

COVID-19 crisis inspires global tightening of Foreign Investment Screening

India

Foreign investment in India is governed by the Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder from time to time (“FEMA”) including the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (as amended from time to time), issued under FEMA (the “NDI Rules”). Accordingly, all Indian persons (including Indian companies) either looking to receive foreign investment or having foreign investment are required to comply with these laws and regulations including entry route norms, sectoral caps, investment limits and pricing guidelines, as applicable.

The Government of India has recently reviewed its foreign investment regime with the objective of curbing opportunistic takeovers and acquisitions of Indian companies due to the current COVID 19 pandemic. On April 17, 2020, the Ministry of Commerce, Government of India issued Press Note 3 (2020 Series) (“**PN 3/20**”) to amend the extant Foreign Direct Investment Policy (“**FDI Policy**”). The concomitant amendments made to the NDI Rules (“**NDI Amendment Rules**”) pursuant to PN 3/20 came into effect from April 22, 2020.

The foreign direct investment laws in India as they stood prior to the NDI Amendment Rules, provided that a person being a citizen of Bangladesh or Pakistan or being an entity incorporated in Bangladesh or Pakistan cannot invest in an Indian company without the prior approval of the Government of India. Further, any citizen of Pakistan or an entity incorporated in Pakistan is not permitted to invest in defense, space, atomic energy and sectors or activities prohibited for foreign investment at all. The NDI Amendment Rules read with PN 3/20 expand the scope of these restrictions briefly summarized below:

- An entity of a country sharing land border with India or the beneficial owner of an investment into India who is situated in or is a citizen of any such country, shall invest in an entity in India only with the prior approval of the Government of India.
- In the event of the transfer of ownership of any existing or future foreign investment in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the above restriction, such subsequent change in beneficial ownership shall also require prior approval of the Government of India.

Consequently, investments from countries like China, Nepal, Myanmar, Bhutan and Afghanistan, in addition to Bangladesh and Pakistan (countries that share land border with India) in India, would also now be subject to the prior approval of the Government of India. Further, the use of the expression ‘directly or indirectly’ in PN 3/20 and the NDI Amendment Rules also implies that an overseas acquisition of an entity by an investor from any of the aforesaid countries, which, upon completion, will result in an indirect acquisition/change in shareholding resulting in acquisition of beneficial interest of an Indian company, will be covered within the ambit of the amendments and such transaction will require the prior approval of the Government of India.

Accordingly, there are a few key aspects which should be analyzed, with respect to investments in India from any of the aforementioned countries, going forward, which are as follows:

1. The amendments seem to cover follow-on investments by investors from these bordering countries in those Indian companies in which they are already invested.
2. The amendments also seem to apply to any investment which does not lead to a change in the shareholding of the foreign investor from the relevant bordering country in the Indian company or where such investment is in exercise of an existing shareholder right/obligation.
3. Any investments in India through a fund which is sponsored and/or beneficially owned by investors resident of such country will require the prior approval of the Government of India.

4. The investments in India from countries which are governed or claimed to be governed by China such as Hong Kong are likely to be covered within these amendments.
5. Given that the terms “beneficial owner” and “beneficial ownership” used in PN 3/20 and in the NDI Amendment Rules are not defined either in the FDI Policy (though used therein) or in the NDI Rules, the meaning of these terms will have to be determined as per the other statutes such as (Indian) Companies Act, 2013.
6. An acquisition of a foreign entity by an investor from China, which, upon completion, will result in an indirect acquisition/change in shareholding resulting in acquisition of beneficial interest of an Indian company, will also be covered by these amendments. The use of the expression ‘directly or indirectly’ in PN 3/20 and the NDI Amendment Rules directly applies to this situation. Therefore, such indirect acquisitions will also be covered within the ambit of the amendments.
7. Whether acquisition of shares by an investor from the aforementioned countries in a foreign listed company which holds shares in an Indian company will be impacted by these amendments. This would depend on the facts of each case. An investor (in that foreign listed company) without any special rights cannot be said to be in a position of holding the beneficial ownership of the Indian company through that listed company. If however the investor itself is in control of that listed company or if he has certain special rights in the listed company (for example, special dividend rights or affirmative voting rights of such nature that indirectly give that investor the beneficial ownership of the Indian company), then the amendments will apply to his investment, irrespective of his shareholding, in the foreign listed company.

Although there are seven countries that share land borders with India, the immediate fallout of the amendments is their impact on investments in India from China. It will also have to be seen if these amendments are only temporary in nature until the COVID-19 pandemic situation is resolved or they continue to regulate the foreign investments in India from these bordering countries for longer.

In drafting these amendments, the Government of India may not have realized that it could impede the flow of foreign investments in India much beyond its stated objective, i.e. the ability to curb opportunistic takeover and acquisitions of Indian companies due to the current COVID-19 pandemic. Yet, given the overarching text of the amendments, and the likelihood of these issues being brought to the attention of the Government of India for their views, it is prudent not to substitute any judgment for what the Government of India thinks pending any clarification. The fact that the amendments do not expressly capture the intent and the objective also do not support in taking a narrow interpretation, the Government of India and authorized dealer banks in India involved in relation to the flow of foreign exchange in India, will be undertaking strict interpretation of the NDI Amendment Rules.

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