

THE FDI CONUNDRUM IN E-COMMERCE

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Abstract *E-commerce has become the cynosure attracting both applause and criticism. It has opened tremendous opportunities for businesses by blurring national boundaries and has provided a whole new universe of options to consumers at a click of the mouse. At the same time it has uprooted the centuries-old established traditional business-to-consumer models and replaced them with a convenient and more affordable mechanism. Regulation of the sector becomes the natural corollary with governments around the world trying to figure out the right mix of laws that ought to be complied by e-commerce entities. The Indian government too, with this objective in mind, is making attempts at governing a sector whose compounded annual growth rate projections are humungous. The following research paper deals with the foreign direct investment laws applicable on e-commerce entities and the impact that the recent amendments will have on the sector.*

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PART I: INTRODUCTION

It is no secret that e-commerce is the next big driver of growth and an area of opportunity having the potential to generate huge returns. Whenever the size of a specific business avenue increases so as to impact a number of persons, the government steps in attempting to regulate them with the utilitarian¹ objective often at the forefront. E-commerce being what it is, a disruptor,

¹ Antoinette Baujard, “Utilitarianism and Anti-Utilitarianism” (2013) Gate 2013-32, 2013 <<https://halshs.archives-ouvertes.fr/halshs-00906899/document>> accessed 1 February, 2019.

it has changed the manner in which sellers used to traditionally sell their merchandise. It has given consumers access to a wide variety of products at competitive prices. On the flipside, it has also had a debilitating effect on the ability of the sellers to price their products and generate the desired profits.

E-commerce entities are at present governed by a potpourri of legislations in India covering a wide gamut of fields such as foreign exchange, company, technology and competition laws, to name a few. Each and every one of these consists of a set of regulations that the e-commerce entities need to comply with, in order to undertake business activities in India. A cursory glance reveals that as a general rule, these laws do not address the e-commerce ecosystem directly but are applicable tangentially. The most significant exception to the aforementioned statement, and the crux of this research paper, is the foreign exchange laws along with their attendant amendments in the recent past.

Inflow of foreign exchange has always been highly regulated in India due to its perpetual paucity and the consequent desire on part of the government to have control over it (up to a maddening degree before the liberalisation of the economy).² The central government dictates the foreign direct investment (hereinafter, FDI) policy of India.³ This is done through the Department for Promotion of Industry and Internal Trade (hereinafter, DPIIT), née Department for Industrial Policy and Promotion (hereinafter, DIPP).⁴ Prior to this change in nomenclature and the accompanied modifications; matters of internal trade came under the Ministry of Consumer Affairs.⁵ With this change, issues concerning promotion of internal trade, including retail trade, welfare of traders and their employees, facilitation of ease of doing business, and start-ups, will be dealt with by the DPIIT.⁶ Formerly, it was amongst the roles and functions of DIPP to formulate the FDI Policy and undertake efforts for the promotion, approval, and facilitation of FDI.⁷ To this effect,

² Montek S. Ahluwalia, "India's Economic Reforms: An Appraisal" <<http://planningcommission.nic.in/aboutus/speech/spemsa/msa018.pdf>> accessed 2 February, 2019.

³ R. Nagaraj, "Foreign Direct Investment in India in the 1990s: Trends and Issues" (2003) *Economic and Political Weekly* 1701.

⁴ PTI, 'Govt. Christens DIPP as Department for Promotion of Industry and Internal Trade' *The Economic Times* (New Delhi, 30 January 2019) <<https://economictimes.indiatimes.com/news/economy/policy/govt-christens-dipp-as-department-for-promotion-of-industry-and-internal-trade/articleshow/67753585.cms>> accessed 2 February, 2019.

⁵ *Ibid.*

⁶ PTI, "Now Both External, Internal Trade under Commerce & Industry Ministry", *The Economics Times* (New Delhi, 30 January, 2019) <<https://economictimes.indiatimes.com/news/economy/policy/now-both-external-internal-trade-under-commerce-industry-ministry/articleshow/67762390.cms>> accessed 1 February, 2019.

⁷ Department for Promotion of Industry & Internal Trade, "Role & Functions of the Department of Industrial Policy & Promotion" <<https://dipp.gov.in/about-us/role-and-functions-department-industrial-policy-promotion>> accessed 5 February, 2019.

the department issued the consolidated FDI policy and press notes that have far reaching consequences for foreign businesses operating in India. The power is obtained from Article 77 of the Constitution of India, 1950, which mandates the President to make rules for more convenient transaction of the business of the Government of India, and for the allocation of the said business, among ministers. In pursuance of the same, the Government of India (Allocation of Business) Rules, 1961 were enacted. The DIPP under the Ministry of Commerce and Industry was conferred with the power to make rules with regards to direct foreign and non-resident investment in industrial and service projects.⁸ Inferentially, it can be said that DIPP has the power to regulate the operation of the e-commerce entities that have the backing of a foreign entity whether in the form of an ownership stake or control over the entity.

