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1. *Operational Framework for Reclassification of Foreign Portfolio Investment to Foreign Direct Investment*

2. *Case Summary: Madhya Pradesh Madhya Kshetra Vidyut Vitran Company Limited and Ors. v. Bapuna Alcobrew Private Limited and Anr. (Civil Appeal No. 1095 of 2013)*

OPERATIONAL FRAMEWORK FOR RECLASSIFICATION OF FOREIGN PORTFOLIO INVESTMENT TO FOREIGN DIRECT INVESTMENT

On November 11, 2024, the Reserve Bank of India (**"RBI"**) promulgated Circular No. RBI/2024-25/90 (**"Circular"**), establishing a detailed operational framework governing the reclassification of Foreign Portfolio Investment (**"FPI"**) into Foreign Direct Investment (**"FDI"**). This framework is triggered when an FPI's aggregate holding in an Indian investee company exceeds 10% of the total paid-up equity capital on a fully diluted basis, as stipulated under Schedule II of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (**"NDI Rules"**). Pursuant to Paragraph 1(a)(iii) of Schedule II of the NDI Rules, an FPI breaching this threshold is required to either divest the excess holding within five trading days from the settlement of the trades causing such breach or reclassify the investment as FDI, subject to conditions specified by the RBI and the Securities and Exchange Board of India (**"SEBI"**).

Prior to the issuance of this Circular, the reclassification process operated without explicit procedural guidelines, resulting in ambiguity and potential non-compliance with the Foreign Exchange Management Act, 1999 (**"FEMA"**) and its subordinate regulations. The Circular rectifies this lacuna by instituting a structured mechanism, ensuring adherence to the statutory and regulatory framework governing foreign investment in India. By way of illustration, consider an FPI holding a 9% equity stake in an Indian entity that subsequently acquires an additional 2%, thereby exceeding the 10% threshold to reach 11%. Absent this framework, the FPI would be compelled to either divest the excess 1% within five trading days or permit an automatic reclassification to FDI without a delineated process, potentially contravening regulatory intent. The Circular now facilitates a deliberate and compliant transition to FDI status, provided the reclassification aligns with sectoral permissions under the NDI Rules. Notably, reclassification is expressly prohibited in sectors where FDI is barred.

This framework serves to harmonize the objectives of fostering long-term foreign investment with the imperatives of regulatory oversight, particularly in sectors subject to heightened scrutiny or involving investors from jurisdictions sharing a land border with India. It delineates clear obligations for FPIs, investee companies, and custodians, thereby enhancing legal certainty and operational efficiency.

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Pre-Reclassification Requirements

The reclassification of an FPI holding into FDI is contingent upon the fulfillment of the following pre-requisites, designed to ensure compliance with India's foreign investment regime:

⇒ **Government Approvals:** The FPI shall procure all requisite approvals from the Government of India prior to exceeding the 10% threshold. This obligation is particularly stringent for investors domiciled in countries sharing a land border with India, pursuant to enhanced scrutiny under the NDI Rules. Such approvals must confirm compliance with FDI-specific conditions, including permissible entry routes (automatic or government approval), sectoral investment caps, pricing guidelines as per FEMA regulations, and other attendant stipulations delineated in Schedule I of the NDI Rules.

⇒ **Investee Company Concurrence:** The FPI must obtain the prior written concurrence of the Indian investee company for the proposed reclassification. This concurrence obligates the investee company to ensure its continued compliance with applicable FDI regulations, including sectoral prohibitions, investment limits, and any additional governmental approvals mandated under the NDI Rules.

⇒ **Submission to Custodian:** The FPI shall formally notify its custodian of its intent to reclassify the investment as FDI, furnishing copies of all requisite government approvals and the investee company's concurrence. Upon receipt of such documentation, the custodian shall suspend further purchase transactions in the equity instruments of the investee company by the FPI until the reclassification process is completed, thereby mitigating the risk of additional breaches pending regulatory clearance.

⇒ **Consequence of Non-Compliance:** In the event the FPI fails to secure the necessary approvals or concurrence, reclassification shall not be permitted. The FPI is then mandated to divest the excess holding (i.e., the portion exceeding 10%) within five trading days from the settlement of the trade causing the breach, failing which it risks contravention of the NDI Rules.

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Post-Reclassification Requirements

Upon approval of the reclassification, the following obligations must be discharged to formalize the transition from FPI to FDI and ensure ongoing regulatory compliance:

⇒ **Reporting Obligations:** The entire reclassified investment shall be reported to the RBI within the timelines prescribed under the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019. This reporting requirement ensures transparency and enables the RBI to maintain oversight over FDI inflows in accordance with FEMA.

⇒ **Request for Transfer:** The FPI shall submit a formal request to its custodian for the transfer of the equity instruments from its FPI-designated dematerialized (demat) account to an FDI-designated demat account. This transfer reflects the distinct legal and regulatory treatment of FDI, which typically entails a greater degree of control or influence over the investee company.

