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LEGALLY SPEAKING

BIT by BIT increase

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The recent award passed by the Permanent Court of Arbitration at the Hague (PCA) in the case of Vodafone Group PLC, has piqued the interest of various parties across the globe and domestically. The verdict essentially held that India's action of seeking to recover a tax demand that had already been adjudicated upon and waived by the Highest Court of the Country, by retrospectively amending its tax code, was in breach of the terms and obligations agreed upon in the investment treaty agreement between India and the Netherlands in particular the obligation of fair and equitable treatment (FET). The tribunal also directed the republic of India to pay 4.32 million pounds to the company as compensation for its legal costs.

Before delving into the nuances of the abovementioned dispute, its ramifications and what the future may hold for India it becomes necessary to understand what exactly is an Investment treaty arbitration and India's complex and often chequered history with regards to them.

Bilateral Investment Treaties ('BIT') establish the terms and conditions for private investments made by individuals and business entities from one sovereign State into another, they are agreements between two states for the reciprocal promotion and protection of investments in each other's territories by individuals and companies situated in either State. BITs typically serve to protect investments made by investors

by laying down amongst other things the extent of regulatory oversight of the host state and further the scope of interference by the host state with the rights of foreign investors.

India signed its first BIT in 1994 with the United Kingdom. As a result of the economic reforms of 1991 and to facilitate the growth of foreign investment India signed around 84 BITs, however as on date 58 out of the 84 BITs have been terminated. India initially adopted an investor first approach and negotiated broadly worded and investment conducive BITs, by providing substantive protection and commitment to foreign investors however this has not always worked in India's favour. Up until 2011 the above model of an investor friendly approach was by and large accepted and did not cause much debate however; this would soon change.

In 2011 the first publicly known BIT award was published against India in the now infamous case of White Industries Vs. India, where in an investor state dispute, a tribunal held that India had violated its obligations under the India-Australia BIT. The tribunal held that there had been a breach on the part of India to provide an effective means to assert claims. The award made India liable to pay an amount totalling to approximately USD 4 million as damages and legal costs. The award in White industries in a sense opened the floodgates, and in a short period of time India was made party to various investor state disputes involving challenges ranging from the application of retrospective taxes (as in the case of Vodafone), cancellation of spectrum licenses and cancelation of telecom licenses amongst others.

The award in White Industries coupled with the profusion in investor state disputes brought against India led to a review being undertaken by the Indian authorities of its existing BIT model which culminated in India firstly adopting its new model BIT in 2016 and secondly terminating over 58 BITs with other nations so as to renegotiate the same on the basis of the new model BIT.

The 2016 model BIT was seen as a significant departure from the previous overtly investor-friendly approach and leaned towards a much stronger state protectionist approach qua foreign investments aimed at safeguarding India's interests. Under the new model BIT various elements such as, Most Favoured Nation clauses have been completely done away with, while the scope of others such as Fair and Equitable Treatment clauses have been hugely restricted. These actions were not welcomed globally by investors and nations alike, and the same is evidenced form the fact that no countries came forward after India requested countries to come forward and re-negotiate new treaties based on the new Model BIT. Since 2016, India has signed just three treaties (Bulgaria, Kyrgyzstan and Brazil) none of which are in force as on date. Although all existing investments in India continue to enjoy treaty protection for the next 10 to 15 years, as most Indian BITs contained a sunset clause, the new changes have prompted Investors to adopted a more cautious approach while making investments in India.

The judgement in the dispute of Vodafone Group PLC emanates from the imposition of a tax demand in 2007 to the tune of of Rs 7,990 crore in capital gains and withholding tax against the Vodafone Group when the company acquired a 67 per cent stake in Hutchison Essar for $11 billion.

The stand of the government was that Vodafone Group was obligated to take into account the capital gains and withholding taxes and as a result of the same was liable to pay Rs 22,100 crore to the exchequer after the computation of interest and penalties along with the initial levy. Vodafone challenged the demand notices before the Hon'ble High Court of Bombay, which confirmed the demand raised by the tax authorities. The company subsequently approached the Hon'ble Supreme Court of India in 2012, the Supreme Court held that the Vodafone Group did not have to pay any taxes for the share transfer transaction and quashed the demand raised by the tax department.

Many thought that the ruling of the Hon'ble Supreme Court of India would lay rest the long-drawn dispute, and few foresaw what was to come next. The Indian government sought to scuttle the decision of the apex court by passing an amendment in the Finance Act, empowering the tax authorities to retrospectively tax for transactions in the nature of those undertaken by Vodafone in the share transfer and share purchase in Hutchison Essar.

These actions of the Indian government of attempting to recover the original demand which had been waived and quashed by the Hon'ble Supreme Court, culminated in Vodafone initiating an arbitration against India, under the BIT signed by India and the Netherlands. As mentioned above the tribunal held that India had violated its FET obligations under the treaty and thus could not recover the amount in dispute.

Although what amounts to fair and equitable treatment and what actions tantamount to a breach of these provisions have never been outrightly defined as it is never advisable to approach and constrict such an evolving and fluid principle by applying a straightjacket definition. Very briefly put the principles behind FET obligations state that foreign investment should receive equitable treatment and should not be subjected to unjustified, unreasonable or discriminatory measures that would impair the legally acquired rights or interests of nationals of other countries in the enterprises, capital, skills, arts or technology they have supplied in a host state.

Applying the above principle, the arbitral tribunal held that Under Article 4 of the BIT executed between India and the Netherlands, Vodafone was entitled to "fair and equitable treatment" (FET) in respect of its investments in India, which was denied to it. The Indian government's conduct in respect of the imposition of tax, interest, and penalties, undertaken specifically despite the Supreme Court judgment, tantamounted to a breach of its obligations under this principle of fair and equitable

treatment. The tribunal also directed India to pay an amount totalling 4.32 million pounds as legal costs.

As the Indian government can still challenge the award in Singapore which was the seat of the arbitration and if the award is so upheld, can further resist the enforcement of the award in India before the Indian Courts it seems that the dispute has far from reached its conclusion.

What the future holds:

A cause for concern for the Indian authorities is that there are similar disputes pending against India for the collection of tax levied retrospectively, none bigger then the dispute with Cairn Energy PLC and Cairn UK Holdings Limited pertaining to investments made in Cairn India Limited (CIL), one of the largest oil and gas exploration companies in India. The dispute pertains to the draft assessment order issued by the Indian Income Tax Department to the tune of USD 1.6 billion plus interest and penalties. As the award is presently awaited in the present dispute the findings of the arbitral tribunal in the case of Vodafone could effectively act as a precedent and be of persuasive value to the tribunal in the matter of Cairn v. India.

Furthermore the actions of the Indian government of banning multiple Chinese apps and cancelling various contracts granted to Chinese companies could theoretically be challenged as being violative of the FET obligations present in the BIT India signed with China in 2007 which includes FET obligations. The said challenges could possibly be maintained looking at the awards passed in Devas v India and Deutsche Telekom v India, in the said two arbitrations India was held guilty of violating the FET obligations in the applicable BITs for arbitrarily cancelling contracts which impacted foreign investment made in India.

It has also been theorised that the cancelation of various BITs by India and the advent of sunset clauses in the same could see a large slew of arbitrations being initiated against India by aggrieved investors, however if the said hypothesis holds true will only be seen with the progression of time.

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