The research paper is divided into four parts. Beginning with the introduction of the issues faced in e-commerce, *Part I* sets the tone for a comprehensive analysis of the FDI policy governing foreign investment into e-commerce entities operating in India. *Part II* gives a glimpse into the history of FDI laws and how they have evolved in the span of a decade or so. *Part III* of the research paper deals with the changes introduced by the latest press note, i.e., Press Note 2 of 2018 (hereinafter, PN2/18). It delves into the ramifications of the mandate of the DIPP and the resultant effects the policy has on the operations of the e-commerce players in the market. *Part IV* of the paper concludes the discussion on PN2/18 and summarizes the analysis in the foregoing parts.

PART II: HISTORY OF FDI LAWS IN E-COMMERCE

The regulation of FDI in e-commerce commenced around the same time it was done for physical retail trade. The restrictions in the offline world applied with just as much vigour to the online world, establishing an equivalence that was unwarranted at the time - between the nascent e-commerce industry and the traditional Indian retail.⁹ This regulatory hostility did not however deter foreign companies from entering the e-commerce space in India, the primary reason being the market size, which was too big to ignore. Hence, lawyers helped them evolve myriad convoluted corporate structures to ensure that the businesses were complying with the regulations as per their strict and literal interpretation. The next time DIPP decided to take a

⁸ The Government of India (Allocation of Business) Rules, 1961.

⁹ Rahul Matthan, "Time to Redo FDI in E-Commerce in India" *Livemint* (Mumbai, 16 January, 2019) <<https://www.livemint.com/Opinion/c00CvCKOwrxUe8usL1QrQO/Opinion--Time-to-redo-FDI-in-ecommerce-in-India.html>> accessed 10 February, 2019.

look at the e-commerce regulations was after a long period of time marked by global recession and the rise of technology-based start-ups. It was only when e-commerce entities operating in India became massive in scale and in operation, that the government sprang into action.

The preceding cause was the constant demands of the small mom-and-pop store owners to control burgeoning e-commerce entities like Amazon and Flipkart that were alleged to be abusing their dominant position.¹⁰ Accordingly, Press Note 3 of 2016 (hereinafter, PN3/16) was passed with the aim of ensuring parity, especially in the pricing power of products on the offline vis-a-vis the online platforms. The concepts of marketplace model and inventory-based model of e-commerce were introduced, FDI in the latter being prohibited.¹¹ In the former, the role of an e-commerce entity is restricted to providing information technology platforms on a digital and electronic network acting as a facilitator between the buyer and the seller.¹² In the latter, the inventory of goods and services is owned by the e-commerce entity and is directly sold to consumers.¹³ At the same time, a slew of definitions were added¹⁴ and certain relaxations were given to FDI in Business-to-Consumer (hereinafter, B2C) companies, that were banned till then.¹⁵

PART III: CRITICAL ANALYSIS OF PRESS NOTE 2 (2018 SERIES)

I. B2C: TO BE OR NOT TO BE

The PN2/18 Para 5.2.15.2.1¹⁶ says that e-commerce entities will engage only in Business-to-Business (hereinafter, B2B) e-commerce and not in B2C

¹⁰ “Flipkart, Amazon Not Abusing Market Position: CCI” *The Hindu* (New Delhi, 7 November, 2018) <<https://www.thehindubusinessline.com/info-tech/flipkart-amazon-not-abusing-market-position-cci/article25437369.ece>> accessed 7 February, 2019.

¹¹ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 3 (2016 Series) <https://dipp.gov.in/sites/default/files/pn3_2016_0.pdf> accessed 7 February, 2019.

¹² Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 3 (2016 Series) <https://dipp.gov.in/sites/default/files/pn3_2016_0.pdf> accessed 7 February, 2019.

¹³ *Ibid.*

¹⁴ *Ibid.*, Definitions added include those of e-commerce, e-commerce entities, inventory based model of e-commerce, marketplace based model of e-commerce.

¹⁵ *Ibid.*, Foreign companies are now permitted to invest in B2C companies as well in:

- (a) a manufacturer manufacturing its products in India;
- (b) a single brand retail trading entity selling its products under a single brand through its brick-and-mortar stores, and;
- (c) an Indian manufacturer who owns the Indian brand and manufactures 70% of its products in-house and sources, at most, 30% from Indian manufacturers.

¹⁶ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 2 (2018 Series) <https://dipp.gov.in/sites/default/files/pn2_2018.pdf> accessed 15

e-commerce,¹⁷ except in case of food manufactured or produced in India which get 100% FDI in B2C model under government route.¹⁸ This means that e-commerce entities cannot hold an inventory of goods to sell it directly to end consumers. Earlier PN3/16 allowed FDI in B2C e-commerce under particular conditions¹⁹ but these never featured in the Consolidated FDI Policy of 2017.

When the DIPP was questioned about PN2/18, the press note was said to be just a clarification and therefore, FDI in B2C e-commerce in multi-brand retail through inventory-based model²⁰ is not allowed in India.²¹ Then a question arises as to why DIPP permitted 51% FDI in multi-brand retailing in other sectors.²² Since B2C e-commerce is not allowed, Amazon, Flipkart, Shopclues, etc., had to change their model to a B2B marketplace model²³ to do business in India. In the authors' opinion, limited FDI should be allowed

February, 2019.

