ASSURED RETURN IN FDI: BLURRING THE LINE BETWEEN EQUITY AND DEBT VIS-À-VIS THE DOCOMO CASE

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ABSTRACT

Foreign Direct Investment (FDI) into India frequently incorporates "assured return" exit clauses within Shareholders' Agreements to mitigate investor risk. These arrangements are governed by Indian foreign exchange regulations, specifically the Foreign Exchange Management Act, 1999 (FEMA) and the Non-Debt Instruments (NDI) Rules, 2019. However, a fundamental conflict exists between these contractual exit options and regulatory mandates: Indian laws strictly prohibit guaranteed exit pricing to prevent foreign investors from disguising debt-like instruments as risk-free equity. Consequently, when an exit is triggered due to underperformance, the guaranteed put option clashes with FEMA valuation rules, which bar share sales below fair market value at the time of exit.

Centered on the landmark NTT Docomo v. Tata Teleservices case, this article examines how the Indian judiciary resolved this conflict by upholding a $1.17 billion arbitral award. By framing the enforcement of an otherwise impermissible pricing clause as a judicial claim for damages arising from a contractual breach, Indian courts effectively navigated rigid FEMA pricing restrictions to prioritize commercial reliability and international investor protection.

INTRODUCTION

Corporate finance primarily relies on three funding pillars: equity, debt, and retained earnings. These capital sources can be mobilised both domestically and internationally. Generally, Foreign Direct Investment (FDI) involves raising equity capital from non-resident entities to establish lasting economic interests and strategic control in an Indian enterprise. Conversely, when an Indian entity raises cross-border debt, it falls under the regulatory umbrella of External Commercial Borrowings (ECB). A unique area exists in Compulsorily Convertible Debentures (CCDs), Compulsorily Convertible Preference Shares (CCPSs), which are characterised as equity instruments[1].This article evaluates the nature of FDI, specifically focusing on Joint Ventures (JVs) and the regulatory frameworks governing them. Through a detailed case study of the ***NTT Docomo v. Tata Teleservices Ltd.(TTSL)s*** [2] dispute, it analyzes whether an "assured return" exit option effectively transforms equity capital into debt. Furthermore, it explores the tension between investor protection mechanisms and capital controls, assessing whether Indian judicial interventions have prioritized global investment inflows at the expense of domestic statutory frameworks.

FDI: MECHANICS, THRESHOLDS, AND STRUCTURING

Defining FDI vs. FPI: Cross-border capital inflows are strictly categorised based on the volume of investment and the level of corporate control. Under Rule 2(r) of the **Foreign Exchange Management (Non-Debt Instruments) Rules, 2019** ("FEMA NDI Rules"), an investment made by a person resident outside India constitutes FDI if it is placed in:

- An unlisted Indian company, regardless of the percentage, or
- A stake equal to or greater than 10% of the post-issue, paid-up equity capital of a listed Indian company.

If a foreign investor acquires less than 10% of a listed company's equity, the investment is classified as Foreign Portfolio Investment[3] (FPI). The fundamental distinction is intent: FDI seeks to forge a long-term strategic relationship with active management participation, whereas

[1] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, Gazette of India, pt. II sec. 3(i), Rule 2(k) (Oct. 17, 2019).
[2] NTT Docomo Inc. v. Tata Sons Ltd 2017 SCC OnLine Del 8078.
[3] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, Gazette of India, pt. II sec. 3(i), Rule 2(r) (Oct. 17, 2019).

FPI represents highly liquid, short-term portfolio diversification.

Market Entry and Sectoral Caps: The Consolidated FDI Policy (administered by the Department for Promotion of Industry and Internal Trade—DPIIT) outlines the maximum permissible foreign equity ownership (sectoral caps) and entry routes across industries. Foreign capital enters India via two pathways:

1. **The Automatic Route:** Requires no prior regulatory approval from the Government of India or the Reserve Bank of India (RBI).

2. **The Government Route:** Demands formal, prior clearance from the relevant administrative ministry.

In the context of the *Tata Docomo* case, the investment falls under "Telecom Services" (Paragraph 5.2.14 of the FDI Policy). While the current framework permits up to 100% foreign equity in telecom, the historical framework split entry requirements: investments up to 49% qualified for the automatic route, whereas any stake exceeding 49% required mandatory approval from the Department of Telecommunications[4] (DoT).

