Foreign direct investment: defence and railways

Defence sector
In May 2001, the defence industry was thrown open to investment by the private sector with the Government permitting 100% equity with a maximum of 26% Foreign Direct Investment component, both subject to licensing. Prior to 2001, fairly limited production was carried out by eight Defence Public Sector Undertakings with very few of them being involved in manufacturing heavy equipment for the armed forces. India has historically relied on foreign manufacturers for fulfilling its heavy military equipment requirement.

In 2010, India surpassed all other countries as largest importer of foreign arms in the World. Government of India, in order to ease dependence on imports and improve domestic manufacturing capability, announced major reforms in the defence sector by liberalising the FDI limit from 26% to 49%, in the Union Budget 2014-15. This is in line with Government’s thinking that it needs to give impetus to indigenous manufacturing and improved R&D.

Following are the key changes that have come into effect with the Press Note:

– The primary change in the policy is the increase in the foreign investment limit in the Defence Industry from 26% to 49% under the ‘Government Approval’ route.

– FDI limit of 49% is composite and includes all kinds of foreign investments such as Foreign Direct Investment, Foreign Institutional Investors, Foreign Portfolio Investors, Non-resident Indian, Foreign Venture Capital Investors and Qualified Foreign Investors. However, total Portfolio Investment by FPI, FII, NRI, QFI and investments through FVCI together cannot exceed 24% of the total equity of the Investee/joint venture company. Portfolio Investments, subject to the above-mentioned cap, will be permitted under Automatic Route.

– Approvals

– Applications falling within the 49% limit would follow the existing procedure followed in the Government Approval route with proposals involving inflows of more than Rs.1200 crores requiring a approval from the Cabinet Committee on Economic Affairs (CCEA).

– Applications seeking permission for FDI beyond 49% in cases that result in granting access to modern and ‘state-of-art’ technology to India would require approval by the Cabinet Committee on Security, upon recommendation of the Ministry of Defence (as against from Department of Defence.

There were certain restrictions or conditions which existed earlier on the foreign investors interested in investing in the defence sector. The same have been removed.
production which was the case in the previous regime) and the Foreign Investment Promotion Board.

- Applications for FDI beyond 49% which involve inflow in excess of INR 1,200 crore are required to be approved by the Cabinet Committee on Security and such proposals would not require further approval of the Cabinet Committee on Economic Affairs. It is pertinent to add here that entity seeking government approval for FDI beyond 49% can either be an Indian company or a foreign company. Further, for such cases the government has dispensed with the requirement stipulated in para (iii) of the revised policy which states that the ownership and control of the management and majority on the Board as well as the position of Chief Executives of the joint venture company would be retained by resident Indian citizens.

- There is an essential condition of appointing a resident Indian Citizen as the Chief Security Officer (CSO) in the investee/joint venture company.

- The investee/joint venture company should be structured to be self-sufficient in the areas of product design and development. Further, the investee/joint venture company along with manufacturing facility shall also have maintenance and life cycle support facility of the product being manufactured in India.

- In a welcome move the government has dispensed with the three-year lock-in period for transfer of equity from one non-resident investor to another non-resident investor as was the case in the previous regime.

As per the new policy Licence applications will now be considered and licences granted by the DIPP in consultation with the Ministry of External Affairs as well in addition to the existing consultation requirement with the Ministry of Defence.

Conclusion

The increase in FDI limit in the defence sector is a much awaited move that would encourage foreign investment in this critical sector. The Indian defence market is the largest in the World on account of India having the World’s third largest Armed Forces and operational commitments.

Therefore, the Indian defence market is the most sought after by the global arms companies and this move by the government is a positive step towards reforming and liberalising this sector.

Government having eased the entry barriers is now engaging with key stakeholders to discuss modernisation plans and critical deals and contentious policy issues at the Defence Acquisition Committee of the Government of India.

