19 pandemic, the Government has introduced a fascinating provision under the OSH Code and the SS Code, per which, in the event of a pandemic, the appropriate government is empowered to exempt workplaces from undertaking certain compliances, and also to allow deferment of social security contributions for certain prescribed periods.

Diversity, Equity and Inclusivity

The last few years have witnessed an increase in conversations around 'DEI', propelled by increasing global awareness and initiatives, efforts of advocacy groups and the explosion of social media. The Indian legislature and judiciary have not been far behind in sparking conversations around diverse, equitable and inclusive workplace, with employers across the industry being at the forefront of implementing measures to bring about a work environment that promotes DEI – which is essentially creating a work culture of respect and fairness, with policies and practices that promote representation, participation and opportunities to different groups of individuals, while respecting and celebrating their differences.

India has always strived towards equality between men and women, as encapsulated in the Equal

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Remuneration Act, 1976. This legislation requires equal pay for same work performed by men and women. In the past decade, the legislature has taken leaps in the DEI space – one landmark legislation passed in this regard was the Rights of Persons with Disabilities Act, 2016 (**Disabilities Act**). The Disabilities Act applies to both government companies as well as private companies. It aims to safeguard persons with disabilities from any form of discrimination in the workplace, and further provides safeguards and measures for inclusivity of persons with disabilities in the workplace. While the Disabilities Act regulates reservations for persons with disabilities in the government sector, the legislation prescribes a number of protections for persons with disabilities across the private sector as well, such as having in place suitable facilities and amenities for persons with disabilities, formulating an equal opportunity policy, etc.

More recently, the Government of India has also passed the Transgender Persons (Protection of Rights) Act, 2019 (**TP Act**), and notified a model policy for establishments in 2022 under the Human Immunodeficiency Virus and Acquired Immune Deficiency Syndrome (Prevention and Control) Act, 2017 (**HIV Act and Model Policy**). These legislations put in place a number of measures such as prohibiting discrimination in matters of employment, having in place an equal opportunity policy, appointment of grievance officers to look into any concerns, etc.

It is also pertinent to note the landmark Supreme Court (**SC**) decisions in *Navtej Sing Johar v. Union of India* (2018) and *Justice K.S. Puttasamy (Retd.) & Anr. v. Union of India & Ors.* (2017). In the former, the SC read down Section 377 of the Indian Penal Code, 1860, decriminalising consensual same-sex relationships between adults, giving an impetus to the rights of the LGBTQ community in India. In the latter, the SC recognised the fundamental right to privacy, recognising sexual orientation as an essential attribute of privacy. These judgments together signal a shift towards the recognition of the rights of individuals, based specifically on gender and sexual orientation. Following these judgements, many companies have started instituting various initiatives to support and include members of the LGBTQIA community into the mainstream, including by extending policies and practices to recognise their representation and rights in the workplace.

Building a workplace that is truly diverse, equitable and inclusive is no easy task in a nation like India. However, it is inspiring to see India Inc. stepping up to this opportunity, allowing various stakeholders, executives, policy experts, legal practitioners and activists to work together to pave the way for a truly DEI-centric work environment.

Changes in Workforce Engagement Models

It would be impossible to talk about the evolution of India's labour law landscape without considering the change in workforce engagement models across India Inc. In light of the COVID-19 pandemic in 2020, employers were compelled to adopt a work-from-home model that came with a vast array of operational, logistical and legal issues. From these necessary experiences, employers have now adopted sophisticated models, enabling them to implement flexible/ hybrid working models efficiently and effectively. The shift to flexible working models has allowed employers to tap into talent that may not have otherwise been available in a traditional work-from-office model, ensuring that the flow of services (to the business itself, their clients, customers, etc.) remained uninterrupted while also allowing employees flexibility and boosting work-life balance.

Another global labour revolution amid rapid urbanisation and the surge of platform-based services in logistics, ecommerce, food-tech, etc., is the rising popularity of the gig economy. The gig economy is a

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broad term used to describe working arrangements outside the traditional employer-employee relationship. Some classic examples of gig workers are delivery partners who work with aggregator companies such as Swiggy, Zomato, Dunzo, Zepto, etc. Simply put, the gig economy is a labour market, broadly comprising independent contractors and freelancers who are not tied down to the traditional model of permanent employment with a single employer.

While presently, gig economy does not enjoy codified recognition, the SS Code recognises gig and platforms workers. One of the most distinguishing features of the SS Code is perhaps the extension of a variety of social security benefits to gig and platform workers, who were until now outside the purview of the traditional employer-employee relationship and hence outside the purview of such Government recognition and related benefits. These benefits may be funded by contributions from the State and Central Governments as well as contributions in the range of 1-2% of the annual turnover of certain aggregators (which includes those involved in *inter alia* ride sharing services, food and grocery delivery services, content and media services, and e-marketplaces).

Moonlighting

The last quarter of 2022 saw numerous reports on the practice of 'moonlighting', particularly in the start-up and IT/ ITES space. Moonlighting is a colloquial term used to describe the practice of an employee working a second job, while continuing their primary job. Some companies have taken strict action against employees found to have engaged in moonlighting, while other organisations have shown that they are open to allowing employees work a second job within a clear framework.

