KUNZ' Country Focus India

A comprehensive orientation for foreign investors

Dr. Hermann Knott, LL.M. (UPenn), Rechtsanwalt and Attorney-at-Law (New York), Partner, KUNZ Rechtsanwälte

Introduction

The EU-India summit on May 8, 2021, offers an opportunity to highlight the possibilities for European business enterprises to invest in the country which by 2027 will have the largest workforce of any country. Ongoing negotiations about the so called early-harvest trade agreement are part of investor-friendly developments of the last few years. Furthermore, the 'connectivity' partnership in sectors including energy, digital and transport shall offer legal safeguards and attractive deal terms for infrastructure projects sponsored by both sides. Compared to China's highly integrated supply chain India offers yet lower costs, in particular in the area of labor, though coupled with workers being well trained.

Of course, at this time all discussions about foreign investments and trade relations are subordinate to the current wave of infections hitting India with particular force.

Mark Twain famously described India as "the cradle of the human race, the birthplace of human speech, the mother of history, the grandmother of legend and the great grandmother of tradition".

Kunz' Advisory Services (Including Project Management) Rendered in Close Coordination with Foreign Partner Firms

In close coordination with our cooperating firms in India which rank among the most highly reputed, in particular Majmudar & Partners, the lawyers of KUNZ' International Transactions and Disputes expert team assist our clients when investing in India. At the same time together with our European cooperating firms our internationally experienced attorneys advise Indian and other foreign investors when starting, expanding, restructuring or disposing of investments held in Europe.

Recent Initiatives

To boost India's manufacturing capacities with a particular view to strengthening exports, in November 2020 the Government approved an extension of the Production-Linked Incentive (PLI) Scheme for 10 important sectors with committed funds in the range of US$ 20 billion. They include sunrise sectors which promise high rates of growth and industries where India wants to be included in the global value chain. They are related to advance chemistry cell batteries, electronic and technology products, automobile, pharmaceuticals and telecom together with networking products, textiles, food, high-efficiency solar PV modules white goods (ACs and LEDs) and specialty steel.

FDI Schemes

FDI projects either qualify under the automatic route not requiring clearance from any government authority. This route is available to investments in most industries which are relevant for FDI. Acquisitions of agricultural and land used for plantations, manufacturing of tobacco products as well as railway operators require governmental approval, as do all projects related to sectors not open to private investments (e.g. nuclear energy). Given the undefined investment goals of a holding company, acquisition of shares in such a company always require government approval.

India Meets and in Most Cases Exceeds Investment Criteria

When making a decision to invest abroad – as opposed to distributing the products by a third party - the following criteria play a central role:

- Demand in host country for products or services offered by the investor
- Ease of doing business
- Costs, quality of workforce, taxes, free flow of capital, infrastructure/logistics
- Tariffs and non-tariff barriers
- Enforceability of contracts and investment protection

For the EU India is the 10th largest trading partner. For India the EU is the largest trading partner. Funds equaling the 3rd largest amount of the EU member states' foreign direct investments (FDI) dedicated to any country is directed to India. In 2020, despite a fall of global FDI by 42% due to the pandemic, FDI in India increased by 13%.

The most important industrial sectors benefiting from FDI into India are (in alphabetical order) Automotive, Electrical Equipment, Industrial Machineries, Pharmaceutical Products, Services and Trading. Especially in the wake of last year's decision of the European Court of Justice in the matter Schrems II invalidating the EU-US Privacy Shield, there is an increasing impact of GDPR on Indian entities as well. More and more Indian companies provide services in information technology, international e-commerce and outsourcing at least indirectly to EU Data Subjects (private individuals). That happens by way of transferring data by the EU Data Controller (e.g. credit card company) to the Data Processor based in India (provider of outsourcing services). Therefore, it is worthwhile to compare the existing and planned legislative and administrative data protection framework in India with the compliance requirements under GDPR. In case of a data breach fines of up to EUR 20 million or 4% of last annual turnover may be imposed by the European Commission.

