

## Defining Control: Future Retail vs. Amazon

Recently a Single Judge of the High Court of Delhi considered, among other substantive matters, the perennial question of “control” in the context of a proceeding initiated by Future Retail against Amazon. The court reached a *prima facie* conclusion that “...the control that is sought to be asserted by Amazon on FRL is not permitted under the FEMA FDI Rules without government approvals...”

The above conclusion was made in the context of the following underlying facts: Amazon.com Investment Holdings LLC (Amazon) holds 49% in Future Coupons Private Limited (FCPL). In turn, FCPL holds 9.82% in Future Retail Limited (FRL). FCPL is engaged in the business of “cash and carry wholesale trading”. FRL is engaged in multi-brand retail.

In terms of the FDI Policy, FDI in multi-brand retail is restricted and subject to conditions (unlike FDI in wholesale trading which is permitted up to 100% under the automatic route). In addition to direct investments in a restricted sector such as multi-brand retail, the FDI Policy also regulates investments in such businesses that may be made indirectly through Indian companies that are “foreign owned” or “foreign controlled”.

The question which arises is whether FCPL is “foreign owned” or “foreign controlled”.

FCPL is majority Indian owned. This leads to the question of whether FCPL is “foreign controlled”.

If FCPL is “foreign controlled”, any downstream investment by FCPL in FRL would have required prior government approval. Also, if FCPL already held an interest in FRL prior to Amazon’s investment in FCPL, then a transaction by which Amazon acquired majority ownership or control over FCPL would have required prior government approval. If, on the other hand, FCPL is Indian owned and controlled, then in terms of the FDI Policy, the level of FCPL’s investment in FRL or indeed the rights that FCPL (or Amazon) has in FRL should be irrelevant.

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Instead of focussing on whether Amazon has control over FRL, the threshold question which ought to have been considered by the court is instead whether Amazon has control over FCPL.

“Control” is defined under the FDI Policy to “include the right to appoint a majority of the directors or to control the management or policy decisions, exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.”

The facts discernible from the judgement are that: (1) Amazon is entitled to nominate two directors on the board of FCPL (who do not constitute a majority of the board); (2) certain matters as specified in in the FCPL shareholders agreement required prior Amazon consent – these matters have not been set out in the judgement; and (3) prior written consent of Amazon would be required before FCPL decides or implements any matter under the FRL shareholders agreement which requires FCPL consent – there are four such matters (transfer of all or substantially all of the assets, amendment of articles which adversely affects the rights of FCPL, and any issuance or transfer of securities not in accordance with the FCPL SHA).

Instead of focussing on (2) above and considering the threshold question of whether Amazon had control over FCPL, the court focusses on whether Amazon has (or could have) control over FRL through the rights mentioned at (3) above. This approach is inconsistent with the current FDI Policy.

Further, even assuming that the question of control of Amazon over FRL is relevant, the court’s reasoning in support of its conclusion is not convincing; the court seems to rely more on the fact that Amazon indirectly has certain rights in respect of FRL rather than on the nature of such rights.

A review of the rights in the FRL Shareholders Agreement as summarized in the judgement would indicate these are protective rights and not participative rights. The key to differentiating between the two types of rights is the underlying activity or action to which the rights relate. Protective rights often apply to fundamental changes in the activities of a legal entity. Examples would include a sale of important assets or an amendment of constitutional documents or an issuance of equity or debt instruments. Participating rights involve the ability to approve or veto the significant financial or operating decisions of a legal entity, and would generally be expected to occur in an entity’s normal course of business.

In fact, the court agrees in paragraph 10.16 of its judgement that these rights may not by themselves amount to control; however the court appears to be influenced by the fact that such rights available to FCPL in respect of FRL flow through to Amazon pursuant to the FCPL shareholders agreement. However, whether or not such rights flow through to

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Amazon should not in any manner affect the true nature of such rights – whether they are protective or participative rights.

In paragraph 10.30 of its judgement, the court states that “*The rights granted to Amazon by conflation of the Shareholders Agreements are prima facie disproportionate to the actual shareholding of Amazon and by camouflaging of words, the extensive rights held by Amazon by the provisions of the inter se agreements set out above, cannot be masked as mere protective rights so as to fall beyond the test of ‘control’ as propounded in ArcelorMittal.*”

The basis for such conclusion is unclear. Also, this draws attention to another aspect of the judgement – the references to, and reliance on, case law analysing “control” as used in other legislations. The court relies on observations in the Supreme Court’s judgement in *ArcelorMittal* which were made in the context of interpreting “control” as used in Section 29A of the Insolvency and Bankruptcy Code. The Supreme Court in *ArcelorMittal* in turn has referred to the Securities Appellate Tribunal order in the *Subhkam* matter which was delivered in the context of “control” as used in the SEBI Takeover Code. In this regard, it would be useful to reiterate that “control” over corporate bodies appears in various forms: single control, joint control, control by virtue of shareholding, rights or custom. Further, control may have different meanings in the context of different legislations and policy documents (the FDI Policy, the Competition Act, the Companies Act, the SEBI Takeover Code and the Insolvency and Bankruptcy Code), depending upon the objective of the legislation in question. The consequences of a finding of control also vary under different legislations.

Given the Delhi High Court’s observations regarding Amazon’s “control” over FRL and compliance with FDI Rules, the relevant regulators may look to consider this matter further. Also, the Delhi High Court’s order is unlikely to be the last word on the subject. Appellate courts may have a different view. In the meanwhile, absent guidance from regulators in the context of specific legislations, it seems that a lack of clarity in the interpretation of “control” will remain the order of the day.

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