The question on the legality of moonlighting, however, is worth considering, while balancing the feasibility of such arrangements. From an employment law perspective, dual employment attracts limited legislative recognition and while the term is not expressly defined under labour and employment legislations, certain laws such as the Factories Act, 1948, and some local shops and establishments acts impose restrictions on working hours in the context of dual employment, implicitly permitting the practice. Interestingly, judicial precedents, including of the SC from 1970, suggest that dual employment is permitted, subject to there being an enabling right to do so under the employment arrangement or with prior consent of the respective employers. This position is also reflected under the model standing orders prescribed under the Industrial Employment (Standing Orders) Act, 1946.

There are also practical and administrative challenges with permitting dual employment, such as with making social security contributions in respect of employees employed with more than one employer. Although, such challenges are irrelevant if one of the arrangements is not an employment relationship, such as where one of the dual arrangements is a consultancy arrangement, project, or gig-based assignment, etc.

Where an employer seeks to outright prohibit moonlighting, there are safeguards that can be put in place, such as, explicitly calling out that the entire employment/ engagement is on an exclusive basis, with any breach of the same amounting to misconduct. Such exclusivity covenants, which are in the nature of non-compete restrictions, that are operative during the term of employment/ engagement have been recognised as enforceable and legitimate under law.

On the other hand, where an employer intends to permit moonlighting to a defined extent, a more cautious approach would need to be adopted, with strict policies, practices, and contractual protections in place. This could include identifying and defining the roles/ departments where moonlighting may be permitted and those where it would be prohibited, detailing the process of engaging in the same (such as with prior consent, intimation, etc.), defining the contours of permitted moonlighting – including that such activities should in no manner breach confidentiality obligations or be detrimental to the employer's business.

That aside, it would be relevant and important for employers to consider the softer aspects of moonlighting, such as the impact on the organisation's culture, the capacity at which employees are able to perform their duties, etc.

In light of the recent spurt in hybrid and dynamic working models, it will be interesting to trace the industry trends in relation to permissibility of moonlighting on the one hand, and operationalising permitted/ regulated moonlighting on the other, especially in light of the change in expectations of the younger workforce.

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MOVE TOWARDS EASE OF DOING BUSINESS

Ease of compliance and ease of doing business in India appears to be one of the significant focal points of the recent policy decisions of the Government. The Labour Codes are no exception and capture the essence of this well. At the outset, the Labour Codes consolidate various registers and records that are required to be maintained by employers under different labour legislations. They also generally allow employers to maintain these registers/ records electronically as well as submit returns and file certain applications electronically, providing substantial relief to employers and reducing the procedural documentation requirements.

A key element introduced under the Labour Codes is the emphasis on ensuring compliance rather than penalising an employer. With this objective, the Labour Codes have introduced various measures, including provisions for appointment of an 'Inspector-cum-Facilitator' whose role is not just limited to inspection, but is widened to encompass supplying information and sensitising employers and workers to the provisions of the Labour Codes and compliance therewith.

Moreover, the Labour Codes have generally reduced the instances of criminalisation for non-compliances, in stark contrast to the extant laws, which prescribe imprisonment even for general/minor non-compliances. Simultaneously, there has been a significant increase in penalties for certain material offences, with non-compliances that are presently punishable with fines ranging from INR 500 to INR 5,000 being increased to INR 20,000 to INR 10,00,000 under the Labour Codes. Further, the Labour Codes also contemplate compounding of certain first offences either before or after an enquiry is held or prosecution is initiated, by paying 50% of the maximum penalty in case of a fine, and 75% of the maximum fine in case of an offence punishable with imprisonment as well.

In line with the emphasis on compliance, the Wages Code, OSH Code and SS Code also provide employers with an opportunity to rectify certain non-compliances under certain circumstances, prior to initiating any actions. In this regard, the appointed Inspector-cum-Facilitator must first issue a notice, providing an employer with an opportunity to rectify the non-compliance. Action can only be initiated if, on expiry of 30 days from such notice, the employer fails to comply with the notice. However, an employer is disqualified from availing such opportunity if it subsequently indulges in a similar violation within three years.

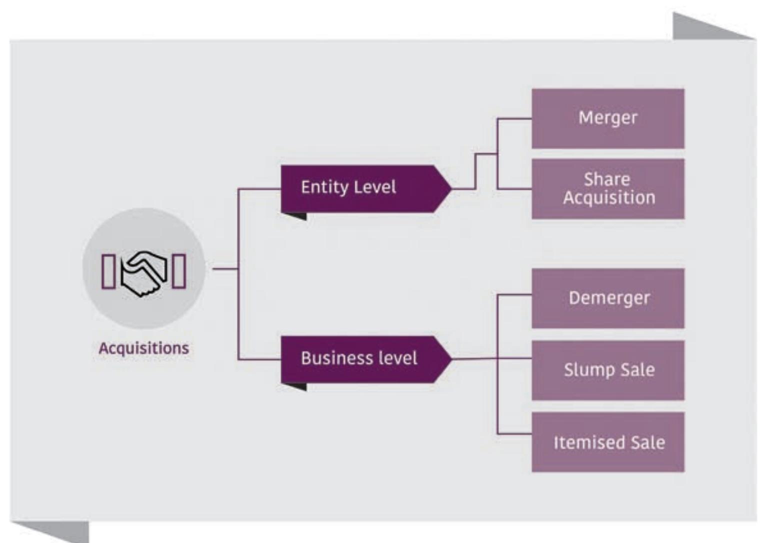
Conclusion

Most Indian labour legislations, despite being around for multiple decades, continue to challenge the industry time and again with the evolving social circumstances and sophistication of businesses. After a long hiatus, the Legislature appears to have shifted the spotlight back on employment legislations in the past decade. With increasing demands from the younger workforce, growing urbanised business needs, rising advocacy groups, influence of social norms and cultures, it is an exciting time for India Inc. to explore opportunities, with the growing talent pool in India.

