FDI In E-Commerce- Anomalous Implications

The regulatory framework governing e-commerce in India needs to be thoroughly overhauled in order to avoid legal and procedural pitfalls that could inevitably spell chaos in the sector

The **Department of Industrial Policy & Promotion ("DIPP")** issued its Press Note No. 3 (2016 series), on 29 March 2016, prescribing guidelines for **Foreign Direct Investment ("FDI")** in e-commerce. Significantly, these guidelines have come in the wake of a notice issued to the Central Government, on 23 September 2015, by the Hon'ble High Court of Delhi in a Writ Petition filed by the 'All India Footwear Manufacturers & Retailers Association' wherein it was alleged that despite FDI being prohibited in retail, the entities retailing goods through the Internet were not being restrained from accepting foreign investment and thereby, the FDI Policy was being violated and prejudice being caused to the petitioners.

Apparently, DIPP's Press Note No. 3 is an attempt to infuse some clarity into a vexed situation but, unfortunately, the contents of the Note raise more questions than they answer, in terms of the legality and practicability of the provisions aimed at regulating Foreign Investment in e-commerce. The following analysis of the guidelines reveals the inherent contradictions and their implications:

i) The guidelines ordain that 100% FDI is permitted, in an e-commerce entity only if it adheres to the "marketplace based model" of e-commerce, whereby the e-commerce company simply provides an IT platform, on a digital and electronic network, to act as a "facilitator" between the buyer and seller and has no ownership in the inventory of goods or services transacted over the platform. Obviously, if the e-commerce entity has no stake in the goods and services being sold, it can, at best be visualised, as an electronic courier (for offer and acceptance between two principal contracting parties i.e. buyer and seller) or as an information exchange. Therefore, it is neither accountable for fulfilling a transaction nor is it answerable for any warrantees or guarantees that the seller may extend to the buyer. By the same token, the buyer would have no legal recourse against the e-commerce

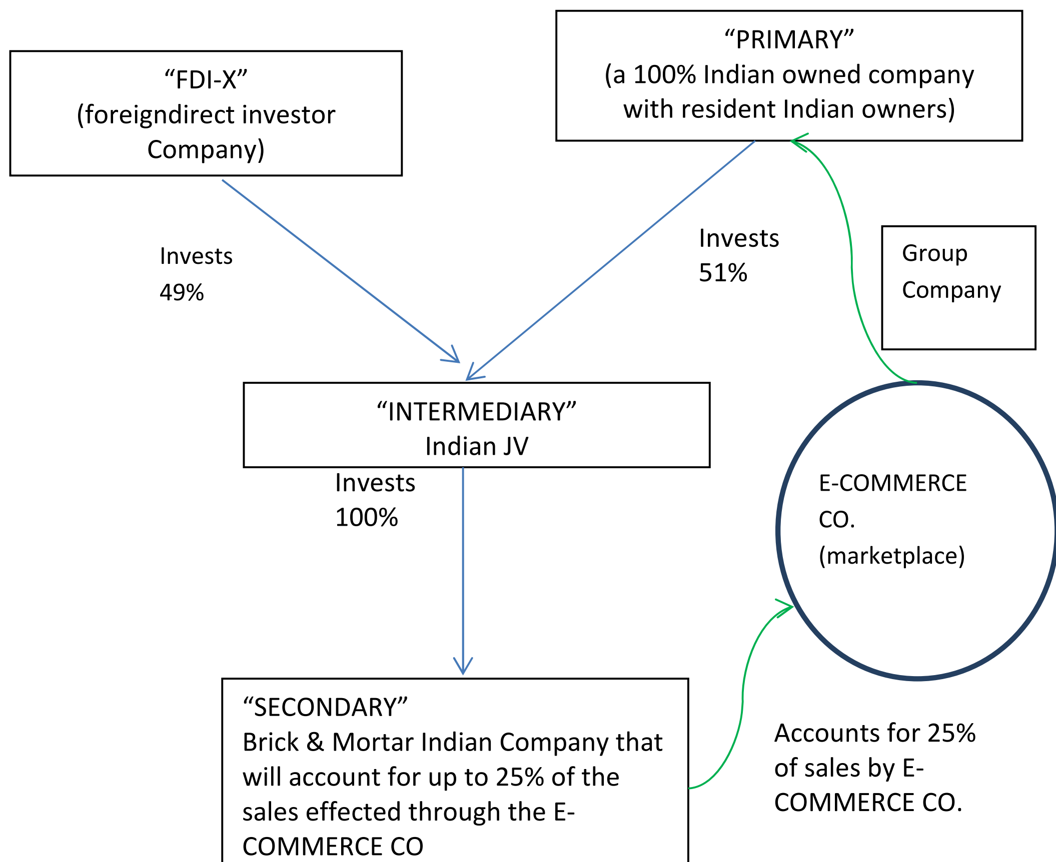
entity if (a) the goods sold are not delivered; (b) the goods/ services that are delivered turn out to be substandard and (c) the e-commerce entity conducts no due diligence at all in regard to the credibility of any seller purporting to vend goods/ services over the IT platform provided by the e-commerce entity.

ii) On the one hand, the guidelines say at para 2.3 (iv) that, "e-commerce marketplace may provide support services to sellers in respect of warehousing, logistics, order fulfilment, call centre, payment collection and other services." Yet, on the other hand, the very same guidelines lay down at para 2.3 (vi) that, "post sales, delivery of goods to customers and customer satisfaction would be the responsibility of the seller". *Here lies the paradox*. A small seller would be liable for delivery of goods to the buyer even though this seller does not have the wherewithal to effect deliveries across a wide geographical expanse; whereas the e-commerce entity, that extends the logistics for such delivery, shoulders no responsibility at all vis-à-vis the buyer. Yet again, while payment may be collected by the e-commerce entity and paid to its account by the buyer, the latter enjoys no remedy against the former in the absence of "customer satisfaction".

