



The Plans of "Seeds" – Blooming by Du Feichen

INDIA: NAVIGATING A GROWING DATA CENTRE MARKET

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WHAT IS DRIVING GROWTH?

ECONOMIC AND REGULATORY FACTORS

The expansion of the data centre market in India can largely be attributed to the growth in its digital economy, coupled with a data-hungry population with high levels of digital literacy (which has driven trends towards social media use and a preference for “over the top” streaming platforms) and an increasing emphasis by governments and regulators on data localisation and sovereignty.

The Indian Government has been bullish in its development of digital infrastructure in the country and has recently classified data centres with 5MW or more of capacity as “infrastructure”. For foreign investors, this classification will allow them to make investments through the Foreign Venture Capital Investors (“FVCI”) route, rather than the FDI route, meaning foreign investors can use hybrid instruments for investments and avoid restrictions on pricing on any exit. The classification also means that entities in the infrastructure sector, which is a priority lending sector for Indian banks, can capitalise on long-term credit available from domestic and international lenders on more favourable terms.

Efforts by the Reserve Bank of India and the Insurance Regulatory and Development Authority to require data localisation have also contributed to growth, although the extent to which this will be hampered by the draft Digital Personal Data Protection Bill, once implemented is yet to be determined.

This briefing has been prepared in collaboration with Khaitan & Co.

India has seen huge growth in its digital economy over the last five years, and its data centre capacity has not been able to keep up.



DATA LOCALISATION

The regulatory framework of India emphasises localising storage of information and documents in India, especially in certain specific sectors. Such regulatory requirements directly translate into a growing need to establish data centres in large numbers in India. Data onshoring / localisation has been prescribed under several laws in India. Set out below are certain significant data onshoring related provisions:

- **Localisation of payments data:** India's central bank requires licensed banks and payment system providers to ensure that all data relating to payment systems operated by them are stored exclusively in India. Such data includes end-to-end transaction details and any information pertaining to a payment or settlement transaction that is gathered / transmitted / processed as part of a payment message / instruction;
- **Localised storage of logs of information and communication technology ("ICT") systems:** Similarly, the Indian Computer Emergency Response Team (another central government authority) requires the logs of the ICT systems of service providers, intermediaries, data centres, body corporates and government organisations to be enabled and stored within India for a rolling period of 180 days;
- **Localisation in respect of digital lending:** The digital lending guidelines of India's central bank prescribe that data pertaining to digital lending must be stored by the relevant entities only in servers located within India (which includes all commercial banks, primary (urban) co-operative banks, state co-operative banks, district central co-operative banks and non-banking financial companies); and
- **Localisation of insurance data:** The insurance regulator in India requires insurance companies to store insurance data of the insured (which includes all records pertaining to insurance policies and claims made etc) within India.

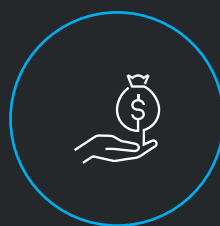
WHO IS DRIVING GROWTH?



DC OPERATORS



TECH GIANTS



FINANCIAL SPONSORS



INDIAN INFRASTRUCTURE AND REAL ESTATE DEVELOPERS

- **Global tech giants such as Amazon and Microsoft:** In November 2022, Amazon Web Services announced the launch of its second data centre in India. Microsoft also recently announced plans to establish its fourth data centre in India, adding to its portfolio of centres in Mumbai, Chennai and Pune.
- **Data centre operators such as Princeton Digital Group (PDG), NTT and CtrlS:** Data centre operators have also been active – PDG launched its flagship data centre (MU1) in December 2022 and NTT and CtrlS recently unveiled data centres in Navi Mumbai and North-East India, respectively.
- **Joint ventures:** Data centre operators are also forming joint ventures with financial sponsors and/or local Indian real estate / infrastructure players predominantly to develop greenfield data centres – for example:
 - Digital Edge (a leading data centre operator in Asia and that is backed by Stonepeak Infrastructure Partners) has partnered with Assetz Property (a leading real estate developer in South India) and the National Investment and Infrastructure Fund to develop a 300MW data centre in India
 - Iron Mountain and Web Werks JV to develop a greenfield data centre in Mumbai
 - Brookfield Infrastructure and Digital Realty JV to form “BAM Digital Realty” in order to develop a data centre in Chennai
 - Yondr Group and Everstone Group JV to develop a data centre in Mumbai
 - EdgeConneX and Adani Enterprises JV to develop data centres throughout India
 - Carlyle Group (through its subsidiary CA Cloud Investments) acquiring a 24.04% stake in Nxtra Data (the data centre arm of Bharti Airtel (a large Indian telecommunications business))
 - Blackstone has also recently set up Lumina CloudInfra, a data centre platform for the Asia market (with their first investment in India), which will be wholly owned and managed by Blackstone’s Real Estate and Tactical Opportunities funds

