

# CANCELLATION OF TELECOM LICENSES IN THE 2G CASE: CLAIM FOR INDIRECT EXPROPRIATION?

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*This paper focuses on the repercussions of the controversial 2G judgment, which resulted in cancellation of licenses held by telecom companies. Aggressive action is being undertaken by irate foreign companies in joint ventures with Indian telecom license-holder companies. Caught in an imbroglio of legal actions, most of the foreign investors have decided to resort to every possible legal measure to protect their investment in the Indian telecom sector. The paper examines whether the Supreme Court verdict leads to an expropriatory act entailing compensation under a Bilateral Investment Treaty. The starting point of such an inquiry is based on the claim made by the Russian investor, Sistema under the BIT signed between Russia and India.*

## I. INTRODUCTION

The alleged 1.76 lakh crore 2G telecom scam presently convulsing the Indian telecom market, has been making headlines ever since it was unearthed in 2010. In a recent judgement, the Supreme Court<sup>1</sup> held the allocation of 2G spectrum in 2008 to be “wholly arbitrary, capricious and contrary to public interest”<sup>2</sup> and “violative of the doctrine of equity”<sup>3</sup> as it favoured some telecom companies. Consequently, 122 licenses granted to 8 telecom operators and the subsequent allocation of spectrum was declared illegal and quashed.<sup>4</sup> The Court’s verdict has left in its wake, unsatisfied foreign investors who had set up joint ventures with Indian telecom licensee companies.<sup>5</sup>

Of the affected foreign investors, Sistema was the first to invoke arbitration under the Agreement between the Government of the Russian Federation and the Government of the Republic of India for the Promotion and

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<sup>1</sup> Centre for Public Interest Litigation v. Union of India, (2012) 3 SCC 1.

<sup>2</sup> *Id.*, ¶ 77.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*, ¶ 81.

<sup>5</sup> Knowledge Wharton Today, *Revoked Indian Telecom Licenses Spur Legal Action*, March 1, 2012, available at <http://knowledgetoday.wharton.upenn.edu/2012/03/revoked-indian-telecom-licenses-spur-legal-action/> (Last visited on November 20, 2013).

Mutual Protection of Investments, 1994 ('India-Russia BIT').<sup>6</sup> Sistema's claim stems from the cancellation of 21 telecom licenses owned by Sistema Shyam Teleservices Ltd. ('SSTL'), in which it owns a majority stake.<sup>7</sup>

Sistema's claim provides tangible evidence of an action that could be taken by foreign investors in an attempt to save their investments and could be a foretaste of things to come. In light of the recent United Nations Commission on International Trade Law ('UNCITRAL') arbitration between White Industries Ltd. and India wherein India was held responsible for its breach under the India-Australia Bilateral Investment Treaty,<sup>8</sup> it becomes pertinent to explore the scope of the Russian investor's claim and the repercussions thereof. This claim raises various unforeseen and unsettling questions regarding the application and scope of investment law in the Indian commercial context. Particularly, in the absence of any legal precedents,<sup>9</sup> a completely niche area of investment arbitration under Bilateral Investment Treaties ('BIT') ought to develop in India.

The pivotal issue addressed in this paper is the legal tenability of Sistema's claim against India and whether the revocation of licenses can be termed as an expropriatory act entailing payment of compensation. Part II of the paper discusses in detail the claim brought forth by Sistema under the

<sup>6</sup> See Shauvik Ghosh, *2G Licenses- Sistema Send Notice to Govt.*, LIVE MINT & THE WALL STREET JOURNAL February 29, 2012, available at <http://www.livemint.com/Home-Page/Z1vlvjEkWXCj52YBjRapQJ/2G-Licences--Sistema-sends-notice-to-govt.html> (Last visited November 20, 2013).

<sup>7</sup> The Russian Company Sistema JSFC holds 56.58% in the joint venture SSTL, while the Russian Government holds 17.14% and India's Shyam Group holds 23.98%. The balance 2% is owned by minority shareholders.

<sup>8</sup> White Industries Australia Limited v. The Republic of India, Final Award, November 30, 2011. See Luke Eric Peterson, *India is Held Liable for Investment Treaty Breach due to Protracted Judicial Delays Suffered by Foreign Investor*, INVESTMENT ARBITRATION REPORTER, February 7, 2012, available at [http://www.iareporter.com/articles/20120207\\_2](http://www.iareporter.com/articles/20120207_2) (Last visited on November 29, 2013).

