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Changing Landscape of the E-Commerce Sector vis-à-vis the FDI Policy

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E-commerce has seen exponential growth in India since the issuance of press note 2 of 2000 by the Government of India permitting 100% foreign direct investment ("FDI") in Business to Business (B2B) e-commerce activities. With the growth came deviations and the Government received many complaints about certain marketplace platforms violating the policy by influencing the price of products and indirectly engaging in inventory based model, which is not otherwise permitted. The Government issued another press note dated December 26, 2018 ("Press Note") to introduce certain changes to the FDI policy in the e-commerce sector. Coming into effect from February 1, 2019, this Press Note has had far-reaching implications on e-commerce entities (with FDI) operating in India, requiring them to significantly overhaul their existing business model to comply with the current FDI Policy. Reportedly various e-commerce giants like Amazon sought an extension for compliance with this Press Note, however, no such extension was granted, and this Press Note became effective on February 1, 2019.

Considering the number of e-commerce businesses existing or coming up in India, let us assess as to what has this Press Note changed and why has it thrown the e-commerce giants in a tizzy?

Under the existing Para 5.2.15.2 of the FDI policy, 100% FDI is allowed in e-commerce entities engaging in a marketplace model of e-commerce, under the automatic route (i.e. without government approval). FDI is not permitted in inventory based model of e-commerce (where inventory of goods and services is owned by the e-commerce entity and is sold to consumers directly). E-commerce entities are to engage only in B2B e-commerce and not in Business to Consumer (B2C) e-commerce. The Press Note has now amended the aforesaid Para to introduce certain additional conditions requiring compliance by e-commerce marketplace entity, as discussed below:



➤ **Deemed Control over Inventory:**

As per the Press Note, the e-commerce entity is not to exercise ownership or control over the inventory (i.e. goods purported to be sold). Inventory of a vendor will be deemed controlled by the e-commerce entity “*if more than 25% of purchases of such vendor are from the marketplace entity or its group companies*”. The intent behind this change was to curb larger e-commerce entities from maneuvering sale of inventory to sellers through their associated companies which inventory found its way back on the e-commerce platform through these sellers thereby bypassing the FDI restrictions on inventory based model.

The erstwhile restriction in the earlier FDI policy required the e-commerce entity to not “*permit more than 25% of the sales value on financial year basis affected through its marketplace from one vendor or their group companies*”. This erstwhile restriction is no longer there in the new FDI policy as amended by the Press Note.

Now does this means that as long as the vendor does not purchase more than 25% of its goods from the marketplace entity/group companies, it can sell its entire inventory on the marketplace platform of the e-commerce entity? Also, how is the e-commerce entity expected to ensure that a vendor (which is not under its control) is not making more than 25% of its purchases from it or from its group companies? These questions remain unanswered, rendering compliance with this condition confusing and difficult.

➤ **No Equity Stake or Control Permitted in the Vendor:**

E-commerce entities are now barred from selling (on its platform) products of any vendor in which it or its group companies has an equity stake. Similar bar is applicable if the e-commerce entity or its companies has ‘control’ on the inventory of the vendor. It is however not clear whether indirect equity stake and/or debt instruments held in vendor entities are excluded from the above restriction.

The above changes appears to have been introduced to address one of the main concerns raised by Indian retail/trading industry that e-commerce entities like Amazon are using companies under their control or where they have equity stake to sell products on its platform at low prices, thereby indirectly by-passing the FDI restrictions on B2C commerce and also creating an unfair business environment.

➤ **Fair and Non-Discriminatory Treatment to all Vendors:**

The Press Note also elaborates on an earlier condition which required e-commerce entities to not directly or indirectly influence the sale price of goods or services and to maintain level playing field. It states that services should be provided by both the e-commerce entity and other entities in which the e-commerce entity has direct or indirect equity participation or common control, to vendors at arm’s length and in a fair and non-discriminatory

manner. Such services can include but not limited to logistics, warehousing, advertisement/marketing, payments, financing etc.

Further, cash back provided by group companies of marketplace entity to buyers is to be fair and non-discriminatory. Provision of services to any vendor on such terms which are not made available to other vendors in similar circumstances will be deemed unfair and discriminatory. The Press Note, however, does not define what is meant by the phrase 'similar circumstances', thereby leaving this condition quite vague and difficult to implement.

➤ **No Exclusivity:**

As per the Press Note, an e-commerce entity cannot require any seller to sell any product exclusively on its platform only. The Press Note, however, does not restrict a seller from willingly on its own accord deciding to sell a product on just one platform. The Press Note also doesn't elaborate whether imposition of negative covenants by the e-commerce entity on the seller not to sell products on certain other competing platforms is in violation of the above restriction.

➤ **Annual Compliance:**

The e-commerce entity is now required to annually furnish a certificate along with a report of statutory auditor to the Reserve Bank of India, confirming compliance of the e-commerce guidelines. The onus of compliance of these e-commerce guidelines is therefore on the e-commerce entity. Unfortunately, the Press Note has failed to take into account that certain compliances (such as the condition that not more than 25% of purchases of a vendor can be from the marketplace entity or its group companies) are not in the hands of the e-commerce entity where it has no control over the vendors. It seems that the e-commerce entity will have no option but to seek certifications from vendors that they have not made more than 25% of purchases from the marketplace entity or its group companies. But an incorrect certificate from a vendor can land the e-commerce company in non-compliance with no implications or penalty on the vendor.

Interestingly, the Government has on Feb 23, 2019 released a Draft National E-commerce Policy inviting comments from the stakeholders. The Policy aims to address six broad issues of the e-commerce ecosystem - (i) data protection; (ii) infrastructure development; (iii) e-commerce marketplaces; (iv) regulatory issues; (v) stimulating domestic digital economy; and (vi) export promotion through e-commerce. It *inter-alia* reiterates the FDI policy on e-commerce sector and lays down - additional conditions which are to be complied with by e-commerce websites/applications; anti-counterfeiting and anti-piracy measures and requirements regarding authentic ratings and reviews, consumer oriented customer service, prevention of sale of prohibited items, which are to be implemented by e-commerce players.

The e-commerce sector can therefore expect tighter control and more compliances in near future with the Government trying to balance its objectives of encouraging foreign investment and protecting the interests of small time traders and vendors (especially in this election year).

Feedback

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