

Client Alert

Latham & Watkins Litigation Department

Foreign Investors Threatened by Indian Measures Seek Remedies Through International Investment Arbitration

The Indian government recently began implementing taxation and telecom license cancellation measures that may affect a large number of foreign investors. Several foreign companies and governments are concerned about the worsening investment climate in India. Some investors have already taken steps to seek recourse through international investment arbitration to obtain compensation for breaches of India's obligations under relevant bilateral investment treaties (BITs).

BITs are treaties between two States, whereby each agrees to provide certain protections to qualifying investors and their investments from the other State. These protections relate to the acts and omissions of the State acting as a sovereign. The "State" includes the central government, any subsidiary governments (such as states or municipalities), courts, the legislature, and any entity that is deemed to be engaging in sovereign acts, including regulatory agencies. As BITs are treaties, their governing law is public international law. Some investors have already invoked their rights under BITs in response to the Indian government's recent actions.

A New Retroactive Tax Affects Foreign Companies in India

In March 2012, Indian Finance Minister Pranab Mukherjee announced the 2012 Budget proposal and Finance Bill, which would amend the 1961 Tax Act with retroactive effect. The proposed amendment would enable the authorities to issue retroactive tax claims on overseas corporate deals involving Indian assets that have occurred over the past 50 years.

Several governments, including the United States and the United Kingdom, have urged India to scrap the tax, and seven international trade organizations, representing 250,000 corporate members, have written to the Indian government, indicating that in light of the proposed tax companies are reconsidering their investments in India.

The Ministry of Finance issued a press release on April 20, 2012, clarifying that the amendment would not allow any tax case to be reopened beyond six years (rather than 50 years) and the retroactive amendment would not affect cases that have been assessed and finalized up to April 1, 2012.

"The Indian government's recent taxation and telecom license cancellation measures affecting foreign companies have triggered criticism from numerous governments and foreign investors concerned about the worsening of the investment climate in India."

Vodafone's Claim Against the Government of India

In 2007, Vodafone Group PLC, a UK company, acquired a controlling stake in India's Hutchison Essar Limited. In 2012, the Indian Supreme Court heard a US\$2.2 billion tax claim against Vodafone Group PLC by the Indian authorities stemming from this deal. The Supreme Court ruled that Vodafone was not liable to pay taxes on this acquisition because the transaction did not take place in India.

In reaction to this decision, the Indian government announced the 2012 Finance Bill, which, if approved by Parliament, would overturn the Supreme Court's ruling. The bill proposes to amend the Income Tax Act so as to empower the authorities to tax companies for acquiring assets in India, including those acquired in overseas deals, retroactively. Under this law, Vodafone would be subject to retroactive taxation for its 2007 purchase of Hutchison.

On April 17, 2012, Vodafone issued a notice of dispute to the Indian government under the Netherlands-India BIT (as the acquisition was structured through its Dutch subsidiary). It urged the Indian government to abandon or suitably amend the retrospective aspects of the proposed legislation, leaving the door open to an amicable solution on the matter. The Netherlands-India BIT provides for a three-month "cooling off period" before an arbitration can be filed.

Vodafone argues that, if enacted, the amendment to the Tax Act would constitute a breach of India's commitments under the BIT, and notably of its duty to provide fair and equitable treatment to investors, not to take steps to directly or indirectly expropriate the investment, to ensure investors full protection and security, and not to breach investors' legitimate expectations in making the investment. While the press release dated April 20, 2012 might be taken as an indication that the government will not reopen Vodafone's tax case, Vodafone is reportedly still in talks with the government to achieve amicable settlement of the dispute.

This Finance Bill will not only affect Vodafone — one of the largest foreign investors in India — but also all foreign investors that acquired stakes in Indian assets. Those investors should watch developments carefully and consult with public international law specialists to evaluate the availability and scope of possible BIT protections.

Cancellation of Licenses in the Telecom Sector

In a separate development, on February 2, 2012, the Indian Supreme Court ordered the cancellation of 122 spectrum licenses in the telecom sector that were issued in 2008. The Supreme Court further directed the government to redistribute licenses through an auction process. The base price, set by the Indian Telecom Regulator is now close to 10 times more than what operators paid in 2008.

Several companies promptly decided to shut down operations in India and other companies have already commenced actions under BITs. On March 26, 2012, Norwegian company, Telenor, issued a notice of dispute to the Indian government, claiming protection of its investment under the India-Singapore Comprehensive Economic Cooperation Agreement, as it invested in India through its subsidiary in Singapore. Upon learning the base price of the licenses at auction, Telenor announced that it will exit the Indian market. Telenor's decision follows from actions of Russian corporation, Sistema, which issued a notice of arbitration under the Russia-India BIT on February 28, 2012. Here again, foreign investors in this sector should look to their rights under potentially appropriate BITs.

Conclusion

In light of the potential effects these two developments will likely have on the value of foreign investments, companies that have made investments into India and that may be subject to these or other measures should consult with counsel specializing in public international law to consider their potential rights under an applicable BIT.

Latham & Watkins will keep readers apprised of new developments as they unfold.

Latham & Watkins' Public International Law Practice

Latham & Watkins has a dedicated team of globally recognized public international law experts who regularly act for both private entities and States in contentious and non-contentious investment treaty matters around the world. The team has a wide range of practical public international law experience, including structuring foreign investments and acting on investment disputes in Asia. In addition, the firm has a significant presence in Asia through its Hong Kong, Singapore and Middle East offices.

For more information regarding investment treaty protection, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

Mark Beckett

+1.212.906.2921
mark.beckett@lw.com
New York

Sebastian Seelmann-Eggebert

+49.40.4140.30
sebastian.seelmann@lw.com
Hamburg

Rachel Thorn

+33.1.40.62.20.48
rachel.thorn@lw.com
Paris

Charles Claypoole

+44.20.7710.1178
charles.claypoole@lw.com
London

Christina Hioureas

+1.212.906.1791
christina.hioureas@lw.com
New York

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney with whom you normally consult. A complete list of our *Client Alerts* can be found on our website at www.lw.com.

If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <http://events.lw.com/reaction/subscriptionpage.html> to subscribe to our global client mailings program.

Abu Dhabi

Barcelona

Beijing

Boston

Brussels

Chicago

Doha

Dubai

Frankfurt

Hamburg

Hong Kong

Houston

London

Los Angeles

Madrid

Milan

Moscow

Munich

New Jersey

New York

Orange County

Paris

Riyadh*

Rome

San Diego

San Francisco

Shanghai

Silicon Valley

Singapore

Tokyo

Washington, D.C.

* In association with the Law Office of Mohammed A. Al-Sheikh