<sup>9</sup> Arbitral awards technically do not have *de jure* precedential value. NAFTA, for e.g., expressly provides that arbitration awards are only binding between the parties. Some commentators suggest that these awards ought to have precedential weight akin to that enjoyed by decisions of Mixed Claims Commissions or arbitration awards rendered by the U.S.-Iran Claims Tribunal. See generally Susan D. Franck, *The Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties have a Bright Future*, 12 U. C. DAVIS J. INT'L L. & POL'Y 47 (2005-2006); Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. & BUS. 243, 260 n.46 (2000) (Discussing that the determinations made by the U.S.-Iran Claims Tribunal are judicial decisions that "may inform the law of expropriation"); Frederick Schauer, *Precedent*, 39 STAN. L. REV. 571, 589 (1987) (Observing that "without an existing precedent, the conscientious decision maker must recognize that future conscientious decision makers will treat her decision as precedent"); Susan D. Franck, *The Legitimacy Crisis in Investment Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1522-23 (2005) (Suggesting that practitioners, investors and sovereigns tend to rely on such decisions as *de facto* precedent and indicators of their potential rights and liabilities).

India-Russia BIT. Part III discusses the meaning of expropriation as a standard of protection under BITs, with Part IV further explaining the concept of indirect expropriation. Part V analyses the merits of Russia's claim, followed by Part VI which examines the question as to whether India is liable to pay compensation in the event of an expropriation proved against it. Finally, the conclusion attempts to summarise the findings of this paper.

## II. SISTEMA'S CLAIM UNDER THE INDIA-RUSSIA BIT

The ubiquity of BITs and the widening scope of investor rights have led to an explosion in the number of investment treaty disputes. These treaties provide the investors with the choice to litigate their treaty claims before domestic courts or to arbitrate their investment claims before arbitral panels and forums such as the International Centre for Settlement of Investment Disputes ('ICSID'), International Chamber of Commerce ('ICC'), or an *ad hoc* tribunal organized under the UNCITRAL Rules. Investors tend to elect to arbitrate their investment claims before such arbitral tribunals, since it provides them with a neutral forum for settlement of disputes that could arise with the host state.<sup>10</sup> Arguably, this technique of allowing the foreign investor to take up his own dispute "depoliticises the process"<sup>11</sup> since the dispute does not become one between the home state and the host state.

Article 9 of the India-Russia BIT contains the provision for settlement of disputes between the investor and the host State. If any such dispute arises, the India-Russia BIT mandates that the first attempt should be to negotiate the dispute amongst the contracting parties; alternatively conciliation procedures provided under UNCITRAL Rules could be resorted to.<sup>12</sup> Failing this the investor may submit the dispute to an *ad-hoc* international tribunal set up under UNCITRAL.<sup>13</sup> Thus, invoking compulsory arbitration to secure a binding award, is presented as a last resort, only subsequent to the exhaustion of the negotiation process.

As previously mentioned, Sistema has exercised its option to force the Indian Government into arbitration subsequent to the cancellation of

<sup>10</sup> See Susan D. Franck, *The Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties Have a Bright Future*, 12 U. C. DAVIS J. INT'L L. & POL'Y 54 (2005-2006); GEORGIOS PETROCHILOS, *PROCEDURAL LAW IN INTERNATIONAL ARBITRATION* 248 (James Fawcett ed., 2004); M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 217 (2010).

<sup>11</sup> *Id.*, SORNARAJAH, 217.

<sup>12</sup> India-Russia BIT, Art. 9.1. Since India is not a signatory to the International Centre for the Settlement of Investment Disputes (ICSID) Convention and the Russian Federation has signed, though not ratified, the Convention; these contracting parties have chosen to submit the dispute under an *ad-hoc* tribunal organized under UNCITRAL Rules.

<sup>13</sup> India-Russia BIT, Art. 9.2.

its licenses. In a statement, the financial corporation announced that it had sent a formal notice to India notifying it of a dispute under the India-Russia BIT,<sup>14</sup> since it believed that India had failed in its obligations to protect Sistema's investments and refrain from expropriating the investments. Russia has invoked its right under Article 9.1 of the BIT on behalf of its telecom giant to seek justice and compensation against its investments to the tune of \$3.1 billion into the Indian telecom sector. It has also filed a review petition in the Supreme Court challenging the revocation of telecom licenses.<sup>15</sup> India is required to settle the dispute amicably within a period of six months, failing which arbitration proceedings would be commenced.

