Lakshmikumaran & Sridharan corporate

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September 2016 / Issue – 61

An e-newsletter from
Lakshmikumaran & Sridharan, India

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September
2016

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A primer on e-commerce business and related laws in India

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E-commerce, in recent times, has mushroomed and has now touched all forms of business transactions in the country. Due to the ease, safety, security and convenience provided by electronic payment systems, E-wallets or mobile wallets have taken over the traditional system of payments.

The latest Consolidated Foreign Direct Investment Policy dated June 07, 2016 issued by the Department of Industrial Policy and Promotion defines 'E-commerce' as the *'buying and selling of goods and services including digital products over digital & electronic network'*[1]. Therefore, e-commerce includes within its ambit all forms of electronic wallets (e-wallets) or mobile wallets (m-wallets). Also, E-wallets are a form of Pre-paid Payment Instruments[2]. E-wallets permit an individual to carry out any commercial transaction, which may involve online purchasing of goods/ services or purchasing of a product or availing a service, at an outlet. E-wallet stores a person's credit or debit card details. Since the payment information is securely stored in an e-wallet, the need to carry cash physically has been eliminated.

Categories of Pre-paid Payment Instruments

Pre-paid Payment Instruments are categorized based on their functioning and operation.

1. Closed System Payment Instruments

These are payment instruments issued by a person for facilitating the purchase of goods or services from him/it. These instruments do not allow cash withdrawal or redemption. As these instruments do not facilitate payments and settlement of third party services, issue and operation of such instruments are not classified as payment systems.[3]

2. Semi-Closed System Payment Instruments

These are payment instruments which can be used for purchase of goods or services, including financial services at a group of clearly identified merchant locations/ establishments which have a specific contract with the issuer to

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1 Consolidated FDI Policy, issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Effective from June 07, 2016, **Circular No. D/o IPP F. No. 5(1)/ 2016 –FC-1**

2 Master Circular of RBI – Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India – dated July 01, 2014 (updated on December 03, 2014), **Circular No. DPSS. CO. PD. PPI. No. 03/02.14.006/2014-15**

3 *Ibid*

accept the payment instrument. These instruments do not permit cash withdrawal or redemption by the holder.[4]

3. Open System Payment Instruments.

These are payment instruments which can be used for purchase of all goods and services, including financial services like fund transfer at any card-accepting merchant locations *(point of sale terminals)* and also permit cash withdrawal at ATM's/ BC's.[5]

4. Semi-closed System Payment Instruments for Mass Transit Systems (PPI-MTS)

The semi-closed payment instruments will be issued by mass transit systems operators *(PPI-MTS)*, after authorization under the Payment and Settlement Systems Act, 2007, to issue and operate such Pre-paid Payment Instruments. The PPI-MTS will necessarily contain the automated fare collection application related to the transit service to qualify as PPI-MTS. Apart from mass transit system, such PPI-MTS can be used only at other merchants whose activities are allied to or are carried on within the premises of the transit system.[6]

With the rapid growth of e-commerce, e-wallets have become the preferred mode of payment. E-wallets offer an easy and hassle-free means of payment, which in turn provides a competitive advantage over the traditional forms of payment.

Laws applicable to electronic payments in India

Due to rapid growth in the electronic payment system and tremendous increase in the usage of e-wallets, it is necessary to know the regulations governing electronic payments.

1. Payment and Settlement Systems Act, 2007

The Payment and Settlement Systems Act, 2007, deals with all the regulatory aspects pertaining to payment systems in India. This Act empowers the Reserve Bank of India *(hereinafter referred to as "RBI")* to serve this purpose. The term *"Payment System"* has been defined under Section 2(i) of the Payment and Settlement Systems Act, 2007, which *"means a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange."*

[4] Master Circular of RBI – Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India – dated July 01, 2014 (updated on December 03, 2014), **Circular No. DPSS. CO. PD. PPI. No. 03/02.14.006/2014-15**