iii) In a seeming attempt at preventing monopolies in e-commerce, para 2.2 (v) of Press Note No. 3 mandates that "an e-commerce entity will not permit more than 25% of the sales effected through its marketplace from one vendor or their group companies". This provision might well have consequences opposite to those intended.As the hitherto prevalent practice of brick and mortar business associates of e-commerce entities(e.g. Cloudtail for Amazon and WS Retail for Flipkart) occupying pre-eminent positions on these platforms would end;this could well open the door for skilfully disguised cartels of the big brick and mortar retailers to corner the e-retail market and dictate terms to small sellers and manufacturers.

iv) The same provision – para 2.2 (v) of Press Note No. 3 – which has been inexpertly drafted, lays itself open to discreet exploitation of the marketplace based model by large e-commerce entities with substantial foreign holdings. In order to understand this, one has to look to the provision in an earlier DIPP Pres Note No. 2 of 2009 which allowed any Indian company "owned and controlled by resident Indian citizens to make downstream investments in any venture in India" adding that "such downstream investments will not

be counted as FDI". Hypothetically, therefore, a foreign investor, say "FDI-X", can invest up to 49% in an Indian JV (say "INTERMEDIARY") with 51% in the JV being owned by a fully Indian Company (say "PRIMARY"). The "Intermediary" then invests 100% in an Indian brick and mortar retail entity, say "SECONDARY". This would, in theory, meet the DIPP criterion of the "INTERMEDIARY" being an Indian company (owned and controlled by resident Indian citizens, i.e. "PRIMARY" which owns 51% or controlling shares in the "INTERMEDIARY") making downstream investments in the Indian retail company namely "SECONDARY". The "SECONDARY", in turn would team up with an e-commerce entity (the "E-COMMERCE CO.") which is a group/ associate company of the "PRIMARY" to effect and account for up to 25% of the sales affected through the marketplace model website of the "SECONDARY". The graphical representation would be:



Hypothetically, if Cloudtail be regarded as the “SECONDARY” company in regard to Amazon, which is the E-COMMERCE CO., then Cloudtail would be able to account for 25% of the online sales made by Amazon. Similarly, WS Retail which may be regarded as the SECONDARY for Flipkart that is the E-COMMERCE Co. could effectively vouch for 25% of Flipkart sales. Moreover, if Amazon and Flipkart could reach an understanding, Flipkart could source a further 25% of its sales from Cloudtail and Amazon could do likewise with WS Retail. In sum, both these e-commerce giants could ensure that their group companies would be able to corner, collectively, 50% of the sales made by Amazon and Flipkart taken together.

v) Para 2.3 (ix) of the guidelines provides that “e-commerce entities providing marketplace will not directly or indirectly influence the sale price of goods and services and shall maintain level playing field”. This is a quixotic idea with devastating consequences (with inevitably resulting legal challenges) for small sellers because they have, so far, prospered on the big sales offers with discounts that only platforms like Amazon and Flipkart could coordinate and put through. According to a report, captioned “Decoding Digital @ Retail”, put out by the Boston Consulting Group, in February this year, discounts were cited as the primary driver for the purchase decision in the case pf more than 40% of the purchases and that too in a potentially $50 billion e-retail market. In one sweep, this DIPP guideline has replaced the level playing field provided for players, big and small, by an e-commerce entity with exploitative controls in the hands of big brick and mortar players who would be able, if they wished, to manipulate prices.

Another area, where the DIPP guidelines are poised to cause significant legal ramifications, pertains to jurisdiction in the event of legal disputes. As the e-commerce entity is no longer a contracting party but merely a “facilitator” between buyer and seller, the question as to which court, located where, would exercise jurisdiction, in case of a dispute between buyer and seller, could deter either the seller from selling or the buyer from buying depending on how the matter of jurisdiction is settled.

Going by recent judgments, the court where the buyer is situated has jurisdiction over disputes in regard to e-commerce contracts. A Division Bench of the Hon’ble High Court of Delhi considered the issue of jurisdiction in relation to “carrying on business” in the

context of business transacted over the Internet in World Wrestling Entertainment Inc. v. M/s. Reshma Collection, FAO(OS) No. 506 of 2013. Their lordships relied on the leading case of Bhagwan GoverdhandasKedia v. GirdharilalParshottamdas& Co.: AIR 1966 SC 543, which would, *mutatis mutandis*, entail that:

- **a)** The advertising of goods/ services on a website is an invitation to offer.
- **b)** The offer proper is only made when the transaction is confirmed by the buyer and payment made to seller.
- **c)** It is only thereupon that the seller (on the e-commerce site) accepts the offer and this acceptance gets instantaneously communicated to the buyer.
- **d)** This would mean that the contract is concluded at the location of the buyer and the court having jurisdiction over the location of the buyer would have jurisdiction over a dispute arising from such a contract.

The DIPP guidelines, having put the e-commerce entity out of the contractual relationship entirely, a seller located in say Kochi, whose goods are sold through the marketplace platform in towns as widely dispersed as say, Patna, Nasik and Kanpur could well be faced with the perilous situation of having to contest lawsuits in all three locations. Most small and medium sellers of goods and services would be incapable of fighting legal battles in distant places and would rather not engage in e-commerce than incur such a risk.

In the light of what has been enumerated above, the regulatory framework governing e-commerce in India needs to be thoroughly overhauled in order to avoid legal and procedural pitfalls that could inevitably spell chaos in the sector.

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