### III. EXPROPRIATION AS A GENERAL STANDARD OF PROTECTION UNDER BITS

The past decade has seen a proliferation of BITs<sup>16</sup> which act as "economic bill of rights",<sup>17</sup> granting foreign investors substantive and procedural means for promotion of their investments and protection of investor rights.<sup>18</sup> India alone has entered into Bilateral Investment Promotion and

<sup>14</sup> This press release from Moscow is notified on Sistema's official website, available at <http://www.sistema.com/press/press-releases/2012/02/sistema-sends-a-notice-to-the-republic-of-india-to-settle-dispute-relating-to-the-revocation-of-sstl's-licenses.aspx> (Last visited on November 30, 2013). See also, Sandeep Joshi, *Sistema Cites Bilateral Treaty to Protect its Money*, THE HINDU February 28, 2012, 1.

<sup>15</sup> See Samanwaya Rautray & Gulveen Aulakh, *2G Verdict: Supreme Court Rejects Curative Pleas Filed by Sistema Shyam, Tata Teleservices, Videocon, Idea Cellular and Ex-minister A Raja*, THE ECONOMIC TIMES February 15, 2013, available at [http://articles.economictimes.indiatimes.com/2013-02-15/news/37119538\\_1\\_curative-petition-review-petition-spectrum-licences](http://articles.economictimes.indiatimes.com/2013-02-15/news/37119538_1_curative-petition-review-petition-spectrum-licences) (Last visited November 20, 2013). Sistema's primary claim under the review petition lay in the fact that it had a unique case from the other foreign players since it was the only CDMA spectrum applicant. Further, they claimed that there was no proof in the CAG Report to show that the demand for CDMA equalled that of GSM in 2008. This review petition was rejected by the Supreme Court in *Sistema Shyam Teleservices Ltd. v. Centre for Public Interest Litigation & Ors.*, Review Petition (C) Nos. 663-664 of 2012 in W.P. (C) Nos. 423 of 2010 and 10 of 2011. See Vladimir Radyuhin, *Russian Telecom Giant Intends to Challenge Ruling*, THE HINDU February 12, 2012, available at <http://www.sistema.com/media/releases?rid=23566&o=2&fnid=68&newWin=0&apage=1&nm=81514&fxsl=view.xsl> (Last visited November 20, 2013). Thereafter, the curative petition filed by Sistema was dismissed in the chambers of the Chief Justice of India before a bench comprising of then Chief Justice Altamas Kabir and Justices P. Sathasivam and G.S. Singhvi. See J. Venkatesan, *Raja, Telecom Firms Curative Pleas Dismissed*, THE HINDU February 14, 2013, available at <http://www.thehindu.com/news/national/raja-telecom-firms-curative-pleas-dismissed/article4415334.ece> (Last visited on November 20, 2013).

<sup>16</sup> See Franck, *supra* note 9, 48; Rudolf Dolzer & Margrethe, *Bilateral Investment Treaties*, INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, 99 (1995).

<sup>17</sup> Franck, *supra* note 9, 48.

<sup>18</sup> Jason Webb Yackee, *Pacta Sunt Servanda and State Promises to Foreign Investors before Bilateral Investment Treaties: Myth and Reality*, 32 FORDHAM INT'L L.J. 1554 (2008-2009).

Protection Agreements ('BIPAs') with 82 countries, of which 72 have become enforceable.<sup>19</sup>

BITs provide for certain general guarantees and standards of treatment of investment and investors. The form and substance of these guarantees remain homogeneous across various BITs. Virtually all of them provide for assurances of fair and equitable treatment; guarantees of national treatment and most-favoured-nation ('MFN') treatment; protection against dispossession, expropriation or other forms of interference with property rights and extension of full-protection and security to investments.<sup>20</sup> Most capital-exporting countries insist on an international formula for protection of investments to be adopted by the host state which provides a certain minimum level of treatment consistent from state to state.<sup>21</sup> The purpose behind this is to guarantee a uniform level of treatment that is not dependent on the host's domestic regulatory or property law regime.<sup>22</sup>