⇒ **Custodian's Obligations:** Upon verification of compliance with the aforementioned reporting requirements, the custodian shall unfreeze the equity instruments—previously restricted during the reclassification process—and effectuate their transfer to the FDI-designated demat account. This step concludes the reallocation of the investment under its new classification.

⇒ **Effective Date of Reclassification:** The reclassification shall be deemed effective from the date of the breach (i.e., the date on which the FPI's holding first exceeded 10%). As of this date, the entirety of the FPI's holding in the investee company shall be treated as FDI, irrespective of any subsequent reduction below the 10% threshold, thereby affirming the irrevocability of the reclassification under the Circular.

<u>Conclusion</u>

The Circular dated November 11, 2024, constitutes a significant advancement in the regulatory framework governing foreign investment in India. By delineating a clear and enforceable process for the reclassification of FPI to FDI, it affords FPIs the flexibility to pursue strategic investments while upholding the integrity of India's foreign exchange

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and sectoral policies. This framework imposes rigorous preconditions and post-reclassification obligations to safeguard national interests, particularly in sensitive sectors or with respect to investments from geopolitically significant jurisdictions. For FPIs, investee companies, and custodians, the Circular eliminates procedural ambiguity, fostering a compliant and predictable investment environment.

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CASE SUMMARY

Case Name: Madhya Pradesh Madhya Kshetra Vidyut Vitran Company Limited and Ors. v. Bapuna Alcobrew Private Limited and Anr.

Case No.: Civil Appeal No. 1095 of 2013

Court: Supreme Court of India

Judges: Hon'ble Justices Dipankar Datta and Pankaj Mithal

Order Date: November 4, 2024

Citation: 2024 SCC OnLine SC 3113

BRIEF FACTS

The dispute centers on the recovery of minimum guarantee charges by the Appellant, Madhya Pradesh Madhya Kshetra Vidyut Vitran Company Limited (**"DISCOM"**), a state electricity distribution utility, from Respondent No. 1, Bapuna Alcobrew Private Limited, a manufacturer of rectified spirit and liquor, for electricity supplied to its Gwalior unit between June 1996 and May 2000. The parties entered an initial agreement on November 18, 1991, followed by supplementary agreements on November 17, 1992, March 30, 1995, and June 1, 1996, increasing the contract demand from 136 kVA to 1170 kVA, with minimum consumption obligations tied to load factors of 35% (no power cut) or 39% (power cut). On May 30, 1996, the Madhya Pradesh Pollution Control Board permitted Respondent No. 1 to install an 807 kVA Turbo Generating (TG) Set for captive use, prohibiting parallel operation with the DISCOM's supply and mandating minimum consumption.

Alleging parallel operation, the DISCOM issued a cancellation notice on March 28, 2000, followed by show cause notices on July 14, 2000, and January 7, 2009, each demanding Rs. 70.50 lakh. Respondent No. 1 challenged the cancellation and the July 2000 notice in Writ Petition No. 677/2000 before the Madhya Pradesh High Court, securing interim orders on May 4, 2000 (staying cancellation, subject to depositing charges), and February 14, 2001 (affirming liability for minimum charges), before withdrawing the petition on February 21, 2006, with liberty to represent the matter. The January

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2009 notice prompted Writ Petition No. 1382/2009, where the Single Judge, on July 16, 2009, upheld the liability but limited retrospective enhancement, while the Division Bench, on October 13, 2011, quashed the notice, applying the two-year limitation under Section 56(2) of the Electricity Act, 2003 (**"EA, 2003"**). The DISCOM appealed to the Hon'ble Supreme Court, contesting the limitation's applicability and the effect of delay, given prior judicial orders.

Procedurally, the DISCOM revised the demand to Rs. 56.81 lakh post the Single Judge's order, encashed a bank guarantee furnished by Respondent No. 1, and refunded the excess, prompting contempt proceedings. Respondent No. 2, the Pollution Control Board, was impleaded but sought no relief.

ISSUES

1. Applicability of Section 56(2) of the EA, 2003 to Pre-2003 Dues: Does the two-year limitation period under Section 56(2) of the EA, 2003 bar recovery of electricity dues accrued between June 1996 and May 2000, prior to the Act's enforcement on June 10, 2003?

2. Effect of Delay and Judicial Finality on Recovery: Is the DISCOM's claim for minimum guarantee charges, reiterated in the January 7, 2009 notice after a nine-year gap, enforceable, considering the delay and the binding effect of prior judicial orders under the principle of issue estoppel?

RULE

1. Section 56(2), EA, 2003: This provision prohibits recovery of sums due from a consumer after two years from when they first became due, unless continuously shown as recoverable arrears, and applies only to liabilities post-June 10, 2003. Pre-2003 liabilities, governed by the Indian Electricity Act, 1910 (1910 Act), are preserved under Section 185(5) of the EA, 2003, and Section 6 of the General Clauses Act, 1897, absent a retrospective bar.

