

Regulatory outlook on Press Notes needs a revamp

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AFTER a decade of its existence, Press Note 9 (1999) has come around to haunt every FDI investor. The Press Note was a step taken by the regulatory authorities, including the Foreign Investment Promotion Board (FIPB) to liberalise the investment regime for foreign companies and enable foreign-owned Indian holding companies make downline investments under the automatic route, subject to the fulfilment of certain conditions — the company in which the investments are to be made should qualify under the automatic route under the current FDI policy.

However, the recent regulatory view adopted by FIPB in interpreting the Press Note has been ludicrous. The regulatory stance is on the premise that in the event an operating company in which there is existing FDI and such operating company further makes a downline investment or acquisition, the character of the company changes from being an operating to an operating-cum-holding company as envisaged under the Press Note 3 (1997) and Press Note 9 (1999). Since investment holding company is not covered within the approved activities of an NBFC within the current FDI policy, thus whenever such operating company makes a downline investment, the character of the company shall change from operating to holding company. Thus, for making a downline investment, the company shall require a prior permission of FIPB. The present view adopted by FIPB is ludicrous and it shall have the cascading effect of foreign investment in India into companies.

Most operating companies float subsidiaries for carrying out different business activities or they make substantial investment or acquire other companies as their model of business growth. Further, there can be a situation wherein the downline investments made by such operating companies were made through the internal accruals and proceeds from the FDI into such an operating company were not used to fund the downline investment.

In such an event that an operating company prior to making such business combinations would require the prior approval of FIPB, it would be deterrence for various factors — regulatory delays, absence of any guidelines whether such an approval would be granted by FIPB.

It is to be analysed whether the present regulatory view is substantiated by the existing FDI regulations. It is to be noted that the terms "holding company", "operating company" and an "operating-cum-holding company" have not been defined under the Foreign Exchange Management Act (FEMA) and the Press Notes. However, reliance can be made to Press Note 3 of 1997, which lays down the guidelines used by FIPB in considering and permitting foreign investment in India. Although it is to be noted that the FDI policy has changed considerably and liberalised to a large extent since Press Note 3 of 1997 till date, reference can be made to Press Note 3 of 1997 to aid in the interpretation of a holding company as was envisaged by the Press Notes. From a concomitant reading of Press Notes, it may be inferred that in the event a company has been set up by a foreign entity, and which in itself does not carry on any activity, but is incorporated for the sole purposes of making successive downstream investments in other Indian companies, the said company may fall within the purview of a "holding company" for the purposes of the Press Notes.

Further, it is to be noted that the Press Note 9 of 1999 refers to the aspect of foreign-owned holding companies. We understand that the ambiguity lies in the fact that the term "owned" has not been defined by a threshold, and the percentage of foreign investment to infer "ownership" has not been made explicit. It is an established rule of statutory interpretation that in the event the regulations are not explicit, we refer to the intention of the authorities while drafting the regulation. Further, on a perusal of the threshold levels prescribed for some sectors like power and NBFC under the Press Notes, it refers to 100% threshold. Hence, it can be presumed that the intention of the FDI policy is for the term "foreign-owned holding company" to mean a 100% investment.

Thus, it is believed that on the present regulatory regime, the view adopted by FIPB is devoid of any base and is against the canons of statutory interpretation.

The authors are with Nishith Desai Associates (Views expressed are personal.)