

# Regulatory Hotline

March 30, 2016

## CLARITY TO AMBIGUITIES IN FDI IN E-COMMERCE – WILL IT REDUCE LITIGATION?

Department of Industrial Policy and Promotion (“DIPP”) on March 29, 2016, has provided certain guidelines on foreign direct investment (“FDI”) in e-commerce trading entities and e-commerce market place entities. In Press Note No. 3 of 2016 (“Press Note”), DIPP has attempted to provide much needed clarity on definitions and guidelines on operations of such entities as well.

## E-COMMERCE UNDER THE FDI POLICY

Prior to the Press Note, e-commerce activities included the activity of buying and selling by a company through an e-commerce platform. It was not clear as to whether buying and selling of only goods would amount to e-commerce activities, or both good as well as services. However, the provisions and debates around retail trading indicated that the provisions applied only to goods. Further, there was no definition of an e-commerce platform.

Press Note has provided the definition for ‘e-commerce’:

*E-commerce means buying and selling of good and services including digital products over the digital and electronic network.*

The term ‘digital and electronic network’ has been stated to include a ‘network of computers, television channels and any other internet application used in automated manner such as web pages, extranets, mobiles etc.’

Thus, now, services are specifically included within e-commerce activities. The interesting addition is ‘digital products’. The term ‘digital products’ is not defined. It is not clear from the definition as to whether the DIPP intended to include ‘digital products’ as goods or services. Depending upon categorisation of ‘digital products’, the relevant compliances under Consolidated FDI Policy of 2015 (“Consolidated FDI Policy”) including the Press Note will get triggered. It would be incongruous to apply provisions applicable to physical goods to ‘digital products’, especially in the absence of clarity of the term ‘digital products’. Hence, it is extremely important to get this clarity.

## TYPES OF E-COMMERCE MODEL

The current regulatory status with respect to foreign investments in the e-commerce space allows 100% FDI under the automatic route (i.e., no FIPB approval is required) in e-commerce entities engaged in B2B e-commerce. Whereas, no FDI is allowed in e-commerce entities which are engaged in B2C e-commerce. As a result, there was an ambiguity regarding treatment of marketplace model under the FDI Policy which led to the writ petition being filed before Delhi High Court in the case of *All India Footwear Retailers & Manufacturers Association v. Union of India*.<sup>1</sup> The Press Note specifically aims to remove that ambiguity by defining Marketplace Model and Inventory Based Model of E-Commerce (discussed below).

The Press Note has provided definitions for inventory based model of e-commerce and marketplace based model of e-commerce as follows:

*Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.*<sup>2</sup>

*Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital and electronic network to act as a facilitator between buyer and seller.*<sup>3</sup>

## E-COMMERCE ENTITIES

E-commerce entities have been defined to include the following entities provided that they conduct e-commerce activities:

1. company incorporated under the Companies Act, 1956, or the Companies Act, 2013;
2. foreign company covered under Section 2(42) of the Companies Act, 2013;
3. an office, branch or agency in India as provided in Section 2(v)(iii) of Foreign Exchange Management Act, 1999 owned and controlled by a person resident outside India;

The above definition does not cover Limited Liability Partnerships (“LLP”) that may be engaged in e-commerce activities, leading to an ambiguity with respect to whether an LLP with FDI can carry on e-commerce business.

## INVENTORY BASED MODEL OF E-COMMERCE

Inventory based model of e-commerce (“Inventory Model”) has been defined to include e-commerce activities where

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inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly. Inventory Model is the B2C model of e-commerce and FDI in such model is strictly prohibited.<sup>4</sup> However, Press Note clarifies that subject to Consolidated FDI Policy in relation to sectors, FDI in relation to provision of services through e-commerce will be under automatic route.<sup>5</sup>

Press Note No. 12 of 2015 ("**Press Note 12**") provided that certain manufacturers engaged in single brand retail would be entitled to receive FDI. These are:

1. an Indian manufacturer which is permitted to sell its own branded product through wholesale retail e-commerce platforms.
2. an Indian manufacturer, who is an investee company, manufacturing in India, in terms of value, at least 70% of its product in house, and sources, at most 30% from other Indian manufactures.
3. a single brand retail trading entity operating through brick and mortar stores.

Further, Press Note 12 provided additional conditions:

1. Product should be sold under the same brand internationally.
2. 'Single brand' product retail trading would cover only products which are branded during manufacture.<sup>6</sup> Therefore, branding as a separate activity may not be considered as a branding for single brand.
3. Non-resident entities whether as owner of a brand or otherwise, shall be permitted to undertake single brand retail trading through an agreement with the brand owner entitling the non-resident entity to undertake single brand product retail in India.
4. FDI Proposals of more than 51% would require 30% of value of goods purchased to be from within India and preferably from MSMEs, village and cottage industries, artisans and craftsmen.