09

Taxation of **Cross Border** Mergers & Acquisitions in India

Industries across the world want to get a slice of India's consumer market. This has resulted in foreign players wanting to establish operations in India. An easy and established method of entering any market is through mergers and acquisitions – be it between two parties within India or through a cross border transaction involving one or more non-residents. In this article, we have focused on tax considerations involved in the various modes of cross-border M&A transactions.



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Merger

A merger is a Court driven process, prescribed under corporate law, that combines one or more companies, with the aim of uniting business resources and attaining synergies. It is represented in the Indian tax legislation as amalgamation and is defined and provides that all assets and liabilities of the amalgamating company should become assets and liabilities of the amalgamated company. Some of the practical considerations to be kept in mind are:

- To avail tax neutrality in case of a merger between a foreign and an Indian company, the merged entity must be an Indian company.
- Non-satisfaction of the prescribed conditions may result in the said transaction being subject to capital gains tax, or may even face expiry of carried forward loss, etc.
- Depreciation may not be available on goodwill

It is pertinent to note that even if the Courts accord their approval for amalgamation of companies, Indian tax authorities are still authorised to verify whether the conditions specified under the Indian tax laws are being met.

In addition to a regular merger between two or more Indian companies, it is also possible for mergers to have an offshore element. A merger with an offshore element may either be an offshore merger or an inbound merger, as discussed in the following paragraphs.

OFFSHORE MERGER

When two foreign companies merge, leading to the transfer of shares of an Indian company, capital gains arising on such transfer of shares of the Indian company shall not be subject to capital gains tax in India if such transaction does not trigger capital gains tax in the country in which the amalgamating company is incorporated and at least 25% of the shareholders of the company proposed to be merged with the merged company become shareholders of the merged foreign company.

INBOUND MERGER

No exemption is available when an Indian company merges with a foreign company. The capital gains arising from the transfer of capital assets of an Indian company could be subject to capital gains tax in the hands of such company. Additionally, shareholders of the Indian company may also be subject to capital gains tax on receipt of shares of the resulting foreign company upon merger with the Indian company, in exchange for their shares in the Indian company. The transaction should also be undertaken at Fair Market Value (**FMV**) so that anti-abuse provisions are not triggered.

Another aspect that needs to be considered in such cases is the risk of creation of a permanent establishment (**PE**) or a place of effective management (**POEM**) of the merged foreign company in India.

PE is generally described in the double taxation avoidance agreements (**DTAAs**) executed between India and the corresponding foreign countries to deal with taxation on income emanating from another country for an entity. A PE could be constituted if the resident of one country has a fixed place of business like a branch office or a service PE in another country. Thus, after amalgamation, if the merged company continues to work in the other country in a similar manner, then it may constitute a PE.

In case a PE is constituted, the profits of the foreign company, which are attributable to the operations carried out in India, are subject to taxes in India.

POEM has been defined under the Indian tax laws to mean the place where key managerial and commercial decisions of a company are taken. Ordinarily, in case of an inbound merger, it may not result in a foreign company having its POEM in India since the key managerial personnel of the merged foreign company are likely to be situated/ based outside India. However, it is possible if the foreign company was earlier managed by Indian managers or Indian shareholders prior to the merger and the situation continues to remain the same post the merger.

If the POEM of the foreign company is held to be in India, the foreign merged company would be considered as a company resident in India for tax purposes and would be subject to tax in India on its global income.

Demerger

A demerger is also a Court driven process prescribed under the Indian corporate law, which is utilised to streamline the business by transferring the identified business from the demerged company to a resulting company. In case of a demerger, capital gains arising on transfer of shares/ capital assets by the demerged company into the resulting company shall not be

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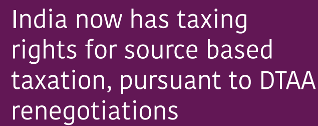

chargeable to tax in India, subject to the satisfaction of the conditions prescribed therein.

For the demerger of a foreign company with an Indian company, one of the mandatory conditions for tax-neutrality is that the demerged company should be an Indian company. If the prescribed conditions are not satisfied, then capital gains earned from the transfer shall be subject to capital gains tax. Carried forward losses may get expired in case the prescribed conditions are not met.

Just like amalgamation, even if the Courts approve the scheme of demerger, Indian tax authorities may still be entitled to verify whether the conditions prescribed under the Indian tax laws have been satisfied or not.

IMPACT OF AN OFFSHORE DEMERGER

As against a domestic demerger involving Indian entities, in case of a demerger of two foreign companies leading to the transfer of shares of an Indian company, capital gains arising on such transfer may not be subject to capital gains tax in India if the transaction does not trigger capital gains tax in the country in which the demerged company is incorporated and at least 75% in value of shareholders of the demerged foreign company continue to remain shareholders of the resulting foreign company.