In 2019 the Indian government had submitted to Parliament the Personal Data Protection Bill which is still under discussion. Especially in outsourcing projects, compliance with data protection regimes under GDPR and the legal requirements in India will thus require integrated and shared advice by the lawyers involved, as we at KUNZ are used to render in close coordination with our foreign partner firms to provide our clients with a harmonized and uniform work product.

There are obviously strong economic reasons to invest in India. At the same time, experienced legal advice is needed to make the investment a long-term success.

- With its huge domestic market, growing disposable income at middle class and the effects from the soon-to-be most populous country of the world, India is very attractive for foreign investment. For 2021, before the new wave of infections hit the country, double-digit growth has been expected, thus showing one of the highest growth rates among industrialized nations.

- Given the high tariffs and import taxes on luxury goods, local manufacturing means a competitive advantage. However, applicable rules of origin need to be taken into account even in the context of local manufacturing.

- India's position in the ranking of ease of doing business has improved considerably with now holding 63rd place according to the World Bank Group's Doing Business 2020 Study. In 2018/19 alone India implemented 59 regulatory reforms, one fifth of all such reforms recorded worldwide!

- In terms of enforceability of contracts India ranks only 163rd from 190 countries surveyed. This is largely the result of the slow path of the handling of claims brought before the ordinary courts (almost three times the average time in OECD high-income economies). As discussed in the Dispute Resolution section of this guide, arbitration is one route to avoid these issues.

How to Realize FDI Projects

- FDI projects may initially be implemented by opening a branch office or establishing a local company, either in the form of a limited company or a limited partnership. No local company may be needed in case of the investor's products solely being distributed in India. A local entity can be capitalized from abroad as needed. It may also remit its profits to the foreign shareholder in form of dividends. The next step may either be initiating a greenfield investment, a M&A transaction in the form of a business acquisition or a Joint Venture (JV). M&A transactions may be structured as the acquisition of shares or assets of a business operating in India. The acquisition of assets may occur in the form of buying itemized assets or an undertaking as a whole ('slump sale'). An important characteristic of a slump sale is that the assets and liabilities forming part of the business activity as a whole are the object of the transfer against a lump sum consideration. Setting up a JV with an Indian company with existing experience in the relevant sector involves considerable advantages for the foreign investor, expertise in the local market and an established distribution chain figuring among them. Partnering with a local entity in a JV, however, requires thorough due diligence to be carried out in advance. In general, structuring and implementing investments require comprehensive legal advice under the laws of both the investor's home state and the laws of India as the host state.

Dispute Resolution

- The ordinary courts in India are heavily overloaded with cases. For international commercial disputes Alternative Disputes Resolution mechanisms, i.e. arbitration and mediation, should be the preferred alternative. The recent amendments to arbitration law, in particular the creation of the Arbitration Council, allows the exercise of authority over arbitration proceedings. With these improvements and a stronger position in favor of arbitration taken by the courts in India the parties have the choice whether to provide for the seat of the arbitration proceedings to be in India or in a neutral place abroad, e.g. Singapore with its established institutional rules (SIAC). In a recent case Indian courts have recognized orders of emergency arbitrators. Emergency arbitration is also provided for in the arbitration rules of Indian arbitration institutions.

- As far as mediation is concerned, India has been among the first group of currently 53 countries having signed the Singapore Convention on Mediation. This treaty will ease the enforcement of settlement agreements in international commercial disputes.

Investor Protection

- When investing in foreign countries investors seek protection against the host state taking action negatively affecting their investments. In many instances the relevant provisions of Bilateral Investment Treaties (BITs) concluded either as independent agreements or as part of more comprehensive Free Trade Agreements in the classical sense or even in the form of modern-style Comprehensive Economic Partnership Agreements between the investor's home country and the host state balance the difference of interest between the freedom of taking sovereign action of the host state and the investor's interest in maintaining the status quo. India has not signed the most widely recognized convention addressing investor-state disputes, the ICSID Convention dated October 14, 1966, which among other provisions addresses dispute resolution by arbitration in case of investor-state disputes. Therefore, without BITs investment protection exists pursuant to the principles of the general principles of international law.