The scope of this paper is limited to the discussion on expropriation as a standard of protection under BITs since it forms the foundation of Russia's claim against India. Usually, expropriation involves an outright taking of private property by the State, with the ownership rights being transferred to the State or to a third person.<sup>23</sup> International law concerning the protection and treatment of aliens and their property developed primarily as customary international law.<sup>24</sup> Norms of customary international law lay down the requirement to expropriate only for a public purpose, in a non-discriminatory fashion, and upon the payment of prompt, adequate and effective compensation.<sup>25</sup> These customary rules are further supplemented by several multilateral treaties such

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<sup>19</sup> This is data available as on December 9, 2012. See Arun S., *Sistema Notice Brings Bilateral Investment Pacts Under the Lens*, THE HINDU BUSINESS LINE March 26, 2012, 3.

<sup>20</sup> See generally, Franck, *supra* note 9; Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 INT'L L. 655 (1990); Yackee, *supra* note 18.

<sup>21</sup> Joshua Robbins, *The Emergence of Positive Obligations in Bilateral Investment Treaties*, 13 U. MIAMI INT'L & COMP. L. REV. 410 (2005-2006). See generally W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 THE BRITISH YEARBOOK OF INTERNATIONAL LAW 115 (2004).

<sup>22</sup> *Id.*, Robbins, 410.

<sup>23</sup> AUGUST REINISCH, THE OXFORD HANDBOOK ON INTERNATIONAL INVESTMENT LAW 408 (Christoph Schreuer et. al. eds., 2008).

<sup>24</sup> Alice Ruzza, *Indirect Expropriation in International Law: Balancing the Protection of Foreign Investments and Public Interests*, 2010-2011, available online at [http://www.unitn.it/files/download/11108/alice\\_ruzza\\_\\_research\\_proposal.pdf](http://www.unitn.it/files/download/11108/alice_ruzza__research_proposal.pdf) (Last visited on November 30, 2013).

<sup>25</sup> See M.N. SHAW, INTERNATIONAL LAW 516-21 (1991); Paul E. Comeaux & N. Stephen Kinsella, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization clauses, and MIGA & OPIC Investment Insurance*, 15 N.Y.L. SCH. J. INT'L & COMP. L. 5 (1994-1995); Dolzer & Margrete, *supra* note 16,97.

as the North American Free Trade Agreement ('NAFTA')<sup>26</sup> and the Energy Charter Treaty ('ECT')<sup>27</sup> which provide for protection against expropriation.

Expropriation may occur by a direct and deliberate formal taking, or indirectly, by measures resulting in a substantial deprivation of the use of and value of investment even though the actual title of the asset remains with the investor.<sup>28</sup> Apart from the distinctive jurisprudence on expropriation evolving from a surfeit of judicial decisions; BITs have also played a significant role in the development of the customary international law of expropriation.<sup>29</sup> The vital purpose of BITs is to shield investors from illegal expropriation and other arbitrary or discriminatory governmental conduct that threatens to hamper Foreign Direct Investment.<sup>30</sup> This provision concerning the obligation of the host state to provide compensation for expropriation is one of the most crucial and frequently relied upon protections provided in investment treaties.<sup>31</sup>

The expropriation provisions across many BITs as well as multi-lateral treaties are similarly worded<sup>32</sup> with minor variations in the terminology. Most of the bilateral treaty pacts do not mention the ingredients of expropriation, and most commonly refer to expropriatory action as dispossession, taking, deprivation or privation.<sup>33</sup> On the other hand, some BITs do not make use of the term expropriation at all, but instead refer to dispossession, deprivation, takings and privation of property.<sup>34</sup> Traditionally, investment treaties do not define expropriation; instead, they make a reference to government measures that are 'same' or 'equivalent' to expropriation or are 'tantamount to expropriation'.<sup>35</sup>

<sup>26</sup> NAFTA, December 17, 1992, U.S.-Can.-Mex., Art.1110, 107 Stat. 2057, 32 I.L.M. 605, 641 (1993).

<sup>27</sup> ECT, Art. 13, Dec. 17, 1994, 34 I.L.M. 360.

<sup>28</sup> ALAN REDFERN, MARTIN HUNTER, NIGEL BLACKBAY & CONSTANTINE PARTASIDES, *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* 494 (2006). See Andrew Newcombe, *The Boundaries of Regulatory Expropriation in International Law*, 20 ICSID REVIEW-FILJ 1, 7 (2005). Expropriation is primarily categorized as follows: (1) Direct expropriation by which the Government directs the transfer of private property to either the state or a state mandated party; and (2) Indirect expropriation by which a government measure (though not *prima facie* expropriatory) result in the deprivation of the foreign investor's property.