2. Section 24, Indian Electricity Act, 1910: This authorizes disconnection of supply for non-payment after seven days' notice, without a statutory limitation period, though suits for recovery fall under Article 15 of the Limitation Act, 1963, prescribing a three-year period from neglect to pay a demand. Delay in raising demands is subject to judicial scrutiny on a case-specific basis.

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3. Issue Estoppel and Judicial Finality: Per *Hope Plantations Ltd. v. Taluk Land Board (1999) 5 SCC 590* and *Bhanu Kumar Jain v. Archana Kumar (2005) 1 SCC 787*, a judicial determination, even interim, attaining finality binds parties and bars re-litigation of the same issue in subsequent proceedings, irrespective of withdrawal or lack of merit-based disposal.

4. Limitation Act, 1963, and Reasonableness: While Section 24 lacks a limitation period, recovery beyond the three-year suit limitation requires justification, and undue delay may be challenged unless supported by prior judicial affirmation or exceptional circumstances.

APPLICATION

Issue I: Applicability of Section 56(2) to Pre-2003 Dues

The Supreme Court ruled that Section 56(2) of the EA, 2003, effective from June 10, 2003, governs only post-enforcement liabilities and does not retrospectively bar recovery of dues accrued under the 1910 Act, such as those from June 1996 to May 2000. Citing *Kusumam Hotels (P) Ltd. v. Kerala SEB* (2008) *13 SCC 213* and *K.C. Ninan v. Kerala SEB 2023 SCC OnLine SC 663*, the Court emphasized that pre-2003 statutory obligations persist under Section 185(5) of the EA, 2003, and Section 6 of the General Clauses Act, 1897, unaffected by the two-year limitation. The High Court's reliance on Section 56(2) to quash the January 7, 2009 notice—assuming the dues became unenforceable by June 2008 (two years post the 2006 withdrawal)—was erroneous, as the provision inapplies to pre-2003 liabilities. The Court clarified that the right to recover subsists absent a statutory bar, overturning the Division Bench's interpretation.

Issue II: Effect of Delay and Judicial Finality

The Court assessed the enforceability of the DISCOM's claim, raised anew in 2009 after the initial 2000 notice, under Section 24 of the 1910 Act. This provision permits disconnection after seven days' notice without a limitation period, though suits face a three-year bar under Article 15 of the Limitation Act, 1963, triggered by neglect to pay a demand (*Ajmer Vidyut Vitran Nigam Ltd. v. Rahamatullah Khan (2020) 4 SCC 650*). The nine-year gap between notices raised a delay contention, but the Court held that Section 24 imposes no temporal limit on notices, and enforceability hinges on case-specific factors, including prior judicial orders.

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The interim orders in Writ Petition No. 677/2000—dated May 4, 2000 (staying cancellation, conditional on depositing charges), and February 14, 2001 (affirming liability for minimum charges irrespective of consumption)—attained finality when unchallenged and the petition was withdrawn on February 21, 2006. The Court applied issue estoppel, noting that these orders "judicially crystallized" Respondent No. 1's liability, barring re-litigation in Writ Petition No. 1382/2009 against the identical Rs. 70.50 lakh demand. The withdrawal, despite liberty to represent, did not negate this finality, as Respondent No. 1 neither complied nor appealed, and no representation was made post-2006.

The Court distinguished interim orders dissolving upon dismissal (*State of Orissa v. Madan Gopal Rungta*, *1951 SCC 1024*) from those addressing subsequent developments (e.g., the July 2000 notice), which survive withdrawal unless reversed. Here, the February 14, 2001 order, upheld the first notice, rendering the second notice a reiteration, not a fresh demand. The High Court's failure to recognize this estoppel and its focus on delay overlooked the binding precedent. However, since the DISCOM reduced the demand to Rs. 56.81 lakh per the Single Judge's order and recovered it via bank guarantee encashment, the Court declined to alter this outcome, balancing finality with practicality.

CONCLUSION

The Supreme Court allowed the appeal, setting aside the Madhya Pradesh High Court's judgment dated October 13, 2011, with the following conclusions:

1. Section 56(2) of the EA, 2003 does not apply to dues accrued before June 10, 2003, rendering the High Court's limitation ruling unsustainable; pre-2003 liabilities under the 1910 Act remain recoverable absent a statutory bar.

2. The DISCOM's claim, affirmed by final interim orders in 2000 and 2001, withstands the nine-year delay due to issue estoppel, binding Respondent No. 1 and precluding re-litigation, despite the withdrawal of the first petition. Therefore, the Hon'ble Court affirmed the DISCOM's recovery of the revised amount as consistent with judicial finality and statutory rights.

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Warm Regards,

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