### MARKETPLACE BASED MODEL OF E-COMMERCE

Marketplace based model of e-commerce ("**Marketplace Model**") includes entities that provide an information technology platform on digital and electronic network to act as a facilitator between buyer and seller.

DIPP has prescribed certain other clarifications in the Press Note:

1. Marketplace Models entities have been permitted to enter into transactions with sellers registered on its platform on B2B basis. However, each seller or its group companies would not be allowed to sell more than 25% of the total sales of the Marketplace Model entity. This amendment to the Consolidated FDI Policy may affect the business of certain e-commerce entities where majority of sales are made by one retail entity.
2. Marketplace Models have been allowed to provide support services to sellers in respect of warehousing, logistics, order fulfilment, call centre, payment collection and other services. This clarification would allow e-commerce entities to have in-house support services instead of reaching out to third party service providers.
3. It has been further clarified that in Marketplace Model, any warrantee or guarantee or return of goods and services sold will be the responsibility of the seller and not the e-commerce entity. Responsibility for the delivery of goods to the customers and ensuring customer satisfaction would be that of the seller and not the e-commerce entity. Consequently, liability under consumer protection laws would be of the sellers and not the e-commerce entity.
4. In Marketplace Models, e-commerce entities cannot 'directly or indirectly influence the sale price of goods or services' and are obligated to maintain a 'level playing field'. The Press Note does not define the expression 'influencing' and 'level playing fields'. There is uncertainty with respect to what may be reasonably considered influencing and whether incentive schemes would be violative of the obligation to maintain a level playing field.
5. It has been clarified that e-commerce entities engaged in Marketplace Model should not exercise ownership over the inventory, i.e., goods purported to be sold, otherwise such ownership over the inventory will render the business into Inventory Model.
6. Para 2.3 (ii) and (x) of the Press Note suggests that Marketplace Model may be used for Cash & Carry Wholesale Trading. However, Para 2.3 (iv) of the Press Note prohibits a Marketplace Model entity from having ownership in inventory. Para 2.3 (x) further provides that the Guidelines in Para 6.2.16.1.2 of the Consolidated FDI Policy will apply in respect of B2B e-commerce entities. Given that there is restriction on ownership of inventory by Marketplace Model entities, these provisions need to be clarified with respect to Cash & Carry Wholesale Trading.

### CONCLUSION

The Press Note has been introduced by the Government at a time when there are litigations pending in courts of India<sup>7</sup> on issues related to FDI in e-commerce. The Press Note purports to be clarificatory in nature yet it provides provisions that go beyond just clarifications.<sup>8</sup> While the Press Note provides clarity to adjudicate challenges to Marketplace Model and FDI in e-commerce it does not provide any time to companies to comply with conditions set in the Press Note as Para 4 states that the Press Note will take immediate effect. To the extent the Press Note provides clarification in respect of the Marketplace Model, it is beneficial to e-commerce entities. The additional conditions therefore ought to be seen as having prospective applicability.

The applicability of the Press Note to e-commerce entities engaged in provision of services may result in ambiguity since certain services such as music, video, software etc. may also be considered as goods which can be bought and sold.<sup>9</sup> The restrictions on e-commerce entities to not 'directly or indirectly influence the sale price of goods and services' and to ensure 'level playing field' appear unreasonable and ambiguous as these expressions are not defined.

It is hoped that DIPP clarifies the time required for compliance in respect of additional conditions set out in the Press

Note. These concerns should be addressed at the earliest to ensure that the FDI Policy in e-commerce truly fulfils its potential.

**M.S. Ananth**

<sup>1</sup> W.P. (C) 7479/2015.

<sup>2</sup> Para 2.1 (iii) of the Press Note.

<sup>3</sup> Para 2.1 (iv) of the Press Note.

<sup>4</sup> Para 2.2.(ii) of the Press Note.

<sup>5</sup> Para 3 of the Press Note.

<sup>6</sup> Para 2.2.25: "Manufacture", with its grammatical variations, means a change in a non-living physical object or article or thing – a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

<sup>7</sup> For instance All India Footwear Retailers & Manufacturers Association v. Union of India [(W.P. (C) 7479/2015)] and Dinesh Kothari & Ors. v. Union of India & Ors. [(W.P. (C) 692/2016)]

<sup>8</sup> Para 2 of the Press Note provides that for the purpose of clarity guidelines for FDI in e-commerce is enumerated while Para 4 provides that it shall take immediate effect.

<sup>9</sup> Tata Consultancy Services v. State of Andhra Pradesh [(2005) 1 SCC 308]; M/s. Associated Cement Companies Ltd. v. Commissioner of Customs (2001) 4 SCC 593

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