Consolidated Foreign Direct Investment ("FDI") Policy

The Department of Industrial Policy and Promotion ("DIPP") has issued the third release of the Consolidated FDI Policy today in the form of Circular 1 of 2011. This Circular overrides the Circular 2 of 2010 issued on September 30, 2010 and all Press Notes/ Circulars/ Clarification etc. issued by DIPP from time to time. The key changes in the FDI Policy of India brought about by this Circular are as follows:

a. *The pricing of convertible instruments*

Circular 2 of 2010 stated that the price of convertible instruments should be decided upfront. However, Circular 1 provides flexibility for such investment and states that the companies shall have an option of prescribing the conversion formula which can be based on performance. However, it has to be ensured that such formula is subject to RBI/ SBI guidelines on pricing. This change in policy would help the recipient companies to obtain better valuations based on performance.

b. *Inclusion of fresh items for issue of shares against non-cash considerations*

The Circular 2 of 2010 provided for conversion of only ECB/lump-sum fee/Royalty into equity (under automatic), the Government, through Circular 1 of 2011 has provided for other non-cash item which can be converted into equity under the Government route. These are: (a) Import of capital goods/ machinery/ equipment (including second hand machinery) (b) pre-operative/ pre-incorporation expenses (including payments of rent etc.). This measure, which liberalizes conditions for conversion of non-cash items into equity, is expected to significantly ease the conduct of business.

c. *Removal of the condition of prior approval in case of existing joint ventures/ technical collaborations in the "same field"*

Circular 2 of 2010 provided that where a non-resident investor has an existing joint venture/ technology transfer/ trademark agreement, as on January 12, 2005, new proposals in the same field for investment/technology transfer/technology collaboration/trademark agreement would have to be under the Government approval route through FIPB/ Project Approval Board. The government, through Circular 1 of 2011 has decided to abolish this condition. This measure of the Government is being considered to be the key for increasing competition and investment in the technology inflow in India.

d. *Guidelines relating to down-stream investments*

Circular 1 of 2011 has changed the classification for determining downstream investment. It states that the companies may now be classified into two main categories: (a) Companies owned or controlled by foreign investors and (b) Company owned and controlled by Indian Resident. This classification is different from the earlier one wherein the Companies were divided into three categories: (a) Investing Companies (b) Operating Companies and (c) Investing cum Operating Companies.

e. *Development of Seeds*

Circular 2 of 2010 stated that FDI was allowed up to 100% under automatic route for the category of "Development of seeds" under "controlled conditions". However, Circular 1 of 2011 states that FDI will now be permitted in the development and production of seeds and planting material without the above said stipulation of "controlled conditions"