Strategic Vehicles for FDI: Foreign investors typically enter the Indian market through three corporate structures:

- Mergers, acquisitions, or cross-border corporate restructurings with existing domestic entities.

- The establishment of a wholly owned subsidiary.

- **Joint Ventures (JVs):** A shared corporate alliance with an Indian partner governed by a Shareholders' Agreement (SHA). JVs represent the most common operational mechanism for large-scale foreign capital entry and serve as the backdrop for the *Docomo* conflict.

The Regulatory Framework Governing Indian FDI: Cross-border investments operate

[4] Department for Promotion of Industry and Internal Trade, Min. of Commerce & Industry, Gov't of Ind., Consolidated FDI Policy 2020,46, (2020), https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020.pdf.

within a complex, overlapping web of corporate, securities, and economic statutes:

- **Primary Legislations:** The Foreign Exchange Management Act, 1999 (FEMA); the FEMA (Non-Debt Instruments) Rules, 2019; and the FEMA (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019.

- **Corporate & Market Regulators:** The Companies Act, 2013; the Securities and Exchange Board of India (SEBI) Regulations; the Income Tax Act, 1961; and the Competition Act, 2002.

- **Administrative Authorities:** The DPIIT sets the overarching policy framework, while the **Reserve Bank of India (RBI)** enforces monetary compliance, issues master directions, and controls the cross-border repatriation of funds.

CASE STUDY: NTT DOCOMO V. TATA TELESERVICES LIMITED

Factual Background[5]: In 2009, Japan's telecom giant, NTT Docomo, entered into a joint venture with Tata Teleservices Limited (TTSL), acquiring a 26.5% equity stake in the venture for $2.7 billion. The strategic relationship was formalised via an SHA executed on March 29, 2009.To hedge its operational risks, Docomo negotiated **Clause 5.7** into the SHA. This downside-protection clause stipulated that if TTSL failed to achieve certain key performance indicators (KPIs) within a 5-year window, Tata would be contractually obligated to find a buyer for Docomo's shares, or purchase the shares itself, at a structured exit price. The pricing mechanism mandated payment of the higher of:

- The fair market value (FMV) of the shares as of March 31, 2014, or

- 50% of the initial acquisition price paid by Docomo (representing a minimum floor price protection).

The venture failed to meet its structural milestones. Consequently, Docomo exercised its right under Clause 5.7, demanding an exit at the 50% floor price ($1.17 billion), as the fair market value of the shares had severely plummeted. Tata expressed an intent to honour the contractual obligation but was blocked by the RBI, which argued that paying a predetermined floor price

[5] Supra at 1.

violated foreign exchange laws. Docomo initiated international arbitration, resulting in an Arbitral Award directing Tata to pay Docomo $1.17 billion in damages for breach of contract.

LEGAL ANALYSIS AND CRITICAL INSIGHTS

1. Does an Assured Return Blur the Line Between Equity and Debt?

The statutory boundary between equity and debt hinges entirely on risk exposure. True equity involves participating in corporate upside while remaining fully exposed to downside business losses. Debt, by contrast, features principal protection and fixed, predictable returns. Indian companies frequently utilise structural loopholes to attract foreign capital, offering instruments that are technically classified as equity but function like debt by guaranteeing a fixed return upon exit.

This dynamic creates significant friction between distinct regulatory priorities: Sometimes, a company brings debt that has the characteristics of equity to claim a reduction of interest in taxation, but the income tax department wants to show that finance is bought through equity and not debt. Similarly, Indian company sometimes brings investment through the equity route but has the colour of debt as they provide for an assured return to attract foreign investors. This is where RBI as in regulator has stepped up and has observed that the company has assigned equity in the feature of debt. The case of Tata Docomo is pari materia to the above circumstance. This situation has time and again been a debatable issue. However, the final say is with the court to decide whether by adding or subtracting some features of security, the colour of debt prevails but the company shows it as equity.

To prevent the uncontrolled buildup of disguised cross-border debt, the RBI defines a true equity check by several strict characteristics: Voting rights are mandatory for equity; non-redeemable; No assured return on the mercy of the Board of Directors; non-convertible; most subordinate claim in liquidation; exist in perpetuity and never paid before the liquidation, the exception is buyback

When an SHA incorporates an unconditional put option at a pre-calculated floor price, it strips away the downside volatility inherent to equity. By insulating the foreign investor from losses, the instrument loses its risk-bearing nature, blurs the equity-debt divide, and effectively operates as an unapproved, synthetic External Commercial Borrowing.