> “Analysis of the applicability of GAAR provisions is imperative since the consequences of default are rigorous.”

Share Acquisition

When a non-resident entity transfers shares, interest or other securities held in an Indian company or LLP as capital assets, since the shares, etc., are capital assets situated in India, any gains arising on such transfer are taxable in India in the hands of the non-resident sellers. Capital gains are calculated

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by reducing the cost of acquisition and expenses directly connected with the transfer from the sale consideration. The rate of tax varies from 10% to 40%, depending on the type of security being transferred, constitution and residential status of the transferor and the period for which the security was held before such transfer.

If the seller is a tax-resident of a country with which India has entered into a DTAA, the seller may claim the beneficial provisions provided under the DTAA, if any. It is important to note that India had favorable DTAAs in the past, which had exempted tax on capital gains earned by non-residents (i.e. tax residents of countries like Singapore, Mauritius, Cyprus) from the sale of shares. However, pursuant to the renegotiations of the DTAAs, the said DTAAs have been revised to give taxing rights to India for source-based taxation and hence, there are no beneficial provisions available henceforth in the DTAAs (except for Netherlands, which gives exemptions under specified circumstances) for shares acquired on or after April 1, 2017.

It is also pertinent to note that under Indian tax laws, any person who makes any payment to a non-resident that is chargeable to tax in India, is obliged to withhold taxes payable on such transaction by such non-resident in India. These obligations include withholding the taxes and depositing it on behalf of the non-resident seller with the Indian treasury, filing of withholding tax returns and issuance of withholding tax certificates by the purchaser, while the non-resident seller shall be required to file tax returns in the event capital gains has been earned, which is liable to tax in India.

Further, there are certain anti-abuse provisions for both the seller as well as the purchaser to ensure that no undervaluation of shares/ other securities take place and that the transaction is undertaken at FMV. The manner of determination of FMV is prescribed in the rules.

INDIRECT TRANSFERS

Share acquisition may not always take place for Indian entities. In case the shares/ interest of an Indian entity are not transferred directly, but the shares/ interest of an intermediary foreign holding entity are transferred, then the Indian tax laws prescribe that such capital assets may be deemed to be situated in India and capital gains on the transfer may be taxable in India in case the shares of such intermediary foreign holding entity derive its substantial value from the assets located in India. However, capital gains taxes on such indirect transfer of shares shall only arise if the following two conditions are satisfied:

i. The value of such Indian assets exceeds INR 100 million; and;

ii. The Indian assets represent at least 50% of the value of all assets owned by the intermediate foreign holding entity.

Further, certain exemptions are provided to small shareholders (holding 5% or less of voting power/ interest/ share capital in Indian assets/ company) and certain foreign portfolio investors. Also, offshore amalgamations and demergers, which attract indirect transfer provisions, have been exempted, provided certain conditions are satisfied.

The method of valuation of shares/ interest of foreign and Indian entity are prescribed in the rules and need to be supplemented by a valuation report to be obtained from a prescribed valuer.

The manner of determination of FMV is prescribed in the rules.

Anti-abuse provision is included in slump sale taxation

Slump Sale

Slump sale is the sale of a business undertaking on a going concern basis for a lumpsum consideration without assigning individual values to the assets and liabilities. This method of transfer is useful since it is quicker, without any involvement of the Court and enables the whole business undertaking to be transferred. It is, however, important for the constituents of transfer to qualify as a business undertaking having business activity and not a mere collection of assets and liabilities. It may be possible to exclude certain assets and liabilities from slump sale, provided the undertaking test is satisfied. However, cherry picking of assets or liabilities is not allowed.

Business undertaking is regarded as a capital asset and thus, gains earned from the sale of an undertaking is taxed as capital gains. The manner of taxing gains arising from sale of business undertaking through a slump sale is specifically provided in the rules.

An amendment was introduced in 2021, according to which, an undertaking should be valued at least at FMV, or else, for the purposes of computing capital gains arising on slump sale, it will be assumed as if the transferor entity has transferred the undertaking at FMV. Accordingly, in case the business undertaking includes land, building, shares, securities, etc., being transferred as part of slump sale, the same will have to be valued at least at FMV. With this amendment, the anti-abuse provision has been included in slump sale taxation. The net worth of the undertaking shall be assumed to be at its cost for computing capital gains and any self-generated goodwill cannot be considered as an asset. Depreciation will also not be allowed on acquired goodwill.

According to the Indian foreign direct investment policies and regulations, a non-resident will not be allowed to acquire a business undertaking in India without establishing a legally permissible entity. However, it may be possible for a non-resident entity to set up an Indian entity or a branch office (after obtaining the requisite regulatory approvals), which can then acquire the desired business through slump sale.

Itemised Sale

An itemised sale is the sale of independently identifiable assets and liabilities. Hence, cherry picking of assets and liabilities of the business is permitted. There is no need to transfer the liabilities alongside assets in case of an asset sale. Certain assets such as land and shares need to be sold at least at their FMV. To compute the gain on itemised sale of assets, sale consideration is to be reduced by WDV (for depreciable assets) or book value (for other assets).