¹⁷ DIPP, Discussion Paper On E-Commerce – 2013-14 <<http://indiafdiwatch.org/wp-content/uploads/2014/01/discussionpaper.pdf>> accessed 16 March 2019. Business-to-Business e-commerce means transactions between two enterprise like manufactures and wholesalers, etc. whereas Business-to-Consumer e-commerce is a transaction between enterprise and end consumers.

¹⁸ Make in India, Foreign Direct Investment: Sectors under Automatic Route with Conditions <<http://www.makeinindia.com/policy/foreign-direct-investment>> accessed 24 February, 2019.

¹⁹ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 3 (2016 Series) <https://dipp.gov.in/sites/default/files/pn3_2016_0.pdf> accessed 7 February, 2019. Foreign companies are now permitted to invest in B2C companies as well in:

- (a) a manufacturer manufacturing its products in India,
- (b) a single brand retail trading entity selling its products under a single brand through its brick-and-mortar stores, and;
- (c) an Indian manufacturer who owns the Indian brand and manufactures 70% of its products in-house and sources, at most, 30% from Indian manufacturers.

²⁰ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Consolidated FDI Policy 2017 <<http://www.makeinindia.com/documents/10281/0/Consolidated+FDI+Policy+2017.pdf>> accessed 13 February, 2019. Inventory-based model of e-commerce means where inventory of goods and services are owned by e-commerce entity and sold to end consumers directly.

²¹ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Response to Comments Reported in the Media on Press Note 2 (2018) <<https://dipp.gov.in/whats-new/response-comments-reported-media-press-note-2-2018>> accessed 23 February, 2019.

²² "E-Commerce Rules Do Not Allow Foreign Investment in Multi-Brand Retail: DIPP" *The Economic Times* (New Delhi, 3 January, 2019) <<https://economictimes.indiatimes.com/news/economy/policy/e-commerce-rules-do-not-allow-foreign-investment-in-multi-brand-retail-dipp/articleshow/67366533.cms?from=mdr>> accessed 15 February, 2019.

²³ Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, Consolidated FDI Policy 2017 <<http://www.makeinindia.com/documents/10281/0/Consolidated+FDI+Policy+2017.pdf>> accessed 13 February, 2019. Marketplace based model means e-commerce entity handling the information technology platform on digital and electronic network to act as facilitator between buyer and seller.

in B2C inventory model because otherwise e-commerce entities will devise indirect ways to undertake the very same prohibited activities. It is better to regulate it rather than altogether ban it, as it is a driver of growth in the economy. Trade bodies like NASSCOM and FICCI have also proposed that FDI should be allowed in B2C inventory-based model for the growth of 'Make in India'.²⁴

B2C inventory-based model is effective for the manufacturers of India to grow their market. It creates jobs, reduces inventory and labour costs, ensures faster deliveries to customers, etc.²⁵ The marketplace model as such is not efficient for companies because a lot of money is needed to handle it such as logistical costs, there are supply chain inefficiencies and they lack control over the quality of goods being sold.²⁶

There are a lot of downsides to the marketplace model as well which would form part of the many reasons due to which the government's protectionist instincts arise. Dr. Rashmi Das in her book '*E-Com in India: Violations & Tax Avoidance*' pointed out that many e-commerce entities created 'name lending' companies through which they started holding stocks. In this case, the e-commerce marketplace buys goods from companies in bulk on discount, then they influence the price of goods - which affects small sellers who can't participate in fast-growing e-commerce sector.²⁷ Start-ups cannot work in the marketplace model because they do not have adequate investment. In a survey, it was established that people buy more electronics and accessories such as hard drives, USB drives, laptop skins, etc., on e-commerce platforms, and a study of Counter Research and E-Marketer estimated that 40% of total smart phones that have been sold in India in the past year are through e-commerce websites.²⁸ Hence, if these goods are kept in inventory,

²⁴ Abhinna Shrestha, "Should 100% FDI be Allowed in B2C E-Commerce?" (Exchange4media, 21 May, 2015) <<https://www.exchange4media.com/digital-news/should-100fdi-be-allowed-in-b2c-e-commerce-60103.html>> accessed 16 February, 2019. NASSCOM said that 100% FDI be allowed in B2C model for growth of "Make in India"; Aditya Srivastava, "Foreign Direct Investment in E-Commerce Sector in India" (*iPleaders*, 18 April, 2018) <<https://blog.ipleaders.in/foreign-direct-investment-e-commerce-sector-india/>> accessed 16 February, 2019. FICCI said that FDI in B2C model should be allowed in phased manner to promote "Make in India" and for sourcing SMEs and MSMEs.

²⁵ Discussion Paper on E-Commerce in India <<http://indiafdiwatch.org/wp-content/uploads/2014/01/discussionpaper.pdf>> accessed 1 March, 2019.

²⁶ Arpita Mukherjee and Avantika Kapoor, "Trade Rules in E-Commerce: WTO and India" (2018) Indian Council for Research on International Economic Relations, Working Paper No. 354 <http://icrier.org/pdf/Working_Paper_354.pdf> accessed 19 March, 2019.

²⁷ Shelley Vishwajet, "The E-Commerce Transgressions and the Cry for a Level Playing Field by Physical Retailers" (India FDI Watch, 9 October, 2018) <<https://indiafdiwatch.org>> accessed 20 March, 2019.

