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CLIENT UPDATE

INDIA ANNOUNCES 'BIG BANG' ECONOMIC REFORMS – ALLOWS FDI IN MULTI-BRAND RETAIL AND AVIATION

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After months of policy paralysis, the Indian government, on September 14, 2012, announced major reforms permitting and/or increasing foreign direct investment ("FDI") in the areas of multi-brand retail, civil aviation, broadcasting and power trading exchanges with a view to boost economic growth. The government also gave a nod to disinvest its holdings from certain public-sector undertakings ("PSUs"). Despite political opposition and wide-spread protests, on September 20, 2012, the Department of Industrial Policy & Promotion, Ministry of Commerce & Industry ("DIPP") issued press notes bringing these reforms into effect.[1] One may recall that DIPP failed to issue an implementing press note earlier this year after the government backtracked on a previously announced incarnation of such FDI relaxation. The main highlights of these reforms are:

FDI in Multi-brand Retail

- Up to 51% FDI in multi-brand retail trading has been permitted with prior government approval, paving the way for foreign supermarket and other retail chains to enter India. However, retail sales outlets can only be set up in Indian states that have agreed or agree in the future to allow FDI in the sector. At present, 10 states, including Maharashtra, Delhi, Rajasthan, Andhra Pradesh and Haryana, have agreed to allow FDI in multi-brand retail.

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[1] The press notes may be found at: http://dipp.nic.in/English/acts_rules/Press_Notes.aspx.

- A foreign investor would be required to invest a minimum of USD 100 million, with at least 50% invested in "backend infrastructure" within three years of its initial investment. Backend infrastructure will include expenditures made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce infrastructure, etc. Expenditures on land cost and rentals will not be counted for purposes of the backend infrastructure investment calculation. This is a significant exception given the cost of land and rentals in major cities in India.
- Retail outlets may only be set up in any of the 53 cities with a population exceeding 1 million. States/Union Territories which do not have any city with a population exceeding 1 million may identify cities of their choice where FDI may be allowed.
- At least 30% of products must be sourced from local "small industries", defined to mean companies where the total investment in plant & machinery does not exceed USD 1 million at the time of installation without providing for depreciation. Companies will need to meet this sourcing requirement for the first time by taking an average of total products purchased in the first five years and on an annual basis thereafter.
- Although FDI norms for e-commerce have been the same as for brick-and-mortar retailers so far, the notification specifically prohibits retail trading by means of e-commerce. This is a big blow to an industry that is still at a nascent stage and needs new entrants that can invest in the ecosystem and drive growth.

It is worth noting that the government had approved FDI in multi-brand retail last year but later suspended its plans due to a lack of consensus among its own political allies. The government is facing similar opposition this time around and it remains to be seen whether it will adhere to its decision or not. Significantly, this is the first time that the government has allowed Indian states the discretion to allow FDI in any sector.

Amendments to the Existing Policy on FDI in Single-brand Retail

India allowed 100% FDI in single-brand retail, with prior government approval, earlier this year. However, the government has now made some important changes:

- The condition requiring the foreign investor to be the owner of the brand has now been modified. Now, one foreign investor, whether the owner of the brand directly or under a licensing/franchise/sub-license agreement, is permitted to invest in single-brand product retail trading in the country, for the specific brand for which approval is being sought.
- The mandatory 30% local sourcing requirement remains in place, but the new policy framework now provides that sourcing in India should preferably be made

from MSMEs (micro, small and medium enterprises), village and cottage industries, artisans and craftsmen, in all sectors, whenever feasible. This procurement requirement would have to be met, in the first instance, as an average of five years' total value of goods purchased, beginning April 1 of the year during which the first tranche of FDI is received. Thereafter, it would have to be met on an annual basis. This appears to be a compromise position as certain retailers were demanding a 10-year period to meet local sourcing requirements.

- Retail trading by means of e-commerce has been specifically prohibited for any company with FDI engaged in single-brand retail trading.

FDI in Civil Aviation

- Foreign airlines will be permitted to invest up to 49% of the paid-up capital of Indian companies operating scheduled and non-scheduled air transport services, with prior government approval.
- The 49% limit will be cumulative for both FDI and Foreign Institutional Investors' ("FIIs") investments.
- Such investments will need to comply with certain securities regulations, such as the Issue of Capital and Disclosure Requirements Regulations/Substantial Acquisition of Shares and Takeovers Regulations, etc.
- In addition, a scheduled operator's permit will only be granted to a company that fulfills the following criteria:
    - it is registered and has its principal place of business within India,
    - its Chairman and at least 2/3rd of Directors are citizens of India, and
    - its substantial ownership and effective control is vested in Indian nationals.
- Security clearance from the relevant authority in the Ministry of Civil Aviation is now required for all foreign nationals likely to be associated with an Indian carrier and all technical equipment that might be imported into India as a result of a foreign investment.

This welcome move is expected to boost the ailing aviation sector in India, which has been crippled with debt in recent times. Media reports suggest that certain Indian carriers have already commenced talks with potential foreign investors, and the industry should soon see foreign participation.

FDI in Broadcasting

- The government has hiked the cap on FDI in the broadcasting carriage sector (direct to home, cable networks, teleports and headend-in-the-sky broadcasting service) from 49% to 74%, where investment up to 49% would be under the automatic route and investments beyond 49% and up to 74% will require prior government approval.
- With respect to cable networks, i.e., MSOs not undertaking network digitalization and addressability upgrades and local cable operators, the existing foreign investment limit of 49% under the automatic route will continue to apply.
- For mobile TV, FDI up to 74% has been permitted, with investments up to 49% via the automatic route and investments beyond 49% and up to 74% with prior government approval.
- For up-linking of "news & current affairs" TV channels/FM radio, the existing limit of 26% FDI, with prior government approval, will continue and for up-linking of non-"news & current affairs" TV Channels/down-linking of TV channels, the existing policy of 100% FDI, with prior government approval, will continue.
- Foreign investment limits in companies engaged in the above activities will include, in addition to FDI, investments by FIIs, non-resident Indians, foreign currency convertible bonds, American depository receipts, global depository receipts and convertible preference shares held by foreign entities.

FDI in Power Trading Exchanges

- Foreign investment up to 49% (with an FDI limit of 26% and FII investment limit of 23% of the paid-up capital) has been permitted in power trading exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010.
- FII investments will be permitted under the automatic route through purchases in the secondary market, and FDI will be permitted with prior government approval.
- No non-resident investor/entity, including persons acting in concert, may hold more than 5% of the equity in these companies.

Disinvestments of PSUs

In the slew of reforms that it announced, the government also approved the sale of its minority stakes in four PSUs, namely, Hindustan Copper, Oil India, MMTC and National Aluminium Company Limited, with a view to raise up to INR 15,000 crores (approx. USD 2.8 billion). The government in the last fiscal year could raise only INR 14,000 crores

(approx. USD 2.3 billion) from disinvestment against their target of INR 40,000 crores (approx. USD 7.5 billion).

Conclusion

As expected, the above decisions have invited varied political reactions in India. However, the stock market has reacted positively to the developments and industry sentiment is cautiously optimistic. There are also media reports indicating the possibility of further reform measures being announced by the government in the near future, including the possibility of raising FDI limits in the insurance sector from 26% to 49%. Such measures should help return India to its prior growth rate of over 8% rather than the anemic 5.3% it registered during the first quarter of 2012.

Please note that we are not qualified to advise on Indian law. This update is based on information that has been published in the press and from other sources in the public domain.

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Please do not hesitate to contact us with any questions.

September 24, 2012