<sup>29</sup> Justin R. Marles, *Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation In International Investment Law*, 16 J. TRANSNAT'L L. & POL'Y 276 (2006-2007).

<sup>30</sup> Reisman & Sloane, *supra* note 21.

<sup>31</sup> REDFERN, HUNTER, BLACKBAY & PARTASIDES, *supra* note 28, 493.

<sup>32</sup> *Id.*, 494.

<sup>33</sup> Dolzer & Margrete, *supra* note 16, 98.

<sup>34</sup> See The Protocol to the Germany-Bangladesh BIT (1981) defines expropriation as: "the taking away or restricting of any property right which in itself or in conjunction with other rights constitutes an investment"; Art. 4 of the Belgium-Burundi BIT provides that a State may not take "any deprivative or restrictive measure or any other measure having a similar effect"; See Newcombe, *supra* note 28, 18.

<sup>35</sup> *Id.*, Newcombe. For instance, see NAFTA (1995), Art. 1110; Barbados-Cuba BIT (1996), Art. 5; Canada-Egypt BIT, Art. VIII; Netherlands-India BIT (1995), Art. 5; along with the Austrian, Canadian, British, French, UK, USA, Swedish BITs.

Expropriation of foreign investments through measures ‘tantamount to expropriation’ is contained in the US-Russia BIT and was subsequently mirrored in substance in almost all BITs.<sup>36</sup> It has been stated that the major achievement of the ‘tantamount clause’ in BITs lies in extending the applicability of the concept of indirect expropriation to an “egregious failure to create or maintain favourable conditions for investments in the host state”.<sup>37</sup>

#### IV. INDIRECT EXPROPRIATION

Though the principle of law in the case of *de jure* expropriation of a direct nature is settled, considerable controversy exists over *de facto* or indirect expropriatory action. Such measures are referred to interchangeably as ‘indirect’, ‘creeping’, or ‘de facto’ expropriation.<sup>38</sup> As previously mentioned, bilateral and multilateral treaties do not define measures amounting to indirect expropriation, instead they include a reference to indirect expropriation or measures tantamount to expropriation.<sup>39</sup> Such wording appears in multilateral treaties such as NAFTA, the 1998 Multilateral Agreement on Investment (‘MAI’) draft prepared by the Organisation for Economic Co-operation and Development (‘OECD’), Energy Charter Treaty (‘ECT’), the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment; and several BITs<sup>40</sup> as well.<sup>41</sup>

Indirect expropriation is considered to bring about results akin to physical taking without actual interference with the property itself.<sup>42</sup> Effectively, it neutralizes the enjoyment and benefit of the property of the foreign investor without involving express measures of expropriation.<sup>43</sup> However,

<sup>36</sup> Reisman & Sloane, *supra* note 21, 118. See the German Model Treaty, Art. 4(2):

“Investments by investors of either Contracting State shall not directly or indirectly be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalisation”. Similarly, United Kingdom Model Treaty, Art. 5(1) provides that, “investments of nationals or companies of either Contracting Parties shall not be nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation”.

<sup>37</sup> Reisman & Sloane, *supra* note 21, 118.

<sup>38</sup> See Dolzer & Margrete, *supra* note 16, 99. For e.g., treaties concluded by the United States refer generally to expropriation, nationalisation and other measures, stating that all of these will be referred to as expropriation. See e.g., U.S.-Tunisia BIT (1990), Art. III. Danish treaties mention nationalisation, expropriation and measures having effect equivalent to nationalisation or expropriation, stating that such measures are “hereinafter referred to as ‘expropriation’”. See e.g., Denmark-Hungary BIT (1988), Art. 5(1).

<sup>39</sup> RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 102 (2<sup>nd</sup> ed., 2012).

<sup>40</sup> See *supra* notes 34-36.

<sup>41</sup> DOLZER & SCHREUER, *supra* note 39.

<sup>42</sup> SORNARAJAH, *supra* note 10, 208.