²⁸ Harish Patil and Rajiv Divekar, "Inventory Management Challenges for B2C E-Commerce Retailers" (2014) 11 *Procedia Economics and Finance* 561 <<https://www.researchgate.net/>

they can be delivered to customers as soon as possible and as they do not take much space, inventory cost is less.²⁹ In the survey, it was also found that many people did not prefer buying online due to long product delivery times (this is one of the touch points of consumer friction). This is another significant reason why an inventory of goods is necessary.

There may be some issues with the B2C inventory model like demand fluctuations, stock outs, etc., but these are risks that businesses have to strategize for. A think tank has suggested that 49% FDI be allowed in B2C e-commerce for domestically produced things to help them gain worldwide recognition,³⁰ and to help small artisans grow and compete with leading business. The authors have attempted to formulate a clause that should form a part of the press note based on the discussion above. A similar formulation has been adopted for each of the issues discussed hereinafter.

Recommended clause:

Para 5.2.15.2.1

1. *“E-commerce entity shall have 100% FDI in Business-to-Business model and 49% FDI be allowed in inventory-based model of Business-to-Customer³¹ in particular circumstances-*
 - a) *The products which are manufactured in India.*
 - b) *Single brand retail trading through brick and mortar or produced by Indian manufactures³² is allowed to sell on e-commerce marketplace.³³ In case of Indian manufacturers, they*

publication/275541054_Inventory_Management_Challenges_for_B2C_E-commerce_Retailers> accessed 18 February, 2019.

²⁹ *Ibid.*

³⁰ Priyanka Sahay, “Government Keen on 49% FDI in B2C E-Commerce; Draft Proposal Being Discussed with Industry Today” Moneycontrol.com (New Delhi, 30 July, 2019) <<https://www.moneycontrol.com/news/economy/policy/exclusivegovt-keen-on-49-fdi-in-b2c-e-commerce-draft-proposal-being-discussed-with-industry-today-2781371.html>> accessed 20 March, 2019.

³¹ Amiti Sen, “Panel of Secretaries Reviewing E-Commerce Draft to Focus on FDI”, *The Hindu Business Line* (New Delhi, 11 September, 2018) <<https://www.thehindubusinessline.com/economy/panel-of-secretaries-reviewing-e-commerce-draft-to-focus-on-fdi/article24928815.ece>> accessed 20 March, 2019.

³² Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 3 (2016 Series) <https://dipp.gov.in/sites/default/files/pn3_2016_0.pdf> accessed 7 February, 2019. Indian manufacture is one who is an Indian brand owner manufactures in India.

³³ Namrota Baruwa, “India Inc Seeks Easing of FDIs in Multi-Brand Retail, E-Commerce & More” (*Plunge Daily*, 8 January, 2016) <<https://mybigplunge.com/trending/india-inc-seeks-easing-of-fdis-in-multi-brand-retail-e-commerce-more/>> accessed on 13 March, 2019. In pre-budget meeting, India Inc. has raised this issue to provide FDI in multi-brand retail. In February 2006, India provided single brand retail trading with 51% FDI.

*have at least 70% of its products with themselves and 30% from Indian manufactures.*³⁴

2. *In case of multi-brand retail there shall be 51% FDI be provided to boost manufacturing, export and start-ups.*³⁵
3. *E-commerce entity will enter into transaction with end customers through business-to-customer model for limited products for which entity having inventory like electronics, accessories or any other product which takes less space to store.*³⁶
4. *E-commerce entity shall have an option to check the nature of quality of goods which are being delivered to customers.”*

II. OWNERSHIP OF INVENTORY

PN3/16 and the subsequent FDI Policy of 2017³⁷ restricted e-commerce entities operating with the marketplace model from exercising ownership over the inventory (i.e., goods purported to be sold). It further stipulated that a single seller or its group companies should not account for more than 25% of the aggregate sales in one financial year on that marketplace, in order to ensure that the affiliated sellers did not account for most of the actual sales on these platforms.³⁸ What PN2/18 adds to the ownership test is the requirement of control test to be satisfied. It is now required that the marketplace entity (apart from not having ownership over the inventory) should not exercise control over the goods to be sold. The PN2/18 further provides the parameters to determine control - the threshold for which is satisfied if more than 25% of the purchases of the vendor are from the marketplace entity or

³⁴ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 3 (2016 Series) <https://dipp.gov.in/sites/default/files/pn3_2016_0.pdf> accessed 7 February, 2019.

³⁵ Namrota Baruwa, “India Inc Seeks Easing of FDIs in Multi-Brand Retail, E-Commerce & More” (*Plunge Daily*, 8 January, 2016) <<https://mybigplunge.com/trending/india-inc-seeks-easing-of-fdis-in-multi-brand-retail-e-commerce-more/>> accessed on 13 March, 2019. In pre-budget meeting India Inc. has raised this issue to provide FDI in multi-brand retail.

³⁶ Harish Patil and Rajiv Divekar, “Inventory Management Challenges for B2C E-Commerce Retailers” (2014) 11 *Procedia Economics and Finance* 561 <https://www.researchgate.net/publication/275541054_Inventory_Management_Challenges_for_B2C_E-commerce_Retailers> accessed 18 February, 2019.