Just like slump sale, a non-resident entity will not be allowed to acquire identified assets and liabilities in India, without establishing a legally permissible form of entity. However, it may be possible for a non-resident entity to set up an Indian entity or a branch office (after obtaining the requisite regulatory approvals), which can then acquire the desired assets and liabilities through itemized purchase.

Important point to ponder: General Anti-Avoidance Rules (GAAR) implications

The analysis of the applicability of GAAR provisions is imperative since the consequences of default are rigorous. The GAAR provisions operate independent of any other provisions in the Indian tax laws and provide that any arrangement entered into by a taxpayer, or its step or part, may be held by the Indian tax authorities as an impermissible avoidance arrangement, if its main purpose is to obtain tax benefit and if it meets at least one of the following four conditions:

i. it creates rights, obligations that are not normally created between parties dealing at arm's length

ii. it either results in misuse or abuse of provisions of Indian tax laws

iii. it lacks or is deemed to lack commercial substance, wholly or partly

iv. it is carried out in a manner that is not ordinarily employed for bonafide purposes.

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If the above conditions are not met, the consequences could range from disregarding or combining or recharacterising of the transaction or any of its steps; reallocation of any receipt (of capital or revenue nature) or expenditure; denial of the DTAA benefits; looking through the arrangement by disregarding the corporate structure, etc.

Before initiating any tax proceedings, the tax officer needs to get internal approval from the Principal Commissioner of Income Tax to avoid any frivolous allegations against the taxpayer and abuse of power by the tax officers. Similarly, the taxpayer is also required to prove that no tax benefit has accrued to it in relation to a particular transaction or arrangement. Thus, before entering into any transaction, parties must undertake GAAR analysis to ensure that tax benefit is not the main objective behind any transaction and additional commercial rationale or other reasons are there which may serve as additional safeguards for the taxpayers.

Conclusion

Having regard to the myriad consequences under GAAR and the risk of the denial of tax treaty benefits, it is vital that the transactions and arrangements, including any structuring thereto, pass the smell test under GAAR and a proper evaluation of pros and cons and commercial justification for the structuring of the transaction is carried out to avoid the rigours of GAAR. Further, the bilateral tax treaty network is also undergoing change in light of MLI and various tax treaties that have been renegotiated, requiring careful consideration of the impact of the applicable tax treaty. In transactions relating to global deals involving Indian assets, one would need to undertake a specific exercise to identify Indian tax issues relating to aspects such as adjustment of the sale consideration outside India, taxability of earn out payments or deferred consideration, applicability of transfer pricing, Indian withholding tax obligations etc. It would be advisable to seek a comprehensive advice on the transaction as a whole, ideally during the planning stages, to avoid any surprises from an Indian tax perspective.

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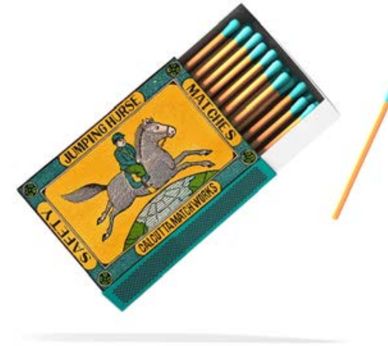
10

A DECADE OF **MERGER CONTROL** REGIME IN INDIA



Indian Antitrust Regime is Pivoting

India’s antitrust regime is rapidly adapting to the evolving economic landscape, business dynamics and the unprecedented digital transformation to protect markets, its participants as well as consumers.

This piece brings perspective to the recent amendments to the Indian merger control and enforcement regime, along with an update on India’s plans to introduce a separate rule-based ex-ante antitrust framework to deal with the challenges emerging from the digital economy.

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Key changes to the Indian Antitrust Regime

India at long last amended its competition law through the Competition (Amendment) Act, 2023 (**Amendment(s)**) recently, ushering in significant changes to the current law, i.e., Competition Act, 2002 (**Competition Act**). The lead-up to this milestone was almost five years in the making.

The Amendment aims to streamline legal provisions, taking into account the learnings and insights of the Competition Commission of India's (**CCI**) decade-long experience. The Amendment is a product of extensive deliberations of the Competition Law Review Committee (**CLRC**), the Parliamentary Standing Committee on Finance (*Parliamentary Committee*), and inputs from various stakeholders.

The Amendment will take effect once the Government of India issues specific notifications to notify its various provisions in the official gazette, possibly in a phased manner. Some of the amendments require further clarifications through regulations issued by the CCI, and are likely to be enforced after such regulations are issued by the CCI. This process is expected to be completed in the next few months.

MERGER CONTROL

INTRODUCTION OF AN ADDITIONAL 'DEAL VALUE' BASED MERGER FILING THRESHOLD

The Amendment has introduced a deal-value threshold (**DVT**) for assessing the CCI notification requirement *vis-à-vis* M&A deals. This threshold is based on value/size/consideration of a transaction and is in addition to the existing thresholds that are based on the asset and turnover of transacting parties.

The DVT will trigger a notification to the CCI in cases where:

- The value of a transaction (i.e., acquisition of any control, shares, voting rights or assets of an enterprise, merger or amalgamation) exceeds INR 20 billion (c. USD 240 million / EUR 220 million / GBP 195 million / JPY 32 billion); and
- The target enterprise in question has "*substantial business operations in India*".