Railway sector

The investment friendly regime in New Delhi is on the course to implementing the announcement of allowing FDI in railways, made in the Union Budget 2014-15. The Government of India, vide its Notification No.S.O.2113(E), dated 22 August 2014 has revised its existing policy of imposing restrictions on foreign investment in the railways by liberalising the FDI limit to 100% on ‘Automatic’ route in the Rail Infrastructure sector. Accordingly, it has been decided to permit FDI in certain construction, operation and maintenance activities of the railways transportation sector. So far the Government vide its notification ‘Exemption of Certain Classes of Industrial Undertakings from Certain Provisions of Act (Notification No: S.O.477 (E) dated 25-Jul-91)’ had reserved railway industry for public sector. Consequently, the railway sector had been included in the list of prohibited sectors given in the FDI Consolidated Policy, 2014.

Key changes in the FDI Policy brought about by the new Notification are as follows

- The FDI in rail infrastructure up to 100% will be cleared through automatic route, which means no approval from the Foreign Investment Promotion Board would be required. However, proposals involving FDI beyond 49% in sensitive areas from security point of view would have to be brought by the Ministry of Railways before the Cabinet Committee on Security for consideration on case to case basis.

- The railway infrastructure where FDI is now permitted will include construction, operations and maintenance activities in the following:
  - Suburban corridor projects through PPP,
  - High speed projects,
  - Dedicated freight lines,
  - Rolling stock including train sets, and locomotives/coaches manufacturing and maintenance facilities,
  - Railways electrification,
  - Signalling systems,
  - Freight terminals,
  - Passenger terminals,
  - Infrastructure in industrial park pertaining to railways line/sidings including electrified railway lines and connectivity’s to main railway line,
  - Mass Rapid Transportation Systems.

The FDI in the abovementioned activities open to private sector participation including FDI is subject to sectorial guidelines of the Ministry of Railways.

- The FDI continues to remain prohibited in the Railway Operations.
Further information
If you would like further information on any issue raised in this update please contact:

Jay Cheema, Partner
E: jay.cheema@clasislaw.com

New Delhi
14th Floor
Dr. Gopal Das Bhawan
28, Barakhamba Road
New Delhi 110 001
T: +91 11 4213 0000
F: +91 11 4213 0099

Mumbai
1202B One Indiabulls Centre,
Tower 2B, Floor 12B,
841 Senapati Bapat Marg,
Elphinstone Road
Mumbai 400 013
T: +91 22 49100000
F: +91 22 49100099

London
The St Botolph Building
138 Houndsditch
London EC3A 7AR
T: +44 20 7876 4848
F: +44 20 7875 5132

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Conclusion
This long overdue measure has come at a time when the Indian Railways require funds to modernise and ramp up capacity to serve the rapidly growing needs of the economy.

This liberalisation would provide railways the much-needed resources to modernise and upgrade its operational capacity while attracting newer technology and increasing the internal resource generation.

Amendments in Paragraphs 6.2.12.1 are as follows:

– Para 6.2.12.1 (ii) of the Consolidated FDI Policy defines the term “Infrastructure” in context of “Industrial Parks”. The definition of “Infrastructure” has now been modified to include terms ‘railways line/sidings including electrified railway lines and connectivity’s to the main railway line’, in addition to the existing activities that were already covered in the definition of infrastructure like “facilities required for functioning of units located in the Industrial Park includes roads (including approach roads), water supply and sewerage, common effluent treatment facility, telecom network, generation and distribution of power, air conditioning”.

– Para 6.2.12.1 (iii) of the Consolidated FDI Policy defines the term “Common Facilities” in context of Industrial Parks. The definition of “Common Facilities” has now been modified to include the terms ‘railway line/sidings including electrified railway lines and connectivity’s to the main railway line’ in addition to the existing activities that were already covered in the definition of Common Facilities like “facilities available for all units located in the industrial park, and include facilities of power, roads (including approach roads), water supply and sewerage, common effluence treatment, common testing, telecom services, air conditioning, common facility buildings, industrial canteens, convention/conference halls, parking, travel desks, security services, first aid centre, ambulance and other safety services, training facility and such other facilities meant for common use of the units located in the Industrial Park”.

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