OPPORTUNITIES IN GREENFIELD DEVELOPMENT

Given the small scale of India’s data centre operations historically, growth in the Indian DC market has been predominantly achieved through greenfield development, with relatively few existing operating assets available for acquisition.

Mumbai and Chennai have emerged as the most sought-after destinations for the establishment of data centres given their concentration of existing and upcoming cable landing stations, uninterrupted power supply and availability of skilled workforce. The undersea cables connecting Mumbai and Chennai to cities in South and South-East Asia, the Middle East, Africa and Europe, has also been a key driver for the development of data centres in these cities.

Other cities such as Bangalore, Hyderabad, New Delhi and Noida are also experiencing rapid developments of data centres to manage demand from large enterprises and urban populations.

We expect the future development of data centres in India to extend to smaller ‘tier 2’ cities, with smaller colocation facilities required to meet rising data consumption in these smaller areas.

ENTERING THE MARKET

FDI RESTRICTIONS

- Foreigners can invest directly (up to 100%) in Indian businesses which own and/or operate data centres without prior regulatory approval through the *automatic route*.¹ However, there are certain other barriers to entering the market as set out in the following bullet point.
- In addition to land ownership restrictions (see below), in 2020 the Indian government laid down certain restrictions on foreign investment by neighbouring countries of India (such as China (including Hong Kong and Taiwan), Pakistan, Nepal and Bangladesh) resulting in the following investments requiring prior approval:
 - i. investments in any sector by an entity from a country which shares a land border with India; or
 - ii. investments into India by any entity where the 'beneficial owner' of such investment is situated in, or is a citizen of, any country that shares a land border with India.

These restrictions have led to a steep decline in foreign investments from these countries (most particularly, China).

LAND OWNERSHIP

- Foreign companies cannot directly acquire or own real estate in India. For this purpose, real estate is defined as all immovable properties, including land and buildings. However, a 100% foreign-owned Indian entity can own real estate other than agricultural land in India on a freehold or leasehold basis. Foreign investors would therefore be required to establish a local entity to develop, own and/or operate a data centre in India. Most foreign investors will opt to establish an Indian limited liability company for this purpose.
- Although foreign ownership of agricultural land in India is prohibited, it is possible to make an application to the regional governmental authorities (known as 'revenue authorities' established under the laws of relevant state in India) to convert the use of agricultural land to industrial use in order to develop and operate a data centre on such land. Such conversion process takes approximately 5 to 7 months, depending on the location of the land and any material objections raised by the regional governmental authorities. That said, the regional governmental authorities have discretionary powers and therefore the entire conversion process may vary on a case-to-case basis.

LICENCES

- **Commercial** - Data centre businesses require the same licences as are needed for any commercial establishment in India. Prior to commencement of business, establishments are required to obtain certain operational licenses such as the shops and establishments' registration, a permanent account number, a fire no-objection certificate and other employment related licenses. The process for obtaining these licenses is straight forward and barring any unanticipated delays, these licenses can be procured in about 3 to 5 months.
- **Environmental** - As with other infrastructure development projects in India, establishing a data centre also requires environmental clearances for construction and operation, which can take about 7 to 8 months to obtain.

¹ The automatic route is the foreign investment route taken in sectors which do not require prior government approval.

FUNDING A DATA CENTRE DEVELOPMENT

FUNDING STRUCTURE

The preferred approach for debt financing varies on a case-by-case basis and depends on the financial capacity of the borrower. However, a project finance structure is usually preferred as this type of financing reduces investment risk and raises finance at a relatively low cost, which benefits both the sponsor and the investor.