[5] *Ibid*

[6] Prepaid payment instrument **(PPI)** guidelines – Introduction of new category of PPI for Mass Transit Systems (PPI-MTS), dated. July 09, 2015, **Circular No. RBI 2015-16/123, DPSS. CO. PD. No. 58/02.14.006/2015-16**

The term *"System Provider"* has been defined under Section 2(q) of the Payment and Settlement Systems Act, 2007, as *"a person who operates an authorized payment system"*. The *"System Participant"* has been defined under Section 2(p) of the act as *"a bank or any other person participating in the payment system and includes the system provider"*

2. Payment and Settlement Systems Regulations, 2008

Under the Payment and Settlement Regulations, 2008, the RBI has been authorized to formulate regulations under the powers conferred upon RBI under Section 38 of the Payment and Settlement Systems Act, 2007. Any person or entity who wishes to set up a payment system has to adhere to the provisions of the Payment and Settlement Systems Regulations, 2008. If such an applicant complies with the provisions and if the RBI is satisfied, then RBI may issue an "authorization certificate" to set up the payment system, subject to provisions of Section 7 of the Payment and Settlement Systems Act, 2007. The authorization certificate has been defined under Section 2(c) of the Payment and Settlement Systems Regulations, 2008 as *"the certificate containing the authorization issued by the Bank under sub-section (1) of section 7 of the Act" [The Payment and Settlement Systems Act].*

Every effort is made by RBI to ensure that the application for obtaining the authorization certificate is finalized within six (6) months from the date of filing such application. If the RBI feels that the application should be refused, then it shall give the applicant a written notice to this effect, stating the same with reasons for such denial. Before refusing any such application, the applicant is given a chance of a hearing before RBI.

The RBI is also authorized to conduct any inquiry, if necessary, to satisfy itself about the information provided by the applicant and any other background details of the applicant, as it thinks are necessary before granting the authorization certificate.

3. RBI Guidelines:

Under Section 38(1) of the Payment and Settlement Systems Act, 2007, the RBI is authorized to formulate all regulations pertaining to Pre-paid Payment Instruments. Banks complying with the eligibility criteria would be permitted to issue all categories of pre-paid payment instruments.[7] However, only those banks who have been permitted to provide

[7] Master Circular of RBI – Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India – dated July 01, 2014 (updated on December 03, 2014), **Circular No. DPSS. CO. PD. PPI. No. 03/02.14.006/2014-15**

mobile banking transactions by the RBI shall be permitted to launch mobile-based pre-paid payment instruments *(mobile wallets and mobile accounts)*.[8] Non-banking Financial Companies *(hereinafter referred to as "NBFC's")* and other persons would be permitted to issue only closed and semi-closed system payment instruments, including mobile phone based pre-paid payment instruments.[9]

The Policy Guidelines issued by the RBI dated July 01, 2014 *(further updated on December 03, 2014)* defines *"Pre-paid Payment Instruments"*[10] as *"payment instruments that facilitate purchase of goods and services, including funds transfer, against the value stored on such instruments."* The value stored on such instruments represents the value paid for by the holders by cash, by debit to a bank account, or by credit card. The pre-paid instruments can be issued as smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instrument which can be used to access the pre-paid amount.[11]

The RBI in its Policy Guidelines defines *"issuer"* as *"persons operating the payment systems issuing pre-paid payment instruments to individuals/ organizations."* The money so collected is used by these persons to make payment to the merchants who are part of the acceptance arrangement directly, or through settlement arrangement.[12]

The term *"Holder"* has been defined in the Policy Guidelines as *"individuals/ organizations who acquire pre-paid payment instruments for purchase of goods and services, including financial services"*.[13]

4. RBI Guidelines for safeguards regarding electronic payments and Know Your Customer ("KYC") policy

The guidelines pertaining to Know Your Customer (*KYC*) norms, Anti-Money Laundering (*AML*) standards and Combating of Financing of Terrorism (CFT) obligations issued by RBI to other banks from time to time, shall apply *mutatis mutandis* to all persons issuing pre-paid payment instruments.[14]

