



Register now for your free, tailored, daily legal newsfeed service.

Find out more about Lexology or get in touch by visiting our [About](#) page.

[Register](#)

Data Centres in India: A Legal Outlook for Emerging Asset

Khaitan & Co



India | July 30 2024

The growth of Indian digital economy and tectonic shift in content consumption habits in India has attributed to unprecedented growth of data centres in India. The Indian data centre market has witnessed significant investments from global operators, real estate developers and private equity investors over the last 5 years and evidently India is emerging as juggernaut data centre destination in the APAC market. Given the nascent boom in digital infrastructure in India, the Indian data centres market is predominantly seeing growth through greenfield development and relatively lesser through acquisition of existing data centres.

This article walks through some of the key legal nuances relating to financing and key infrastructure and licensing requirements for setting up or investing in a data centre in India.

Funding Considerations

Foreign Investment Route

Under the Indian exchange control laws, 100% foreign direct investment is permitted under the automatic route in Indian companies and LLPs that are engaged only in the data centre business. If the investee entity is also engaged in other sectors / businesses then, any foreign investment would also have to comply with the investment conditions applicable to these sectors. For example, a data centre company may also be owning fibre assets. In such cases, any foreign investment in such an entity would also be subject to conditions applicable to an entity owning fibre assets like the investee company be required to comply with the guidelines for infrastructure providers issued by Department of Telecommunications and comply with conditions to meet national security and public interest requirements.

To boost the investor sentiment, the Indian Government took a welcome step by including data centres with a minimum capacity of 5MW that are housed in a dedicated / centralised building as part of the infrastructure sector. With the inclusion, foreign investors are now permitted to invest in an Indian data centre entity under the foreign venture capital investment (FVCI) route. Investment through FVCI route will provide more flexibility to foreign investors to structure their investments in Indian data centre entities (meaning foreign investors can use hybrid instruments for investments and avoid restrictions on pricing on any exit). As Indian data centre entities can be classified as entities engaged in infrastructure sector, these entities can avail long-term credit from domestic and international lenders on more favourable terms.

Debt Funding

On the debt side, data centre operators have been opting for traditional Indian bank loans as financing source (as opposed to foreign debt) since they are not subject to the host of conditions / regulations that govern foreign debt making the latter as a unprofitable financing option.

Infrastructure for Data Centre

Reliable power supply, high-speed internet connectivity, and adequate water supply for cooling are crucial for a successful construction and operation of a data centre. India's varied geographic and climatic conditions pose unique challenges and opportunities in this regard. Choosing the right location is strategic, not only for operational efficiency but also for minimizing environmental impact. For this almost all of the current installed capacity is located in a handful of cities where Mumbai and Chennai are leading that race on account of concentration of existing and upcoming cable landing stations in these cities, continuous power supply and availability of skilled workforce. Other cities such as Bengaluru, Hyderabad, NCR and Kolkata are also experiencing rapid developments of data centres and it is expected that future development would expand to smaller 'tier 2' cities with smaller colocation facilities.

Few nuances on core components like land and power are discussed below:

Land

As foreign investors cannot directly own or acquire land in India, the foreign investor, either themselves own Indian entities to acquire real estate in India or partner with existing Indian data centre operators or real estate developers for setting up data centres in India. Indian law also restricts a foreign owned Indian entity from owning agricultural land in India. In such cases, foreign owned Indian entities can convert agricultural land into industrial use land through regional governmental authorities, which authorities may permit conversion on a case-to-case basis.

As an alternative to owning land for setting up a data centre, the data centre operators may also opt for leasing the land parcel for development of data centres from private landowners or state industrial development corporations. Typically, leases from government run industrial development corporations come with a long-term tenure and comes in a standard form (which reduces any protracted negotiations), which makes it attractive for data centre operators. However, these leases also involve costs like payment of transfer premium (which is updated periodically) and stamp duty for use of such land on leasehold basis. While the leases from private lessors may not involve costs like transfer premium but these will come with higher lease rental, may not have a longer tenure and possible involve protracted negotiations.

Contrary to a hyperscale data centre, colocation data centres are also becoming increasingly popular. These data centres enter into colocation agreements which are in the form of service agreements under which data centres provide digital space to customers. Considering the nature of these agreement, these arrangements should not be treated as leases under Indian laws. However, based on their nature, colocation agreements may be treated as a license (akin to a lease and license agreement) if such agreements contemplate the continuous occupation of a premise by the occupier entity and/or any of its employees or use of the space for any purpose apart from operating the data servers. To mitigate the risk of a colocation arrangement being treated as a lease as opposed to a service contract, the contract should capture unambiguous provisions, that clearly detail the existence of no right or interest, being created in the premises, including any right to physically occupy / possess the premises.

Power:

Uninterrupted power supply is key for operating a data centre. Set out below are few power sources which are prevalent and used by data centre operators:

1. Supply of power by local power distributor companies is widely used, not only for data centres but for other industrial purposes as well. The licensee distribution companies enter into agreement for supply of power at a pre-determined charges prescribed by such distribution companies. The charges may vary depending on the location of the data centre.
2. Data centers source power directly from power generation companies as well. The power generating companies enter into long term bilateral power purchase agreements with data center operators due to substantial demand of power and supply power at charges prescribed under appropriate regulations by governmental authorities.
3. Under captive model, data center entities construct, operate and maintain a captive generating plant and maintain dedicated transmission lines for their own consumption. Since generation of power is not licensed, captive model offers lesser regulatory scrutiny. For captive power user, the Indian electricity regulations set out certain conditions for a power generation plant to qualify as a captive generating plant. One of the key conditions being that at least 26% of the equity ownership of the entity setting up such plant must be held by the captive user(s) and at least 51% of the total power generated from the plant, determined on an annual basis, be used for captive consumption.

Due to significant environmental impact involved in operation of data centres coupled with the exponential rise of renewable energy in India, data centres are increasingly looking to tie up directly with renewable power developers for sourcing power by entering into bilateral PPAs (as opposed to sourcing from the grid).

Key Licenses for Operation of Data Centre

The data centres in India are not regulated by a dedicated regulatory authority and when it comes to permits to set up a data centre, data centre being a unique combination of a real estate, infrastructure and IT asset, data centre operators require the same licences as are needed for any commercial establishment operating in these spaces. Key permits include, among others, environmental clearances for construction, change in land use order for seeking the permission to use the agricultural land for industrial use, registration under labour laws for hiring employees and contract labour, fire no-objection certificates etc.

Khaitan & Co - Shantanu Gupta and Rohan Shrivastava

The content of this document does not necessarily reflect the views / position of Khaitan & Co but remain solely those of the author(s). For any further queries or follow up, please contact Khaitan & Co at editors@khaitanco.com.

Powered by
LEXOLOGY.