BANKS AS LENDERS

- The Indian data centre market has already witnessed sizeable investments and banks are actively considering lending to the sector given this activity. Given that data centres have been classified as 'infrastructure', data centres can now raise long-term credit from domestic and international lenders on more favourable terms.
- Banks and financial institutions do, however, conduct a customary due diligence on the borrower before granting credit to entities engaged in a data centre business, including a check on its creditworthiness, the assets forming the collateral and its compliance with applicable data protection laws.
- With respect to sensitivities on the quantum of credit, banks may consider factors like possibility of rapid technological obsolescence in data centres, fierce competition in the data centre space, rising energy costs and cybersecurity risks associated with storing and processing sensitive information.

TAKING SECURITY

- Loans may be secured by way of a charge (on assets or contracts), financial securities and/or the issuance of corporate or personal guarantees.
- The creation of any security or collateral in relation to ECB requires the borrower to obtain a prior no-objection certificate ("NOC") from an Indian Authorised Dealer Bank, which can take between 3 and 5 days.

OFFSHORE LENDING INTO INDIA

Borrowers in India may access offshore lending in the form of external commercial borrowings (**ECBs**), through various forms like loans, floating / fixed rate notes / bonds / debentures etc. ECBs could either be denominated in: (a) foreign currency (**FCY ECB**); or (b) Indian Rupees (**INR ECB**). Set out below are a few key conditions that a borrower is required to comply with:

- **Eligibility criteria:** ECBs can be accessed by all entities eligible to receive foreign direct investment. As such, companies operating data centres can raise ECBs.
- **Borrowing Limits:** Under Indian exchange control regulations, eligible borrowers are allowed to raise up to USD 750 million per financial year under the automatic route (i.e., without any government approval).
- **Minimum average maturity period (MAMP):** MAMP is the minimum tenure for the ECB facility and is computed on a weighted average basis, assuming a 360-day year. Generally, the MAMP for ECBs is 3 years.
- **End-use restrictions:** The funds accessed from ECBs cannot be deployed for activities other than infrastructure activities. Deployment for infrastructure activities includes investment in a capital market, an equity investment, or other similar activities. For completeness, data centres housed under dedicated / centralized buildings for storage and processing of digital data applications with a minimum capacity of 5 MW of IT load fall within the infrastructure sector. In our view, the use of the ECB funds for buying land for data centres with a capacity of 5 MW or more is permitted as deployment for infrastructure activities.
- **Other restrictions:** The ECB guidelines prescribe numerous other conditions and restrictions on the eligibility of borrowers and lenders, such as the amount of interest and fees that can be paid on ECBs and the assets that can be provided as security for an ECB.

LOCAL THIRD-PARTY DEBT

Given the restrictions associated with raising ECBs (as outlined above), data centre assets are often financed through local third-party debt, which benefits from relaxations awarded to infrastructure companies and avoids the conditions linked to ECB financing.

COMPANIES ISSUING CONVERTIBLE OR HYBRID INSTRUMENTS

- Foreign direct investment is permitted by Indian exchange control laws in equity shares, warrants and compulsorily convertible instruments (such as preference shares and debentures).
- Companies can also issue non-convertible debentures, which can be subscribed by banks, fund houses, insurance companies and non-banking finance companies in India.
- Instruments that are non-convertible or optionally convertible are generally treated as debt and subject to the ECB conditions, except for entities registered with the Securities and Exchange Board of India ("SEBI") as 'foreign portfolio investors' or 'foreign venture capital investors' who may use such instruments to make investments subject to compliance with certain conditions.

EQUITY

Pricing restrictions and lock-in periods on investments apply unless an investment is made under the FVCI route.