The "*value of transaction*" includes every valuable consideration, whether direct or indirect or deferred. The CCI will issue regulations to determine the scope of "*substantial business operations*" of the target in India.

The *de minimis* or small target exemption (which is an absolute objective exemption available to transactions where the asset value in India does not exceed INR 3.5 billion (c. USD 43 million / EUR 39 million / GBP 34 million / JPY 6 billion) or the revenue from India does not exceed INR 10 billion (c. USD 120 million / EUR 110 million / GBP 100 million / JPY 16 billion)) will not apply where the DVT is breached. However, it remains unclear whether other exemptions under Schedule I of the CCI's combination regulations would continue to apply where the DVT is breached.

OPEN ISSUES

The Amendments states that the CCI would frame regulations clarifying how the DVT would operate, including determining "*substantial business operations in India*". Some of the interpretational questions that the CCI will need to clarify are: (i) if it is the global transaction value (as opposed to India-specific transaction value) that would be considered; (ii) in case of a fundraising round with multiple investors, would the transaction value be determined basis the investment amount of each investor, or the total size of the investment round; (iii) how will transactions that contemplate post-closing adjustments in the consideration value be dealt with; and (iv) what would constitute "*value of transaction*" in cases where the value includes non-monetary consideration (such as long term preferential contractual relationships in the nature of supply or marketing agreements, payment of royalties in return for sharing IP/tech/know-how transfer, etc.).

Whilst the CCI may be able to pre-empt some of these queries and address them in its regulations, many of these issues are likely to be clarified through the Indian competition authority's decisional practice once the law comes into force. It is also likely that the regulations and clarifications issued by the CCI are similar in first principles to the guidelines for the calculation of DVT in jurisdictions such as Germany and Austria.

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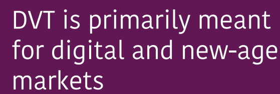

Text of the Amendment does not restrict the application of DVT to any specific sector.

DVT IS SECTOR AGNOSTIC

The Ministry of Corporate Affairs, in its submissions before the Parliamentary Committee, had clarified that DVT is primarily meant for digital and new-age markets, where the target entities may have minimal assets and turnover, but may possess significant potential in terms of data, technology, innovation, etc. However, the text of the Amendment does not restrict the application of DVT to any specific sector. In Austria and Germany (where deal value/transaction size thresholds have been implemented), regulators have received notifications across pharma, real estate, and other sectors. Stakeholders in India have argued that such blanket application of DVT could increase the administrative burden for the CCI, and transaction costs for parties.

ALIGNING THE DEFINITION OF 'CONTROL' WITH DECISIONAL PRACTICE

The definition of 'control' under the Competition Act holds great relevance in determining whether a transaction is notifiable and for its substantive assessment by the CCI. However, the current definition of control is circular and vague (as it merely refers to '*control over affairs and management of an enterprise or group*') and does not specify the type of rights that could potentially confer control over an enterprise.

Over the years, the CCI has interpreted 'control' to include 'material influence' (*which is considered to be the lowest degree of control*). Whether an entity exercises material influence is a question of fact, determined basis an investor's board representation, special rights that it can exercise, etc. The Amendment replaces the existing definition of control, giving statutory recognition to this 'material influence' standard.

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While the new definition aligns the Competition Act with the CCI's decisional practice, it does not provide certainty as to when an entity is said to have 'material influence'. In line with CLRC's recommendations, the CCI could soon introduce regulations identifying a limited set of rights that would amount to 'material influence' (although this is likely not a priority for the CCI).

ALLOWING POST-ACQUISITION FILINGS FOR TIME-SENSITIVE MARKET PURCHASES ON STOCK EXCHANGES

In case of notifiable transactions, the Competition Act does not allow parties to acquire shares or securities (including those listed on stock exchanges) or pay any consideration, without prior approval of the CCI. This 'standstill' obligation has impeded open market purchases over stock exchanges, given price sensitivity and confidentiality concerns in such transactions (especially in case of block and bulk deals, and hostile takeovers). Incidentally, in certain early cases in the past, the CCI had penalised entities for 'jumping the gun' and completing open market purchases without obtaining its approval.

The Amendment introduces long awaited and much-needed derogation mechanisms allowing acquirers of listed securities to notify the CCI of open market purchases *after* completing such transactions on stock exchange within a prescribed time period. However, the acquirer must not exercise any ownership, beneficial rights or interest in the target entity until CCI's approval is received.

The CCI, through its regulations, is expected to lend further clarity to this much-needed exemption.

SHORTER APPROVAL TIMELINES

The Amendment has reduced the CCI's review / approval timelines significantly.

- **Phase I / *prima facie* approval**: The Amendment states that if the CCI does not form its *prima facie* opinion (Phase I review) within 30 calendar days, then the transaction shall be deemed to have been approved. At present, a transaction is deemed to be approved if it does not receive final approval within the outer time limit of 210 calendar days.

- **Phase II / *cases requiring in-depth inquiry***: The outer time limit for final approval (for complex cases including those that may move to a Phase II review) has been reduced from 210 days to 150 days. To account for this compressed timeline, corresponding reductions have been made in the time available for each step in the review process.

