Amazon versus Future Coupons and Others – Lessons in Regulations and Contract Enforcement in India

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Background

A recent verdict of the Indian Supreme Court (SC) in favour of the global e-commerce giant Amazon ("Amazon") against India's Future Group (FG) has been hailed as a landmark ruling affirming the enforceability, in India, of an interim arbitration award by an international "Emergency Arbitrator" (EA). In giving effect to an EA's award, the SC reinforced the principle of autonomy of the parties to an arbitration agreement, and the primacy of the arbitral terms voluntarily consented to by both parties.

By recognizing the EA, the SC has, by implication, accepted the EA's critical interim order (as further affirmed by the Delhi High Court). The EA's order has far reaching implications for complex cross border M&A transactions in regulated sectors involving groups of companies in India.

Issues

1) Structuring around regulatory restrictions: Amazon initially invested in an intermediate company of FG (Future Coupons (FC). FC, in turn, down streamed the amount invested by Amazon, into Future Retail (FR). Though Amazon did not have a direct contractual relationship with FR, the commercial understanding between the parties was that any alienation of assets by FR to 'restricted persons' (including Reliance) would require Amazon's consent. Thereafter, when a financially beleaguered FR attempted to divest its retail assets to Reliance, Amazon argued that its investment agreement prohibited FR from doing so. FG contended before the EA *inter alia* that Amazon's investment violated India's Foreign Direct Regulations and RBI regulations that restrict majority foreign investment in multi-brand retail in India, without prior consent from the Government of India. Though EA rejected this argument by holding that Amazon's indirect veto rights over FR *did not* amount to 'control' over FR (and hence did not violate Indian law), this episode has a precautionary lesson for foreign investors contemplating structured M&A transactions in India.

2) Doctrine of Group Companies: Pushed to a wall, FR argued before the EA that as Amazon's arbitration agreement was with FC, it (FR) was not bound by it. However, the EA invoked the "doctrine of group companies" and held that FR was a proper party to these proceedings. According to the EA, the facts on record clearly established "*cogent commonality, intimate interconnectivity, and undeniable indivisibility*" of the contractual arrangements between Amazon and FC on the one hand, and FC and FR on the other. Not only was FR actively involved in negotiation, it was its ultimate beneficiary of the transaction.

3) **Whether Amazon's investment was tantamount to 'control' over FR?:** Where indirect/stepdown investments in India are concerned, foreign investors need to be mindful of such investments being construed as indirect control of the ultimate beneficiary. In the present instance, FR argued that a negative covenant restricting a transfer of FR's assets to restricted persons was in effect, indirect control by Amazon over FR, thus violating Indian law.

Analysis

1) **Structuring around regulatory restrictions:** One key takeaway from the Amazon-Future dispute is that in cross border M&A transactions in India, foreign investors would be wise to evaluate the enforceability of deal structures carefully, especially where the concerned transaction is in a regulatory grey zone. A decade ago, foreign investors relying on call and put options in India (the enforceability of which was similarly suspect), found Indian sponsors reneging on their put obligations to foreign investors, using regulatory restrictions as an excuse. While in Amazon's case the EA concluded that Amazon's investment was *not* a breach of Indian law, the lesson for prospective investors is to include (to the extent feasible) clarificatory language in shareholder/investment documentation evidencing in clear terms the commercial intent of the parties involved. In the absence of commercial clarity in the documentation, under hostile circumstances, a domestic party may perversely invoke regulatory restrictions to avoid its obligations, contending that '*what cannot be done directly cannot be done indirectly*'.

   While there is no standardized antidote to such unsatisfactory outcomes, foreign investors should ensure that

structured cross border FDI transactions in regulated sectors include mechanisms for investor protection, should aspects of the transaction be held to be unenforceable in the future. Protective provisions could include, for instance:

- Guarantees from the target's foreign obligors (if possible) if the transaction were to fail in India;
- Holdbacks, deferred consideration and earnouts, payable once parties obtain regulatory clarity;
- Option-based covenants on the Indian obligor to if the transaction failed to receive regulatory approvals; and
- Indemnities from the seller if the transaction is unenforceable.

2) **Was Amazon's investment tantamount to 'control' over FR?:** In rejecting FG's contention that Amazon's investment amount to illegal control of FR, the EA reasoned as follows:

I) In the absence of control overboard of FR, Amazon could not be said to have "control" over FR;

ii) FG induced an investment from Amazon based on specific representations that the investment is in accordance with law and that the control remains with FG despite the special, material and protective rights to Amazon;

iii) Having benefited from substantial investment from Amazon, FR's argument that Amazon's veto violates law, cannot be permitted;

iv) Though the EA and DHC did not specifically invoke promissory estoppel, their rulings appear to predicate considerations of equity and specific representations from the sellers/Indian obligors, over expedient arguments of transactional illegality by the Indian obligor at a later point in time; and

v) Amazon's agreement with FC provided "*for the avoidance of doubt*" that Investor and FC have no agreement for exercising control over, FR.

3) Doctrine of Group Companies: In upholding that the EA's award against FR, another critical issue that was affirmed by the SC was privity of contract. FR had argued that it was not bound by obligations entered into between FC and Amazon, as FR did not have a direct contractual relationship with Amazon. The EA observed that given:

- the close inter-connected nature of both transactions (Amazon and FC on the one hand; and FC and FR on the other);
- simultaneous negotiations and discussions on both sets of the Agreements by a single/ common legal team; and
- the fact that Amazon's investment in FC was immediately routed to FR (which was a direct beneficiary of monies invested by Amazon), FRL is a proper party to the arbitration proceedings between FC and Amazon (doctrine of "group of companies").

4) **Incorporating investor rights into target's Articles:** Where M&A involves indirect acquisitions in India or downstream investments through intermediate companies, any special rights to the investor should be included in the ultimate downstream beneficiary entity's articles. One can speculate as to why Amazon did not insist, at the time of its investment in FC, on incorporating its protective rights into FR's articles. A plausible explanation could be regulatory uncertainty around Amazon's veto rights against FR, which may have caused Amazon to err on the side of discretion by not reflecting its rights in a public document, i.e. FR's Articles. However, the fact that FR used this to repudiate Amazon's restrictive covenant against transfer of FR's business, should serve as a warning to prospective investors.

Conclusion

This SC's verdict reaffirming the sanctity of commercial contracts against an Indian party, is a positive signal on enforcement of contractual terms and the ease of doing business in India. By virtue of the SC's ruling, both the EA and DHC's detailed interim orders in Amazon's favour reiterating axiomatic positions under Indian law on various critical and contentious matters, assume validity. These include the finding that protective rights (of Amazon) do not amount to "control" (of FR); a restriction on transfer to a strategic competitor is not a restraint of trade; and '*economic hardship alone is not a ground for disregarding legal obligations*'

The Amazon-Future battle is a sobering reminder of the inherent regulatory complexities of doing business in India. However, with FG reigned in for the moment, all eyes are now on the ongoing proceedings before the SIAC to determine the rights and obligations for the parties involved.

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