³⁷ Ministry of Commerce and Industry, Department of Industrial Policy & Promotion, “Consolidated FDI Policy 2017” <<http://www.makeinindia.com/documents/10281/0/Consolidated+FDI+Policy+2017.pdf>> accessed 13 February, 2019.

³⁸ “Review of FDI Policy in E-Commerce” (Trilegal, 7 January, 2019) <<https://www.trilegal.com/index.php/publications/analysis/review-of-fdi-policy-in-e-commerce>> accessed 15 February, 2019.

its group companies. The failure to comply with either of these requirements (i.e., the ownership test or the control test) will result in conversion of the business into the inventory-based model,³⁹ effectively attracting the prohibition on FDI. Hence, non-compliance with this condition is a death-knell for foreign entities that have invested in the e-commerce space in India. There is, however, a lack of clarity as to whether the 25% requirement is to be met annually or otherwise, as the press note is silent on the same.⁴⁰ However, it may be presumed that the requirement is to be met annually considering the same requirement was followed previously.⁴¹ Another issue that crops up is whether the stipulation is 25% of the purchases of the seller's inventory on the e-commerce entity by the ultimate consumers, or the percentage requirement is for the purchases by the vendor from the e-commerce entity or its group companies. In the absence of any further clarification from the DPIIT, e-commerce entities may be required to comply with both possible interpretations in order to avoid falling on the wrong side of the law.

Apart from the difficulties created by the language, this change will impact marketplace entities that use one or more of their group entities to sell goods to sellers on a B2B basis with such sellers in turn listing the goods on the marketplace entity's platforms for sale to retail customers.⁴² Additionally, significant disadvantages have emerged for sellers selling on marketplace platforms, most of whom are devoid of any monetary benefit in the form of FDI and are now forced to diversify their procurement channels. This may mean that each of such sellers may be required to build additional channels / relationships such that they comply with the new condition.⁴³ As a result, their margins will be affected which is contrary to the government's desire of ensuring the protection of seller community. The peculiarity of the clause is that its non-compliance will result in violation of the FDI laws by the

³⁹ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 2 (2018 Series) <https://dipp.gov.in/sites/default/files/pn2_2018.pdf> accessed on 15 February, 2019.

⁴⁰ DIPP Press Note on the Consolidated FDI Policy for E-Commerce (Economic Laws Practice, 28 December 2019) <<https://elplaw.in/leadership/dipp-press-note-on-the-consolidated-fdi-policy-for-e-commerce/>> accessed 15 February, 2019.

⁴¹ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 3 (2016 Series) <https://dipp.gov.in/sites/default/files/pn3_2016_0.pdf> accessed 7 February, 2019.

⁴² Vinay Joy, Rishabh Bharadwaj and Neil Deshpande, "India: FDI in E-Commerce Activities: Press Note No. 2 (2018 Series)" (Khaitan & Co., 2 January, 2019) <<http://www.mondaq.com/india/x/768654/Fiscal+Monetary+Policy/FDI+IN+E-COMMERCE+ACTIVITIES+PRESS+NOTE+NO+2+2018+SERIES>> accessed 16 February, 2019.

⁴³ DIPP Press Note on the Consolidated FDI Policy for E-Commerce (Economic Laws Practice, 28 December, 2019) <<https://elplaw.in/leadership/dipp-press-note-on-the-consolidated-fdi-policy-for-e-commerce/>> accessed 15 February, 2019.

concerned e-commerce entity⁴⁴ imposing a burdensome requirement on them without much thought as to the practicality of execution. Due to its loosely worded nature, the press note also brought into its ambit the private labels of e-commerce entities exclusively sold on its market platform. However, a later clarification introduced by the department stated that the modified policy does not ban private labels.⁴⁵

Recommended clause:

“Para 5.2.15.2.4 (iv): E-commerce entity providing a marketplace will not exercise ownership or control over the inventory that is the goods purported to be sold. Inventory of a vendor shall be deemed to be controlled by e-commerce marketplace entity if 25% of annual sales of such a vendor are from the marketplace entity or its group companies.”

III. EQUITY PARTICIPATION

The latest DIPP diktat prohibits an entity from selling its goods on the platform of the marketplace entity if the latter has a stake in the company by means of equity participation. The prohibition is also attracted if the e-commerce marketplace entity exercises control on the inventory of the entity. The phrase “equity participation” is an ambiguous term without any inkling in the entire press note with respect to whether both direct and indirect equity participation is banned. Although keeping in mind the intention of the government, it may be safely inferred that both are prohibited. The above statement is still guesswork at best because in the succeeding clause, where the government seeks to regulate cash backs and logistical services provided by e-commerce entities or their affiliates, both direct and indirect equity participation is prohibited. Hence, it is estimation at best as to why this clause was left uncertain and ambiguous. The trouble that arises as a result of such an expansive interpretation is that in the absence of a minimum disqualification percentage even minority participation by e-commerce marketplace entities has been disallowed.

⁴⁴ Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, Press Note No. 2 (2018 Series) <https://dipp.gov.in/sites/default/files/pn2_2018.pdf> accessed 15 February, 2019.

