

iCe Hotline

August 31, 2007

REVISED GUIDELINES FOR FDI IN THE INDIAN ISP BUSINESS

The internet service sector was opened for private participation in 1998 with a view to encourage growth of the Internet sector in India and increase its penetration. Regulations with respect to Foreign Direct Investment ("FDI") in the telecommunication sector have recently been at the forefront of the continuous endeavor of the government to liberalize.

The Department of Industrial Policy & Promotion (DIPP) had issued Press Note No.5 (2005 Series) which had enhanced the FDI limit in telecom services (such as Basic, Cellular, Unified Access Services, National/International Long Distance, V-SAT, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS) and other value added services), from 49% to 74%. New security norms were also introduced vide this Press Note which became controversial, but were later finalized in March 2007. Please refer to our earlier hotlines 'Press Note No. 5-FDI Limit in Telecom Sector increased to 74%' dated November 14, 2005 and 'Revised Guidelines under Press Note No.3 (2007 Series) for Foreign Direct Investment in the Telecom Sector' dated May 3, 2007.

In the internet services sector, the FDI limit for ISP with gateways is 74%, while it was 100% for ISP without gateways. For ISP without gateways, there is a condition stipulated by the Government that such ISP shall divest 26% of their equity in favor of Indian public within five years, if such ISP is listed in any other part of the world.

On August 24, 2007 the Department of Telecommunications ("DoT") introduced revised guidelines^[1] for grant of license for operating internet services in India. Amongst myriad new provisions the major revisions include a reduction in the FDI limit in internet services to 74% from the existing 100% and the introduction of revenue sharing. A reduction in the limit of FDI is the first of its kind in the telecom sector in India.

A GLANCE AT THE CHANGES

§ FDI limit reduced from 100% to 74%.

§ A higher entry fee of INR 2 million will be introduced for Category A (national-level) ISP license and INR 1 million for Category B (state-level) ISP license, as against a flat fee of INR 1 earlier. Category C (local-level) ISP license has been done away with altogether. Existing Category C license holders will have option of migrating either to Category B or Category A license, subject to fulfillment of certain conditions. In case Category C ISPs do not migrate, they will be allowed to continue in Category C till the expiry of the existing license which will not be renewed any further. However, the entry fee criteria will not be applicable to existing ISPs.

§ Annual license fees @ 6% of Adjusted Gross Revenue ("AGR") which is currently charged to Internet Telephony operators will be extended to all ISPs, subject to a minimum of INR 50,000 and INR 10,000 charged for Category A and B respectively. However revenues accrued from pure Internet Services will be excluded from the definition of AGR for the purpose of computing license fees. It appears that the annual license fees are not going to be levied on existing ISPs.

§ All new ISPs will now be permitted to offer Internet Telephony services as against the earlier policy requiring a special license for it. However, the new policy continues with the existing norm that bars ISPs from terminating internet telephony calls on landlines or mobiles within India.

§ Non-functional ISPs are going to be "physically investigated to verify their presence, nature of activities and the financial viability".

§ ISPs having a net worth of INR 1 billion or more are allowed to offer Internet Protocol TV ("IPTV"). Until now there has been no regulation relating to IPTV.

§ ISPs cannot offer IP Virtual Private Network (IP-VPN) services. On November 10, 2005, the DoT issued a Press Note to liberalize the National Long Distance ("NLD") and International Long Distance ("ILD") licenses and decided to do away with IP-II and IP-VPN licenses. It however clarified that the existing IP-II and IP-VPN licensees will be allowed to migrate to NLD/ILD service license.

§ ISPs will be required to follow stringent security norms similar to those applicable for other telecom services. The chief officer in charge of technical network operations and the chief security officer can only be resident Indian citizens. Besides majority Directors on the Board of the company shall be Indian residents. The key positions, if held by foreign nationals, would require clearance from the home ministry. In other telecom services, even existing service providers had to comply with all the norms (including security related norms) and were given three months to comply with these guidelines/norms. There is no such compliance provision for existing ISPs in these guidelines. Thus, it appears that they do not have to comply with these guidelines.

§ The ISP shall provide services within 24 months from the date of signing of the license agreement with the DoT as

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regards 18 months specified in the old guidelines.

§ Other security norms as that applied to telecom companies with regard to monitoring facilities, remote access and providing information to all security agencies will also be applicable to ISPs.

§ A Financial Bank Guarantee (“**FBG**”) of INR 1 million for Category A and INR 100 thousand for Category B license, valid for one year, is to be provided before signing of the license agreement. Based on the AGR, the amount of FBG shall be reviewed annually by the Licensor. However the provision of Performance Bank Guarantee (“**PBG**”) of INR 20 million for Category A and INR 2 million for each Category B service area valid for two years remains unchanged.

CONCLUSION

Government and TRAI have been discussing the need for a unified license for all telecom services. In order to achieve a unified license, it is important to have uniform norms. It appears that the rationale behind revising the ISP guidelines and lowering the FDI limit to 74% is a step towards unified licensing and brings the regulations governing ISP services at par with other telecom services.

Unfortunately, as is often the case, the revised guidelines do not deal with their applicability to existing ISP's who have 100% FDI in them. If the guidelines are applicable only to new applicants for ISP licenses then a level playing field would not be available for such new ISPs vis-a-vis the existing ISP's. This has undoubtedly created certain ambiguity and will probably require the government to issue a clarification.

The revised guideline identifies certain services, such as IPTV that can be provided within the scope of the ISP license for Internet Services. The guideline defines Internet Access as use of any device / technology / methodology to provide access to Internet including IPTV. Although the Indian Government seems to have recognized the potential of IPTV and have taken as step towards its regulation for the first time, it has raised more questions than answers. For e.g. does it mean that other service providers (like licensed Telecom Service Providers providing basic and mobile telephony services, cable operators, or Broadcasters) can not provide IPTV?, Further, the term 'IPTV' remains undefined in the revised guidelines. There is lack of clarity if content regulation which is applicable to broadcasters would also be applicable in this case or whether the content will not be regulated at all.

Further, consider a situation where an IPTV content provider provides IPTV services such as video directly through the internet thereby surpassing the involvement of an ISP. In such a situation it is not clear from the revised guidelines as to what control can an ISP, who merely provides internet connectivity, has with respect to such IPTV services.

On the one hand, it was necessary to rationalize regulations to bring them at par with regulations of other telecom services; on the other hand, lowering FDI would be seen as a retrograde move from Indian FDI policy perspective.

- Prerak Hora, Vaibhav Parikh or Vivek Kathpalia

[1] No.820-1/2006-LR dated August 24, 2007

Source:

- The Economic Times, August 26, 2007
- Internet Service Guidelines issued by the DoT, August 24, 2007

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