The KYC policy includes the following four

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8 *Ibid*
9 *Supra*
9 *Supra*
10 *Supra*
11 *Supra*
12 Master Circular of RBI – Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India – dated July 01, 2014 (updated on December 03, 2014), **Circular No. DPSS. CO. PD. PPI. No. 03/02.14.006/2014-15**
13 *Ibid*
14 *Supra*

key elements:

- Customer Acceptance Policy;
- Risk Management;
- Customer Identification Procedures (CIP); and
- Monitoring of Transactions.
- **Customer Acceptance Policy:** Every bank should develop a clear customer acceptance policy laying down explicit criteria for acceptance of customers.[15]
- **Risk Management:** The board of directors of the bank should ensure that an effective KYC program is put in place by establishing appropriate procedures and ensuring their effective implementation. It should cover proper management oversight, systems and controls, segregation of duties, training and other related matters.[16]
- **Customer Identification Procedures (CIP):** The policy approved by the board of banks should clearly spell out the customer identification procedure to be carried out at different stages, i.e. while establishing a banking relationship; carrying out a financial transaction or when the bank has a doubt about the authenticity/ veracity or the adequacy of the previously obtained customer identification data.[17]
- **Monitoring of Transactions:** Banks should pay special attention to all complex, unusually large transactions and all unusual patterns which have no apparent economic or visible lawful purpose. Banks may prescribe threshold limits for a particular category of accounts and pay particular attention to transactions which exceed these limits.[18]

FDI and E-Commerce in India

The latest Consolidated FDI Policy Circular (hereinafter *"FDI Policy"*) dated June 07, 2016, defines *'E-Commerce'* as *"buying and selling of goods on an electronic network"*.[19]

The FDI Policy further defines an *'E-Commerce Entity'* as a *"company incorporated under the Companies Act 1956 or the Companies Act 2013 or a foreign company covered under section 2(42) of the Companies Act, 2013 or an office, branch or agency in India as provided in section 2 (v) (iii) of FEMA 1999, owned or controlled by a*

[15] Master Circular of RBI – Know your customer (KYC) norms, Anti-money laundering (AML) standards/ Combating of financing of terrorism/ Obligations of bank under PMLA, 2002, **Circular No. RBI/2013-14/94, DBOD. AML. BC. No. 24/ 14.01.001/ 2013-14.**

[16] Master Circular of RBI – Know your customer (KYC) norms, Anti-money laundering (AML) standards/ Combating of financing of terrorism/ Obligations of bank under PMLA, 2002, **Circular No. RBI/2013-14/94, DBOD. AML. BC. No. 24/ 14.01.001/ 2013-14.**

[17] *Ibid*

[18] *Supra*

[19] Consolidated FDI Policy, issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Effective from June 07, 2016, **Circular No. D/o IPP F. No. 5(1)/ 2016 –FC-1**

person resident outside India and conducting the e-commerce business"

The FDI Policy defines *'Inventory based model of E-commerce'* as *"an E-commerce activity where the inventory of goods and services is owned by that particular e-commerce entity and the goods are sold to the customers directly*[20]*."*

The FDI Policy defines *'Marketplace based model of E-commerce'* as *"providing an information technology platform by an e-commerce entity on a digital & electronic network in order to act as a facilitator between buyer and seller*[21]*."*

Entry Routes for Foreign Investment

Investments can be made by non-residents in (i) equity shares; (ii) fully, compulsorily and mandatorily convertible debentures; and (iii) fully, compulsorily and mandatorily convertible preference shares of an Indian company, through the Automatic Route or Government Route. Under the Automatic Route, the non-resident investor or the Indian company does not require prior approval from the Government of India for the investment. Under Government Route, prior approval from the Government of India is required. Proposals for foreign investment under Government Route are considered by Foreign Investment Promotion Board (*hereinafter referred to as "FIPB"*).[22] The question of automatic route or prior Government approval will come in, depending on the nature of activities to be carried out by the company looking for investment.