<sup>43</sup> CME Czech Republic B.V. (The Netherlands) v. The Czech Republic, Partial Award, September 13, 2001, ¶604.

in the absence of an unequivocal definition of acts constituting indirect expropriation, it is generally understood that they materialise on the basis of certain acts and conduct, which possess an element of depriving one of rights or assets.<sup>44</sup> For instance, in *Metaclad Corporation v. United Mexican States*,<sup>45</sup> ‘*de facto*’ or indirect expropriation under NAFTA has been defined as:

“covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or significant part, of use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.”

The reluctance to provide a comprehensive definition of expropriation in BITs may be motivated by the consideration that a host State is capable of undertaking certain measures which will have an effect similar to expropriation; although they do not *de jure* constitute an act of expropriation, they have an expropriatory effect nonetheless.<sup>46</sup> Resultantly, a wide range of measures are vulnerable to a finding of indirect expropriation and therefore, each case is decided on the basis of its attending facts and circumstances.<sup>47</sup>

## V. CANCELLATION OF 2G LICENCES: A CASE OF INDIRECT EXPROPRIATION?

### A. EXPROPRIATION AND THE CRITERIA TO BE SATISFIED UNDER THE INDIA-RUSSIA BIT

Article 5.1 of the India-Russia BIT lays down the condition that the investments of parties to the treaty shall not be nationalised or expropriated except for public purpose, on a non-discriminatory basis and upon the payment of compensation.<sup>48</sup> Article 5.1 clearly includes cases of indirect expropriation within its ambit as it seeks to protect all investments from actions having an “effect equivalent to nationalisation or expropriation”. At the outset, to establish whether Russia’s investment is covered under the treaty’s expropriation

<sup>44</sup> *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, Award, May 29, 2003, 43 ILM 133 (2004), ¶114.

<sup>45</sup> *Metaclad Corporation v. United Mexican States*, ICSID Case No. ARB (AF)/97/1, Award, August 30, 2000; 40 I.L.M. 36 (2001), ¶130.

<sup>46</sup> Dolzer & Margrete, *supra* note 16, 99.

<sup>47</sup> *Ronald S. Lauder v. The Czech Republic*, Final Award, September 3, 2001, ¶200. *See also*, the 2004 and 2012 US Model BITs, Annex B, ¶4:

“The determination of whether an action or series of actions...constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers..(i) the economic impact of the government action...;(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and (iii) the character of the government action”.

<sup>48</sup> India-Russia BIT, Art. 5.2.



clause, it is necessary to carefully examine not only the expropriation clause itself, but also the satisfaction of the jurisdictional threshold analysis for arbitration proceedings under the aegis of UNCITRAL.

On the first level, Sistema needs to satisfy the criteria of being an investor as per the India-Russia BIT. Essentially, this would entail an enquiry as to whether a Russian corporation holding equity in an Indian company could be considered as an investor.

Article 1(2)(b) of the India-Russia BIT, *inter alia*, defines an ‘investor’ as a “legal entity, including a corporation, company, firm, enterprise or association incorporated or constituted in the territory or the State of that Contracting Party”. Therefore, *prima facie* Sistema will be construed to be an investor for the purpose of the BIT. On the second level, Russia’s claim must validate existence of an investment protected under the BIT. In case of matters appearing before the ICSID, all the investments are required to meet the threshold laid down by the *Salini* test.<sup>49</sup> However, since all BITs define investments for the purpose of the treaty, the *Salini* test is not applicable in case of arbitration under BITs. Modern definitions of investment in BITs are introduced by a broad, general description followed by a non-exhaustive list of typical rights.<sup>50</sup>

In the present case, immediately after acquiring telecom licences, many Indian telecom companies offloaded their shares in the name of infusing equity and received huge foreign investments.<sup>51</sup> A case in point is Unitech, which transferred 60% stakes to Telenor Asia Pte. Ltd. for Rs. 61 billion (USD 1.2 billion), after it obtained the licence for Rs. 16.5 billion (USD 338 million).<sup>52</sup> Swan Telecom Pvt. Ltd., Tata Teleservices and SSSL also followed suit with SSSL selling 73.71% stake to Sistema at a premium of USD 600 million<sup>53</sup> in 2008. Participation in companies or shareholding as a form of investment has been accepted in a number of cases.<sup>54</sup> Now, Article 1(1)(b) of the BIT, *inter alia*,

<sup>49</sup> This test was laid down in the case of *Salini Construttori S.A. and Italstrade S.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, July 23, 2001. The four elements of the Salini Test are: (i) contribution in money or other assets; (ii) a certain duration over which the project is implemented; (iii) an element of risk; and (iv) a contribution to the host State’s economy. It is interesting to note that at present, Sistema has opted to initiate the dispute before UNCITRAL since India is not a signatory to the ICSID Convention.