⁴⁵ “No Ban on Private Labels, FDI Policy Not against Consumer: Government”, *The Economic Times* (New Delhi, 4 January, 2019) <<https://economictimes.indiatimes.com/news/economy/policy/no-ban-on-private-labels-fdi-policy-not-against-consumer-government/articleshow/67374862.cms?from=mdr>> accessed 16 February, 2019.

This in turn could limit the prospect of e-commerce players investing significantly in the vendor ecosystem in India, leading to an undesired effect on the ability of Indian e-commerce companies to develop and sell white-label brands or provide growth-capital to small-scale artisanal brands.⁴⁶ Globally, white-label and artisanal brands have been a driver of volumes and margins for e-commerce entities, providing them with an incentive to invest in this ecosystem.⁴⁷ This is not some anticipated dystopian event whose occurrence is a remote possibility. The adverse effect of this clause has already surfaced with Amazon no longer contemplating buying a stake in Future Retail,⁴⁸ a direct causality of the PN2/I8.

Prior to the absence of any such restrictions, the e-commerce entities backed by foreign players had evolved such structures where they had a stake in a substantial number of sellers on their platform which enabled them to exert influence on the price of goods and services on their platform and provide discounts. Prohibition on the same has created a lot discomfort for foreign e-commerce players who are now revamping their structures following the refusal of the government to extend the deadline of February 1, 2019⁴⁹ for compliance despite intense lobbying.

Recommended clause:

“Para 5.2.15.2.4 (v): An entity having direct equity participation by an e-commerce marketplace entity or its group companies or having control over its inventory as defined in Para 5.2.15.2.4 (iv) by an e-commerce marketplace entity or its group companies will not be permitted to sell its products on the platform run by an e-commerce company.”

IV. NON-DISCRIMINATORY PRICING

PN2/I8 Para 5.2.15.2.4 (ix) states that e-commerce marketplace entities or other entities (wherein e-commerce marketplace entity has direct or indirect equity participation or common control) providing services such as logistics,

⁴⁶ Review of FDI Policy in E-Commerce (Trilegal, 7 January, 2019) <<https://www.trilegal.com/index.php/publications/analysis/review-of-fdi-policy-in-e-commerce>> accessed 15 February, 2019.

⁴⁷ *Ibid.*

⁴⁸ Ajita Shahsidhar, “Amazon-Future Retail Deal has Fallen Through, Sources Say”, *Business Today* (New Delhi, 4 January, 2019) <<https://www.businesstoday.in/current/corporate/kishore-biyani-may-not-sell-stake-in-future-retail-to-amazon-say-sources/story/306941.html>> accessed 30 February, 2019.

⁴⁹ PTI, “Government to Not Extend February 1 Deadline on Revised Norms for E-Tailers”, *The Hindu* (New Delhi, 31 January, 2019) <<https://www.thehindubusinessline.com/economy/policy/govt-to-not-extend-february-1-deadline-on-revised-norms-for-e-tailers/article26140099.ece>> accessed on 30 February, 2019.

warehousing, advertisement/ marketing, payments, financing, etc., to vendors shall do so at arm's length basis and in a fair and non-discriminatory manner. They should not directly or indirectly influence the sale price of goods or services and they have to maintain a level playing field. In all similar circumstance, the services which are provided to one vendor will be provided to other vendors. Furthermore, cash back provided by group companies of marketplace entity to buyers shall be fair and non-discriminatory.

The model of business is that a B2C entity buys goods from a B2B company at heavy discounts and sells these on the e-commerce platform attracting a lot of customers. The foreign investor holding shares in B2B companies absorbs this discount that increases the Gross Merchandise Value which is used in ascertaining the valuation of market place models. This directly influences the sale price of goods and the objective is to ensure maximum sales happen through their platform.⁵⁰ There is also indirect influence on sale price of goods when e-commerce giants like Amazon through a concept known as promotional funding recommend its sellers to offer discount and subsequent to the consent of the seller, a debit note is offered to Amazon which is then duly paid by it.⁵¹

The PN2/18 has been brought to solve issues between offline and online market but the clause providing for a fair and non-discriminatory treatment raises a number of issues and also prima facie seems to encroach on the jurisdiction of the Competition Commission of India (hereinafter, "CCI"). The issue relating to 'influencing the sale price of goods' is a concern of the CCI and not of the DIPP,⁵² because if marketplace is directly or indirectly influencing prices, then offences and the punishment are mentioned in Competition Act, 2002. According to Competition Act, 2002 if the e-commerce marketplace is involved in predatory price (influencing the sale price of goods) then it must be in a dominant position⁵³ in a relevant market.⁵⁴ CCI

⁵⁰ Aakash Kamble and Dr Shubhangi Walvekar, "Policy Regulations in E-Commerce Sector – Critical Analysis of FDI Guidelines for Market Place Model", *Journal of Commerce & Management Thought* (2017) 8(3) *International Journal of Commerce and Management* 409.

⁵¹ *Ibid.*

⁵² Srinivas Katta, Aakash Dasgupta and Ankita Gupta, "Indus law Guidelines for Foreign Direct Investment in E-Commerce" (IndusLaw, April 2016) <<http://www.manupatrafast.in/NewsletterArchives/listing/Induslaw/2016/April-2016%20-%20GUIDELINES%20FOR%20FOREIGN%20DIRECT%20INVESTMENT%20IN%20E-COMMERCE.pdf>> accessed 15 March, 2019.