The CCI will issue regulations to determine the scope of "substantial business operations" of the target in India.

The Amendment aims to provide deal certainty and expedite the approval process. However, it is likely to prolong timelines and increase uncertainty. The CCI's case officers are expected to prepare detailed reports during their review. Given the truncated timelines, it is probable that overburdened case officers will issue more requests for information (**RFIs**) from parties to 'stop the clock' and buy time. This would, in turn, add to the burden of parties and may also result in some filings being invalidated, in situations where the parties need more time to respond to RFIs or in complex fact scenarios.

It would be advisable for parties to opt for the CCI's informal consultation process before filing notifications, as it would give case officers additional time to examine the parties' submissions before the statutory timeline begins. They should agree on well thought-out long-stop dates and antitrust risk shifting provisions, taking into account potential delays in obtaining merger control approval in India.

CLARIFICATION ON CALCULATION OF 'TURNOVER' FOR MERGER FILING ASSESSMENT

Turnover is a key criterion for determining the applicability of the *de minimis* exemption and the jurisdictional thresholds. The Competition Act provides a very limited definition of turnover, i.e., "*value of sale of goods or services*". Basis the CCI's precedents and its FAQs, turnover is interpreted as the value of revenue from operations and includes export income and intra-group sales, (which can be excluded only in certain limited circumstances).

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The Amendment states that turnover in India shall be determined by excluding intra-group sales, indirect taxes, trade discounts and all amounts generated through assets or customers located outside India. In essence, turnover in India will purely focus on sales made to third parties in India. It remains to be seen how the CCI interprets 'turnover' since the proposed definition is at variance with some of its decisional practice.

POTENTIALLY HIGHER PENALTIES FOR GUN-JUMPING AND INCOMPLETE DISCLOSURES / MATERIAL OMISSIONS

The maximum penalty that could be imposed for gun-jumping will now be the higher of 1% of the total turnover or assets of the parties as well as the transaction value. Further, withholding information and providing false information in merger assessment now could cost up to INR 50 million (approx. USD 600,000 / EUR 550,000 / GBP 500,000 / JPY 80 million).

ENFORCEMENT

COMMITMENT AND SETTLEMENT MECHANISM

Aligning the Competition Act with developed competition regimes such as the European Union, the United Kingdom and Singapore, the Amendment introduces a mechanism for 'settlement' and 'commitment', allowing parties under investigation (for an abuse of dominant position or anti-competitive vertical restraints) to offer commitments or settle the matter with the CCI. A party may opt to offer commitments to close an investigation any time after the commencement of the investigation, but before the Office of Director General (**DG**) completes its investigation and shares the investigation report with parties. Whereas a party may opt to settle the matter with the CCI any time after the DG has shared the findings of its investigation with parties, but before the CCI passes its final order in the matter.

While settlement and commitment agreements may include behavioural, structural or hybrid changes (such as changes to parties' contracts with their customers / suppliers), a settlement agreement may additionally involve payment of a settlement amount. Parties will have the opportunity to negotiate the terms of settlement / commitment agreements with the CCI.

Contrary to the recommendation of the Parliamentary Committee, the Amendment makes it compulsory for the CCI to consider the objections / suggestions raised by third parties (in addition to the DG) while deciding on settlement/commitment proposals. This makes the entire process as contentious as ordinary proceedings before the CCI!

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Parties considering a plea for settlement should be mindful of the possibility of follow-on claims for damages, as that has been allowed under the Amendment.

COMPUTATION OF PENALTIES BASIS 'GLOBAL' TURNOVER

This change has come as a surprise to all – the Amendment expands the scope of turnover in the context of penalties that may be imposed for anti-competitive agreements and abuse of dominance to global turnover derived from all products and services provided by a person or an enterprise. Notably, this change neither featured in the original amendment bill of 2022, nor was examined by the Parliamentary Committee.

This move undoes the Supreme Court's seminal decision in *Excel Crop Care (AIR 2017 SC 2734)*, where it reasoned that the CCI must be guided by the principle of proportionality while imposing penalty. At present, 'relevant turnover' is calculated pertaining to the affected products and services market in India as a result of an anti-competitive conduct. Post *Excel Crop Care*, in most cases (though not all), the CCI has imposed penalties based on 'relevant turnover'.

From a business' point of view, the consideration of global turnover may lead to punitive outcomes. There are two far reaching implications for business of this change: (a) the CCI could theoretically penalise the infringing party's income / turnover from products and services not covered under its anti-competitive conduct; and (b) companies with a global presence may be penalised more than companies present largely in India, signalling potential protectionism. For instance, for export-oriented companies, should the turnover from other jurisdictions be relevant for the imposition of penalty?

The CCI may address these concerns through the statutorily mandated penalty guidelines that will be framed in due course (though we don't expect this to be an immediate priority for the CCI), which may possibly draw inspiration from the fining practices / penalty guidelines of developed competition law jurisdictions. Only time will tell whether this expansive provision will hold up in judicial scrutiny against the proportionality principle promulgated by the Supreme Court.

CAPTURING 'HUB AND SPOKE' CARTELS

The Amendment specifically recognises 'hub and spoke' cartels. This provision aims to capture collusive anti-competitive agreements between parties which are not engaged in the same or similar businesses, such as a facilitator, platform, intermediary, or an agent (i.e., the 'hub') on one hand, and one or more competitors (i.e., the 'spokes') on the other hand.