<sup>50</sup> CHRISTOPH H. SCHREUER, LORETTA MALINTOPPI, AUGUST REINISCH & ANTHONY SINCLAIR, *THE ICSID CONVENTION: A COMMENTARY* 122 (2009).

<sup>51</sup> *Centre for Public Interest Litigation v. Union of India*, (2012) 3 SCC 1, ¶44.

<sup>52</sup> *Id.*

<sup>53</sup> JOINT-STOCK FINANCIAL CORPORATION SISTEMA, ANNUAL REPORT, 2008.

<sup>54</sup> See SCHREUER, MALINTOPPI, REINISCH & SINCLAIR, *supra* note 50, 126. Also see Appendix 1 to *Vivendi v. Argentina*, Resubmitted Case: Decision on Jurisdiction, November 14, 2005 listing 18 cases to this effect; *IBM v. Ecuador*, Decision on Jurisdiction, December 22, 2003, ¶¶ 44, 48; *Continental Casualty v. Argentina*, Decision on Jurisdiction, February 22, 2006, ¶¶ 51–54, 76–89; *Suez et al. v. Argentina*, Decision on Jurisdiction, May 16, 2006, ¶¶ 46–51; *Pan American v. Argentina*, Decision on Preliminary Objections, July 27, 2006, ¶¶ 209–222; *Suez and AWG v. Argentina*, Decision on Jurisdiction, August 3, 2006, ¶¶ 46–51; *Telenor*

defines an investment to include “shares, stock and any other form of participation in a company, enterprise, corporation, firm, association or other legal entity”.<sup>55</sup> Consequently, the equity holding by Russia’s Sistema squarely falls within the definition of investment provided under the BIT.

With these conditions satisfied, the question which warrants examination in this case would be whether the effect of the Supreme Court verdict amounts to an expropriation or an action equivalent to expropriation as defined under the India-Russia BIT. At this juncture, it can be argued that a decision given by the apex court of India would not amount to a governmental action *per se*. However, the principle of state responsibility for the conduct organs of state,<sup>56</sup> settles this point. The conduct of the state organ, which is the judiciary in the present case, would be considered as an act of state under Article 4 of the International Law Commission’s (‘ILC’) Articles on State Responsibility.<sup>57</sup> That said, since the threshold jurisdictional criteria stands fulfilled, the next segment discusses the merits of Sistema’s claim.

## B. INDIRECT EXPROPRIATION OF SISTEMA’S INVESTMENTS

Focussing on the factual matrix in the present case, in 2008, SSSL purchased 21 United Access Services (‘UAS’) licences and 2G spectrum from the Indian government to facilitate its pan-Indian mobile network operations. With the Supreme Court verdict cancelling the allegedly scandal-tinged licences, Sistema’s investment of billions of dollars stands at a great loss since these funds were being utilised for rolling out networks under the license. Not only would this cause a loss of billions of dollars to the telecom operator; it would also end up causing great inconvenience to MTS subscribers.<sup>58</sup>

As aforementioned, the standard for determining whether governmental measures amount to expropriation is to see whether the cumulative effect of the measures on the investor’s property is to substantially deprive the

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v. Hungary, Award, September 13, 2006, ¶¶ 19, 27, 60; *Parkerings v. Lithuania*, Award, September 11, 2007, ¶¶ 250–254.

<sup>55</sup> India-Russia BIT, Art. 1(1) provides that an investment means, “every kind of asset, including intellectual property rights, [i]nvested by an investor of one Contracting Party in the territory of the State of the other Contracting Party in accordance with the laws of the State of that Contracting Party..”

<sup>56</sup> Draft Articles on Responsibility of States for Internationally Wrongful Acts, Art. 4, International Law Commission, November 2001, Supplement No. 10 (A/56/10), chp.IV.E.1.

<sup>57</sup> Art. 4.1 states that: “The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State.”