⁵³ Competition Act, 2002, S. 4. Predatory price is defined in S. 4 Explan. (b) as when the price of goods is below the cost for the sale of goods to reduce the competition or eliminate the competitors. Dominant position is defined in S. 4 Explan. (a) as position of strength enjoyed by enterprise in relevant market to work independently of leading forces and to affect the relevant market, customer or competitors in their favour.

⁵⁴ *All India Online Vendors Assn. v. Flipkart India (P) Ltd.*, 2018 SCC OnLine CCI 97 : 2018 Comp LR 1122. Relevant market was defined as services provided by online marketplace

does not recognize e-commerce marketplace as a dominant player because it's not the only platform available in India.⁵⁵

CCI in case of *Ashish Ahuja v. Snapdeal.com*⁵⁶ stated that Snapdeal is not a dominant player because it acts as a facilitator who manages a web portal so that sellers and buyers can come together to interact, and is not itself engaged in purchase or sale of storage devices. In case of *Mohit Manglani v. Flipkart India (P) Ltd.*,⁵⁷ CCI was of the opinion that e-commerce marketplace entity is not individually dominant whether it operates as a separate relevant product market or only as a distribution channel, because there are many online players who offer similar facilities to their customers. In yet another case of *All India Online Vendors Assn. v. Flipkart India (P) Ltd.*,⁵⁸ a complaint was filed against Flipkart under Section 3 and Section 4 of Competition Act, 2002 saying that it sells products from WS Retailers at discounted prices by giving preference. The CCI re-affirmed its earlier stance stating that in the present market structure, online marketplace is not in a dominant position because there are several players online and it can't be said that one player is dominating the whole marketplace.

Hence, the above cases prove that an e-commerce marketplace entity directly or indirectly influencing the prices of the goods to be sold is not liable under Competition Act, 2002. The reason to have PN2/18 is to curb the practice of influencing the sale price of goods but it will be very hard to prove that marketplace is doing it because CCI does not recognize e-commerce marketplace as dominant player. So, in case the DIPP really wants the established status quo to change then a new regulatory authority should be established whose only task is the regulation of the e-commerce market.

Another concern is what the government means by "influencing the sale price of goods" as there can be many interpretations to it. Does it only refer to deep discounting or does it include predatory pricing as well? Does it cover within its ambit discounts offered for marketing and advertisement purposes? Or does the government mean that pricing algorithms⁵⁹ should be

platforms for selling goods in India.

⁵⁵ Esha Shekhar, "Are Deep-Discounts in E-Commerce Anti-Competitive? Flipkart's Big Billion Day Sale and the Way Forward" (ipleaders, 17 October, 2014) <<https://blog.ipleaders.in/are-deep-discounts-in-e-commerce-anti-competitive-flipkarts-big-billion-day-sale-and-the-way-forward/>> accessed 19 March, 2019.

⁵⁶ 2014 SCC OnLine CCI 67.

⁵⁷ 2015 SCC OnLine CCI 61.

⁵⁸ Competition Commission of India, Case No. 20 of 2018.

⁵⁹ Bill Baer, Sonia Kuester Pfaffenroth and Vesselina HMusick, "United States: Pricing Algorithms: The Antitrust Implications" (Arnold & Porter, 17 April, 2018) <<https://www.arnoldporter.com/en/perspectives/publications/2018/04/>

stopped? Are the ‘buy one get one free’ offers by e-commerce entities hit by the prohibition on predatory pricing?

Moreover, there are no prohibitions on cash backs i.e., one of the methods of discounting which should be fair and non-discriminatory. The vendors have raised a hue and cry about the fact as to how the cash backs by Paytm have negatively influenced the price of goods,⁶⁰ completely obliterating any control over pricing and adversely affecting profit margins.

In *Fast Track Call Cab (P) Ltd. v. ANI Technologies (P) Ltd.*,⁶¹ CCI considered the radio cab service as different relevant market on the basis of convenience, ease of availability, round of clock availability, etc. This put the e-commerce marketplace at same place as that of cab service, which makes it a different relevant product market. Therefore, offline and e-commerce market are placed on different pedestals. So if discounting is provide by e-commerce platform, then offline market can’t say that it affects their market.

The issues do not end here. Common control has not been defined in press note. It is defined in neither the Consolidated FDI Policy nor the PN_{3/16}. What does it mean? Does it mean common ownership? Does it mean the services which are being provided to e-commerce marketplace, vendors also have a common control over it?

Another important distinction is between small vendors on one hand, and medium and big vendors on the other hand, who are not in the same class. Small vendors need more support for their sustenance and growth from e-commerce marketplace.⁶² If services provided are in a fair and non-discriminatory manner, then it will only impact the small vendors. The start-up business will also be affected because of this rule as to make a mark on customer there are many things which are to be done which can’t be possible if services provided are fair and non-discriminatory for all the vendors. Article 14⁶³ also says that like should be treated alike and alike should be treated

pricing-algorithms-the-antitrust-implications> accessed 1 March, 2019. Pricing algorithm means that when different customers open the e-commerce portal, they are shown a different price for the product.