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Notifications & Circulars

Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016 ('Amendment'), notified:

The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016, which was introduced in May 2016, sought to amend four key legislations:

(i) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (*"SARFAESI Act"*);

(ii) Recovery of Debts due to Banks and Financial Institutions Act, 1993;

(iii) Indian Stamp Act, 1899; and

(iv) Depositories Act, 1996.

The corresponding Act of Parliament, i.e. the Enforcement of Security Interest and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 (*"Act"*),

[20] Consolidated FDI Policy, issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Effective from June 07, 2016, **Circular No. D/o IPP F. No. 5(1)/ 2016 –FC-1**

[21] *Ibid*

[22] *Supra*

was subsequently notified by way of publication in the Official Gazette on August 16, 2016. The main objective behind this Amendment is to ensure that creditors have sufficient recourses for expeditious recovery of bad loans.

Amongst other changes that the said Act has brought to SARFAESI Act, major amendments include the following:

1. The process of taking possession over collateral by secured creditors, upon default in repayment, is to be undertaken with the assistance of a District Magistrate. The Amendment seeks to have this process completed within a time frame of 30 days.

2. The Amendment empowers the District Magistrate to assist banks in taking over the management of a company by converting their outstanding debt into equity shares, and consequently holding a stake of 51% or more, if such company is unable to repay its loans.

3. The Amendment seeks to integrate records of the registrations made under various legislations including Companies Act, 2013, Registration Act, 1908 and Motor Vehicles Act, 1988 and create a Central Registry whereby all the records will be maintained at a central level.

4. The secured creditors will not be allowed to take possession over the collateral or have priority over others in repayment of dues, unless the collateral is registered with the Central Registry.

5. With the change, listed debenture securities have also been included within the ambit of SARFAESI Act. Debenture trustees appointed in respect of debt securities listed in accordance with applicable SEBI Regulations have been specifically included as 'secured creditors' under the SARFAESI Act.

Appointment of Managing or whole-time director - Schedule V of Companies Act, 2013 amended:

Section 197 read with Schedule V of Companies Act, 2013 (Act) prescribes the conditions for overall maximum managerial remuneration and managerial remuneration by companies having no profit or inadequate profit. Section II, Part II in Schedule V of the Act sets out the statutory limits for maximum remuneration payable to managerial personnel by such companies, without Central Government approval.

Recently, the Ministry of Corporate Affairs *vide* its Notification dated 12th September, 2016 (Notification) has amended the statutory limits set out under Schedule V of Companies Act, 2013. This amendment has now enhanced the statutory yearly remuneration limits considerably (i.e. up to twice the existing limits), payable by the companies having no profit or inadequate profits without the need for prior approval from the Central Government. This Notification has also brought into force a new provision pertaining to remuneration of managerial personnel functioning in a professional capacity.

Approval from the Central Government shall not be required if a managerial person is working in his professional capacity and does not have any direct or indirect interest in the capital of the company, its holding company or any of its subsidiary and also does not have any direct or indirect interest or related to the directors or the promoters of the company or its holding company or its subsidiaries anytime during the last two years before or on or after the date of his appointment. Further, such managerial person should possess graduate level qualifications and have specialised knowledge in the field in which the company operates. The proviso further clarifies that any employee whose holding in the company does not exceed 0.5% of the paid-up share capital of the company would be deemed to be a person not having any interest in the capital of the company.

Earlier, a company in default of repayment of any of its debts, debentures or interest payable thereon for a continuous period of 30 days in the preceding financial year before the date of appointment of a managerial person, was debarred from payment of remuneration to such person. Now, the Notification allows such defaulting companies to pay remuneration upon prior approval from its secured creditors along with stating the same in the explanatory statement to the notice of the general meeting.