Despite objection from stakeholders, the wording in the Amendment allows 'hubs' to be investigated for either participation or an intention to participate in a cartel. It, however, remains unclear from the Amendment whether or not the 'hub' will be eligible for leniency.

SUMMONING AND DEPOSING LEGAL ADVISORS

The original amendment bill of 2022 included a provision that empowered the DG to summon and depose, on oath, 'legal advisors' of parties under investigation (which was read as covering even external counsels). The Parliamentary Committee, concurring with the widespread criticism that this provision evoked, suggested that this provision was contrary to the concept of attorney-client privilege encapsulated under the Indian Evidence Act, 1872 and the Bar Council of India Rules. The Amendment has now limited the scope of this provision to 'persons employed as legal advisors' by parties under investigation. In the absence of any clarity as of now, this change is being read as covering only in-house legal advisors 'employed' by a party under investigation, who may be investigated / summoned / deposed by the CCI / DG going forward.

APPEAL AGAINST CCI'S ORDER SET TO BECOME AN EXPENSIVE AFFAIRS

The Amendment requires parties intending to appeal an order (including a penalty) of the CCI before the appellate tribunal, the NCLAT to mandatorily deposit 25% of the penalty imposed. Under the prevailing regime, the deposit amount is not specified. However, as a matter of practice, the NCLAT (at its discretion) directs parties to deposit 10% of the penalty amount, and in certain cases, has ordered larger deposits of 25% by parties.

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The Proposal to introduce an Ex-ante Framework to Regulate Digital Markets

In addition to the amendments to the Competition Act (some of which are intended to address the supposed gaps in the CCI's existing toolkit for regulating digital businesses), the Parliamentary Committee through a report '*Anti-competitive Practices by Big-tech Companies*' has suggested a separate ex-ante framework to regulate 'Systemically Important Digital Intermediaries' (**SIDIs**) under a new Digital Competition Act (**DCA**).

The Parliamentary Committee has identified 10 types of anti-competitive practices that need to be addressed. These are *anti-steering practices, self-preferencing / platform neutrality, bundling and tying, data usage, mergers and acquisitions, deep discounting, exclusive tie-ups, search and ranking, restrictions on third-party applications and advertising policies.*

The Parliamentary Committee has also suggested that a specialised Digital Market Unit should be established within the CCI, enabling it to monitor SIDIs and provide recommendations to the government on designating SIDIs, review SIDI compliances and adjudicate on digital market cases. This digital unit will be staffed by experienced tech-experts, academicians and attorneys.

The Parliamentary Committee seems to be inspired by the *ex-ante* framework introduced in jurisdictions, such as the European Union's Digital Markets Act, American Innovation and Choice Online Act, German Competition Act and laws among others. In other countries, such as Japan and South Korea, there is little or no evidence yet if *ex-ante* regulations would be suitable to regulate digital markets effectively.

A 16-member inter-ministerial committee constituted by the Government of India is currently in the process of assessing the need for a separate law on competition in digital markets. Consultations with stakeholders are currently ongoing, but the initial impressions seem to suggest that a new *ex-ante* competition law regulating SIDIs is a *fait accompli* and businesses should start thinking about the emerging compliance requirements that could come-up in the near future.

The DCA would usher in a new era of rules for digital businesses, online ecosystems and intermediaries, considered to be SIDIs, marking a significant departure from the current sector-agnostic framework.

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CONTRIBUTORS

Editors

Smruti Shah

Jhini Phira

Devika Ghosh

Authors

Aditya Mehta

Ajay Sawhney

Anu Tiwari

Avaantika Kakkar

Bharat Vasani

Bishen Jeswant

Indranil Deshmukh

Kirthi Srinivas

Kunal Savani

Mudit Shah

Pallavi Rao

Rashmi Pradeep

Ravi Shah

SR Patnaik

Vijay Chauhan

Bose Varghese

Krithika Radhakrishnan

Reema Arya

Agneya Gopinath

Ragini Agarwal

Varun Kannan

Vivien Tulzapurkar

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www.cyrilshroff.com
www.cyrilshroff.com/blogs

mumbai

Peninsula Chambers, Peninsula Corporate Park, GK Marg,
Lower Parel, Mumbai – 400 013, India
T +91 22 2496 4455 F +91 22 2496 3666
E cam.mumbai@cyrilshroff.com

delhi-ncr

Level 1 & 2, Max Towers, C-001/A, Sector 16 B,
Noida – 201 301, Uttar Pradesh, India
T +91 120 669 9000 F +91 120 669 9009
E cam.delhi@cyrilshroff.com

ahmedabad

Block A-1512, 15th Floor, Navratna Corporate Park,
Ambli Bopal Road, Bodakdev, Ahmedabad – 380 058, India
T +91 79 3503 9999
E cam.ahmedabad@cyrilshroff.com

bengaluru

3rd Floor, Prestige Falcon Tower, 19, Brunton Road,
Off M G Road, Bengaluru – 560 025, India
T +91 80 6792 2000 F +91 80 2558 4266
E cam.bengaluru@cyrilshroff.com

presence also in hyderabad, chennai, gift city and singapore

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