- **Shares:** Foreign shareholders may acquire shares in an Indian company (by transfer from an Indian entity or fresh issue) for no less than the 'fair value' of the shares as determined by any internationally accepted pricing methodology. Where a company is newly incorporated, shares can be acquired for par/ face value.
- **Convertible instruments:** The conversion ratio must be determined at the time of investment and the conversion price cannot be lower than the fair value determined at the time of initial subscription of the convertible instrument. However, as mentioned, these pricing restrictions would not apply to any investments made under the FVCI route.
- **Option arrangements:** Under Indian exchange control laws, exits must comply with the above pricing restrictions and put options are subject to a lock-in period of one year, preventing an exit by way of put option within a year of investment.



OTHER POTENTIAL ISSUES TO BE AWARE OF WITH RESPECT TO DATA CENTRES

Power and water supply

Consumers may explore multiple sources in relation to the procurement of long-term **power supply** in India:

- **Supply of power by distribution licensees:** One of the common modes for power supply is for consumers to enter into a power-supply arrangement with local power distribution companies. Typically, distribution companies process these applications within 1 month. The owner or the occupier of the premises bears these charges as prescribed by the distribution companies – these charges may depend on the location of the premises;
- **Supply of power by independent power producers:** Power generating companies in India also execute long term bilateral power purchase agreements with consumers having a higher requirement of power (for example, a data centre owner or operator). In such a scenario, the transmission charges and surcharges related to supply of power are regulated by the regulations of the appropriate governmental authorities. A consumer in such an arrangement is liable to pay tariff as agreed under the power purchase agreement to the relevant power generating company for the procurement of power, as well as other potential charges such as a surcharge to cover cross subsidy (as a part of the tariff), save with respect to captive generating stations; and
- **Supply of power under a captive structure:** Under the captive model, a person is allowed to construct, operate, and maintain both a captive generating plant and dedicated transmission lines and then generate electricity primarily for its own use. This model is less cumbersome from a regulatory perspective considering that generation of power is a delicensed activity in India. The key requirement to set up a captive power generating plant is that the plant should be set up primarily for captive consumption with a minimum consumption of 51% of the total power generated, on annual basis, and the owner/operator should hold at least 26% ownership of such plant.

For the procurement of water supply, industrial consumers in India have the following sources:

- **Supply by a local government water supply authority:** Typically, industrial consumers procure water supply by making an application to the local governmental authority. For this purpose, the consumer makes a payment in relation to the installation charges which includes a security deposit. These charges may vary between locations; and
- **Procurement through extraction of ground water:** Extraction of ground water by industrial consumers in India is regulated by a central government authority and industrial consumers are required to seek a no objection certificate from such authority. Such no objection certificate is granted only when the local government water supply agencies are unable to supply the desired quantity of water. All industries / infrastructure projects drawing ground water are required to pay ground water extraction charges in accordance with the provisions of the guidelines issued by such central government authority.

HOW KWM CAN HELP

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As the only global law firm headquartered in Asia, we have an exceptional cross-border regional team with broad and deep corporate experience across Asia Pacific, including India. We know the data centre asset class extremely well, having advised on some of the most significant data centre transactions over many years including M&A and greenfield and brownfield financing and development projects.

For further information on broader data centre trends in South & Southeast Asia, please follow the link below to KWM's South & Southeast Asia Data Centre Briefing:



[KWM South & Southeast Asia Data Centre Briefing - KWM](#)

KWM has also produced a detailed India M&A Guide which can be made available on request.

Please do not hesitate to contact any members of our data centre specialist team with any questions, or for a copy of the M&A Guide.



OUR DATA CENTRE SPECIALIST TEAM



JAKE ROBSON

PARTNER, HEAD OF CORPORATE
SOUTH & SOUTHEAST ASIA

TEL +65 6977 6710
MOB +65 8725 3592
EMAIL jake.robson@sg.kwm.com



NICOLA YEOMANS

PARTNER - CO-HEAD PRIVATE CAPITAL
SINGAPORE

TEL +65 6653 6738
MOB +65 8339 5896
EMAIL nicola.yeomans@sg.kwm.com



NICK DAVIES

PARTNER
SINGAPORE

TEL +65 6977 6712
MOB +65 8725 3595
EMAIL nick.davies@sg.kwm.com



AZLAN MOHAMED NOH

SENIOR ASSOCIATE
SINGAPORE

TEL +65 6977 6715
MOB +65 9248 7006
EMAIL azlan.mohamednoh@sg.kwm.com





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