- India is currently in the process of renegotiating its BITs. Having been faced with numerous investor claims in the wake of a landmark decision in an investor dispute in 2011, in 2015 the Indian Government presented a Model BIT. In order to renegotiate older-style BITs India terminated 72 of its 83 BITs, including the one with Germany. For investments undertaken prior to the effective dates of the termination so-called 'sunset clauses' continue to provide treaty protection for periods of more or less than 15 years. New investments started after 30 June 2017 (the effective date of termination in most cases) were made without benefiting from investor protection based on bilateral treaties.

- The existence of a BIT appears, however, not to be a mandatory requirement for FDIs into India to thrive. India never had concluded a BIT with the US and the ones with Mauritius and The Netherlands had also been terminated. All three countries figure among those with strongest FDI into India. Initiatives such as the announcement by the Indian government of a domestic law on investment protection providing for mediation and the establishment of special fast-track courts apparently help in building trust given the recent history of fast and efficient reform in India.

- Negotiations aiming at a full-fledged Comprehensive Economic Partnership Agreement with the EU were discontinued in 2013. Tariffs imposed by India on luxury cars and complaints raised by India on the subsidized character of the European market for agricultural products have been the main obstacles. Therefore, the initiative to make an attempt to reach an early-harvest trade agreement ahead of a subsequent full-fledged economic partnership agreement is a welcome and timely development. It could take a form which is similar to the Investment Incentive Agreement between the US and India. This treaty only allows the respective governments to file arbitration notices seeking investor protection. Other than that, the focus of such preliminary agreement is likely to be on most urgent needs with regard to tariffs and similar restrictions affecting free trade.

Conclusion

India is a hugely important country for foreign direct investment offering more opportunities than ever given the economic conditions for projects and the systematic work to eliminate issues and problems known from the past. Cheap and skilled labor, a vast domestic market, entrepreneurial dynamism and cultural affinity are the major advantages to do business with partners from India on a long-term basis. Investments in the country require, however, excellent planning, structuring and implementation, in particular regarding legal aspects. As the complex situation regarding commercial and investor disputes show, the need for comprehensive legal advice does not end with the successful start of the project. Continuous advice on ongoing matters, prevention and managing of employment disputes and regulatory issues is needed to run the business successfully on a long-term perspective.

About KUNZ Lawyers

KUNZ is a medium-sized full service German business law firm with about 50 lawyers working in four offices. It follows a dynamic and organic growth path. The firm is organized along competence groups with its members collaborating on client projects across offices, as appropriate for each relevant engagement. On an international level KUNZ assists both foreign clients with their inbound investments as well as German clients investing abroad. In the latter context KUNZ benefits from its close cooperation and long-term relations with leading firms around the world spearheaded by the partners of its International Transactions and Disputes competence team led by partners Hermann Knott and Heiko Giermann. For all inquiries please contact Hermann.Knott@kunz.law and visit our website www.kunz.law.

About Majmudar & Partners

Majmudar & Partners (formerly Majmudar & Co.), established in 1943, has evolved into one of India's premier law firms representing the who's who of banks, companies, and financial institutions. Inbound investments into India, corporate/M&A, restructuring, competition, securities, banking and corporate finance, private equity and venture capital, fund structuring, tax, technology, media and telecommunications, employment, projects, infrastructure and energy, biotechnology, outsourcing, IP, distribution, real property and disputes are the main practice areas of the firm.

We are one of the few Indian law firms to have created an industry focus. We specialize in the following industries: (i) financial services and insurance; (ii) pharmaceuticals and life sciences; (iii) technology; (iv) manufacturing and industrial; and (v) consumer and retail. This coupled with senior partner led delivery and extreme responsiveness has made us a sought-after firm for clients who need high quality and high value services in tight timeframes.

We have a national team of close to one hundred (100) lawyers. Most of our lawyers have international work experience and have been recognized as leaders in their field. We are structured on the lines of an international law firm, where each lawyer is on a partnership track.

For further information on this or any related subject, please contact us at mailbox@majmudarindia.com

Cologne, Germany, May 3, 2021