2. The Conflict Between Clause 5.7 and FEMA Regulations

2.1 The Legality of the Exit Mechanism

The central legal friction stems from **FEMA pricing guidelines**. Under the foreign exchange framework, a person resident outside India can transfer shares to a resident entity provided the transaction complies with prescribed valuation parameters. Specifically, the exit price cannot exceed the prevailing fair market value calculated via internationally accepted pricing methodologies on an arm's length basis. Because the value of the venture's shares had collapsed, the contractually guaranteed floor price (50% of the initial investment) was significantly higher than the actual market value.

Through **RBI Circular No. 49 (May 2010)**[6] and subsequent amendments enacted via **Notification No. FEMA 306/2014 (May 23, 2014)**[7], the regulator explicitly declared that foreign investors could not be granted an assured exit price at the time of making an investment. The rules mandated that any optionality clause must require an exit at the prevailing market price at the time of the transaction. This policy shift was reaffirmed in judicial precedents like ***IDBI Trusteeship Services Ltd. v. Hubtown Ltd.***[8] where investment structures guaranteeing fixed returns on hybrid instruments were recognised as non-compliant with the core objectives of FEMA.

2.2 The Regulatory Loophole: Right to Damages vs. Equity Pricing

This tension exposed a significant legal loophole: the distinction between the **enforceability of a pricing clause** and the **remedy for a contractual breach**. When the RBI intervened to prevent the transfer of funds at the unapproved floor price, the Delhi High Court rejected the regulator's attempt to implead itself [9]. The Court ruled that Tata was not paying an *assured exit price for shares* in violation of FEMA; rather, it was paying **general damages** awarded by an arbitral tribunal to compensate a foreign partner for the total breach of a valid contractual commitment. This transaction was legally enforceable as payment of arbitral damages for

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[6] Reserve Bank of India, FDI in India - Revised Pricing Guidelines for Transfer of Shares by way of Sale, A.P. (DIR Series) Circular No. 48, RBI/2009-10/445 (Apr. 26, 2010), https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=856 (last visited Feb. 14, 2026).

[7] Reserve Bank of India, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Seventh Amendment) Regulations, 2014, Notification No. FEMA. 306/2014-RB (May 23, 2014).

[8] **(2017) 1 SCC 568.**

[9] Foreign Exchange Management Act, No. 42 of 1999, § 6(3) (Ind.).

breach rather than violation of FEMA rules for transfer of shares at an assured price.By framing the payment as compensation for failing to find a buyer or hit performance metrics, the Court bypassed the RBI's strict pricing rules. This created a notable loophole: while an assured-return pricing clause remains technically illegal under FEMA, an award of damages for failing to honour that exact clause can still be legally enforced.

2.3 Investor Protection vs. Sovereign Capital Controls

The resolution of the *Docomo* case[10] demonstrates a conscious shift by Indian courts to prioritize institutional investor protection over rigid capital control regimes. On RTI, RBI has observed at one instance "that assured return would include principle amount plus some return. In the present there is downgrading of 50% of shares". RBI further stated that on a literal interpretation of the regulation, this clause cannot be allowed, but equity intention behind regulation can side with foreign investors, cited strategic relationship with Japan and said this a larger issue of fair commitment to a reasonable contract concerning FDI inflow[11]**.**By validating the arbitral award and blocking the RBI's intervention, the Delhi High Court signaled that once an international commercial commitment is made, domestic regulatory changes cannot be used as an escape hatch to avoid liability.

CONCLUSION

The intersection of cross-border equity investments and debt-like exit guarantees remains one of the most complex battlegrounds in Indian corporate law. While the statutory text explicitly prohibits assured-return options to protect the domestic economy from disguised foreign debt, the judiciary has carved out a vital distinction between prohibited share transfers and enforceable claims for contractual damages. By requiring Tata to pay $1.17 billion in damages, the Delhi High Court protected foreign investor interests at the expense of a strict interpretation of foreign exchange rules. This pragmatic approach emphasizes that "ease of doing business" and commercial reliability are critical priorities for India's integration into the global economy. Ultimately, the *Docomo* precedent highlights how the strict rule of law can be shaped by the broader demands of international diplomacy and economic policy.

[10] Supra at 1.
[11] NTT Docomo Inc. v. Tata Sons Ltd 2017 SCC OnLine Del 8078,para 44.