⁶⁰ Shashidhar K.J., “CCI to Look into Cashbacks Models for Predatory Pricing: Report” (MediaNama, 17 May, 2016) <<https://www.medianama.com/2016/05/223-cci-cashbacks-models/>> accessed 12 March, 2019.

⁶¹ 2015 SCC OnLine CCI 139.

⁶² Srinivas Katta, Aakash Dasgupta and Ankita Gupta, “Indus Law Guidelines for Foreign Direct Investment in E-Commerce” (IndusLaw, April 2016) <<http://www.manupatrafast.in/NewsletterArchives/listing/Induslaw/2016/April-2016%20-%20GUIDELINES%20FOR%20FOREIGN%20DIRECT%20INVESTMENT%20IN%20E-COMMERCE.pdf>> accessed 15 March, 2019.

⁶³ Constitution of India 1950, Art. 14.

like. Therefore, small vendors and leading vendors are two different classes and for each class, there should be fair and non-discriminatory practices.

Lastly, “similar circumstances” has not been interpreted by the Government. It cannot be interpreted as “same circumstance”. Any meaning to the word will limit the growth of e-commerce.⁶⁴

Recommended clause:

“Para 5.2.15.2.4 (ix) E-commerce entities shall provide discounts and cash backs for a maximum duration (sunset clause) or shall provide monthly limit to the discounts, i.e., for the month this much discount be given on the goods and shall maintain a level playing field for the same class of sellers.

For the purposes of this clause, provision of services to vendor who fall under same class not made available to other vendors in same class in similar circumstances will be deemed unfair and discriminatory.”

V. EXCLUSIVE SALE AGREEMENTS

PN2/18 Para 5.2.15.2.4 (xi) says that marketplace e-commerce will not mandate any seller to sell any product exclusively on its platform. There can be two interpretations to it. First, whether they are prohibiting the seller from entering into exclusive contract with e-commerce entity? Second, whether they are restricting the seller from entering into multiple platforms that are run by group companies or marketplace entity?⁶⁵

Press note has not mentioned what would happen if sellers want to enter with e-commerce entity exclusively? How can one show that sellers entered exclusively and not the e-commerce entity?⁶⁶

Recommended clause:

“Para 5.2.15.2.4 (xi) E-commerce entities are prohibited from mandating sellers to enter into exclusive sale agreements. In case sellers

⁶⁴ Review of FDI Policy in E-Commerce (Trilegal, 7 January, 2019) <<https://www.trilegal.com/index.php/publications/analysis/review-of-fdi-policy-in-e-commerce>> accessed 15 February 2019.

⁶⁵ Vinay Joy, Rishabh Bharadwaj and Neil Deshpande, “FDI in E-Commerce Activities: Press Note No. 2 (2018 Series)” (Khaitan & Co. 2 January, 2019) <<http://www.mondaq.com/india/x/768654/Fiscal+Monetary+Policy/FDI+IN+E-COMMERCE+ACTIVITIES+PRESS+NOTE+NO+2+2018+SERIES>> accessed 16 February, 2019.

⁶⁶ Anubhuti Mishra and Parth Sehan, “Press Note 2 of 2018: Reinventing E-Commerce?” (LinkedIn, 3 January, 2019) <<https://www.linkedin.com/pulse/press-note-2-2018-reinventing-e-commerce-anubhuti-mishra/>> accessed on 23 March, 2019.

want to enter then 'certificate of voluntary entry' shall be issued to them."

CONCLUSION

One of the elements of Lon Fuller's principles of inner morality is that law should be constant,⁶⁷ meaning it should not change so frequently as to render obedience difficult. While the law does need to keep evolving so that the changing needs of the society are met with as little friction as possible, it cannot be a reason for the government to make substantive alternations without a discernible policy objective. The changes introduced by PN2/18 force foreign entities in the e-commerce space to completely alter their structures that were carefully built and operated over the years, within a months' notice. Request for extension or a grandfathering clause were denied. With elections around the corner, the move seemed more and more directed towards appeasement of the small sellers who along with their families form a significant voter base. The piecemeal manner in which changes are introduced is nothing more than a hindrance in the overall development of the sector. The need of the hour is a specific set of laws governing the e-commerce ecosystem and a national e-commerce regulator enforcing them. This will ensure that there are not multiple regulators each coming out with their own set of rules for the businesses to comply with.

Specifically with respect to PN2/18, the addition of the control test over the goods purported to be sold (inventory) increases compliance, and burdens and compels marketplace entities to alter their business models. The restriction on equity participation does seem to be bit stretched as it covers both direct and indirect participation in both the entity as well as its group company. The requirement of fair and non-discriminatory treatment for all vendors is especially a laudable step in view of the stake of e-commerce marketplace entities in multiple sellers on their platforms. In this manner cash backs will be within limits too.

The PN2/18 is one among the many regulations and changes that the government will keep on introducing as and when it encounters new challenges. Businesses will also respond to them. The sector being at a nascent stage, the regulations that govern it are nebulous at best and clarity will be achieved only in due course of time.

⁶⁷ Collen Murphy, "Lon Fuller and the Moral Value of the Rule of Law" (2005) 24(3) Law and Philosophy 239 <https://www.jstor.org/stable/30040345?seq=1#metadata_info_tab_contents> accessed on 27 March, 2019.