Companies (Mediation and Conciliation) Rules, 2016 notified: The Ministry of Corporate Affairs vide its Notification dated 9 September, 2016 has notified the Companies (Mediation and Conciliation) Rules, 2016 (*"Rules"*). Section 442 of the Companies Act, 2013 authorizes the Central Government to set up a panel of experts for mediation and conciliation between parties to the dispute. The objective is to reduce the burden on the National Company Law Tribunal and the National Company Law Appellate Tribunal by offering the parties, during the pendency of their dispute, an additional forum to settle their disputes.

By way of these Rules, the Regional Director appointed by the Central Government in the Ministry of Corporate Affairs, has been vested with the power to set up the panel in compliance with the said Rules. The Rules specify the procedure which is required to be followed by the mediator and the conciliator for disposal of matters. Further, the mediators and conciliators are required to complete the process of mediation and conciliation within a strict time frame of 3 (three) months from the date of appointment of expert/s from the Panel. Other relevant provisions under these Rules relate to formation of panel of mediators and conciliators, their qualification, appointment, scope of work etc., to describe a few.

Restrictions on promoters and whole-time directors of compulsorily delisted companies pending fulfillment of exit offers to the shareholders: SEBI, through Circular SEBI/HO/CFD/DCR/CIR/P/2016/81 dated 7 September 2016 (*'Circular'*), has imposed further restrictions on the promoters

and whole-time directors of a company under compulsory delisting.

Under the existing regulatory framework, the promoters and whole-time directors of a company that has been compulsorily delisted are denied all kinds of direct and indirect access to the securities market for a period of 10 (ten) years from the date of such compulsory delisting, in terms of Regulation 24 of the SEBI (Delisting of Equity Shares) Regulations, 2009. Pursuant to compulsory delisting, the promoters of a compulsorily delisted company are also required to acquire delisted equity shares from the public shareholders at a fair value determined by an independent valuer at the public shareholders' option.

Now, in addition to the above-mentioned restrictions, the Circular seeks to ensure effective enforcement of exit option to the public shareholders. By virtue of this Circular, SEBI has directed that in cases where the fair value of such compulsorily delisted companies is positive:

a) Such company and its depositories shall not be permitted to effect transfer, by way of sale, pledge, etc., of any equity shares, and corporate benefits like dividend, rights, bonus shares, split, etc. shall be frozen, for all the equity shares, held by the promoters/ promoter group till the promoters of such company provide an exit option to the public shareholders in compliance with the Delisting Regulations; and

b) The promoters and whole-time directors of such compulsorily delisted company shall also not be eligible to become directors of any listed company till the exit option to the public shareholders is provided.

Ratio Decidendi

Recovery of arrears when a company is no longer a 'sick' company

The Hon'ble Supreme Court of India, recently pronounced a judgement on a very interesting issue regarding recovery of arrears when a company is no longer a 'sick' company. The dispute in question pertained to demand by the Income tax department during the time the Draft Rehabilitation Scheme (scheme) was circulated and sanctioned by the Board of Industrial and Financial Reconstruction (Board).

On appeal, The Supreme Court held that once the net-worth of a company turns positive, it is no longer a 'sick' company. The Income Tax Department, therefore, has the right to recover the arrears from such a company [*Director General of Income Tax v. GTC Industries Ltd.* - AIR 2016 SC 2825]

Arbitration – Scope of enquiry under Section 45 to not include enquiry of legality and validity of substantive contract

The Hon'ble Supreme Court of India has held that the scope of enquiry under Section 45 of the Arbitration and Conciliation Act, 1996,

is confined only to the question – whether the arbitration agreement is "null and void, inoperative or incapable of being performed" and not on the legality and validity of the substantive contract. Submissions that some portion of the agreement were inconsistent with some provisions of the Indian Contract Act, 1872, and Section 23 of the Indian Contract Act (as being contrary to public policy), thus invalidating the arbitration agreement, were rejected by the Court observing that arbitration agreement is independent from the substantive contract. [*Sasan Power Limited v. North American Coal Corporation India Private Limited* -C.A. No.8299/2016, decided on 24-8-2016]

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