<sup>58</sup> SSSL operates its telecom services under the MTS brand in India.

investor of the use, value and enjoyment of its investment.<sup>59</sup> The cumulative effect of cancellation of license here, leads to a diminution in the value of investments made by Sistema which were to fund SSTL's plans for expansion of its retail network in current telecommunication circles and to accelerate the launch of operations in new circles.<sup>60</sup>

As a result of being stripped of its licenses, the market price of the equity of SSTL will fall tremendously, leading to a devaluation of the company in the market.<sup>61</sup> As per sources, Sistema took a write down of nearly \$1 billion on account of the suspension of its Indian telecom licenses.<sup>62</sup> Of this amount, around half of the write down was a direct corollary of license revaluation and the rest was attributed to goodwill.<sup>63</sup> This in turn will have the effect of causing a windfall loss to those foreign investors that invested in the equity of licensee companies for billions of dollars. It is pertinent to note here that all the licensee companies attracted foreign investments only consequent to the grant of UAS licenses and the allotment of spectrum was the main factor behind the inflow of FDI.<sup>64</sup> This is clear from the fact that Sistema increased its stake in SSTL from 10% in 2007 to 73.74% in 2008 after the grant of licenses.

In various cases, tribunals have vacillated between different factual scenarios to determine a finding of indirect expropriation in each case. However, arbitral practice has laid down that revocation or denial of government permits and licenses would lead to indirect expropriation in cases where it interferes with the foreign investor's enjoyment of his property.<sup>65</sup>

<sup>59</sup> B.H. Weston, *Constructive Takings Under International Law: A Modest Foray into the Problem of Creeping Expropriation*, 16 VIRGINIA JOURNAL OF INTERNATIONAL LAW 103 (1976); UNCTAD, *Series on Issues in International Investment Agreements, Takings of Property* 11, available at <http://unctad.org/en/docs/psiteiitd15.en.pdf>. (Last visited on January 2, 2014); Restatement (Third) of Foreign Relations of Law of the United States (1987), § 712, comment g; *Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica*, 15 ICSID REVIEW –Foreign Investment Law Journal (2000), 169, ¶ 76.

<sup>60</sup> As per Sistema's press release dated December 21, 2010 available at <http://www.sistema.com/media/releases?rid=23566&oo=2&fnid=68&newWin=0&apage=10&nm=80372&fxsl=view.xml> (Last visited November 20, 2013).

<sup>61</sup> An example to explain this point further: Swan Telecom (now Etisalat DB Telecom) paid a license fee around \$350 million. Afterwards, it transferred around 45% equity in favor of Etisalat for over \$700 million which had the effect of valuing the company at \$1.55 billion when, at the time of transaction, it was valued at nothing more than the license. Unitech, which had paid a similar amount for its license, brought in Telenor of Norway as a 60% equity holder by issuing fresh shares of \$1.2 billion. The valuation of the company rose to \$2 billion. See Knowledge Wharton Today, *Revoked Licenses are the Latest Fallout from India's 2G Telecom Scam*, February 6, 2012.

<sup>62</sup> Maria Kiselyova, *Sistema to Take \$1 bn Write Down on India: Sources*, April 20, 2012, available at <http://in.reuters.com/article/2012/04/20/sistema-india-2g-writedown-idINDEE83J02H20120420> (Last visited November 20, 2013).

<sup>63</sup> *Id.*

<sup>64</sup> CAG Telecommunication Report, 54-55, March, 2010, available at <http://www.2gscam.co.in/pdfs/cagreport/chap5.pdf> (Last visited November 20, 2013).

<sup>65</sup> REINISCH, *supra* note 23, 454.

In *Goetz v. Burundi*,<sup>66</sup> the act of revocation of the investor's free zone certificate without any formal taking of property was held as indirect expropriation.<sup>67</sup> The ICSID tribunal held that, even in the absence of any formal taking of the property, revocation of the free zone certificate resulted in a halt of all activities which "deprived their investments of all utility and deprived the claimant investors of the benefit which they could have expected from their investments".<sup>68</sup> Thus, the revocation of the free zone certificate was equated to a 'measure having similar effect' to expropriation in this case.<sup>69</sup> In another case the revocation of a free zone license was held to have resulted into an indirect taking of the investment.<sup>70</sup>

The tribunal in *Techmed v. Mexico*<sup>71</sup> found that the revocation of an operating license was an act 'tantamount to expropriation'. The proposition that a property is expropriated when the effect of the state measures lead to a deprivation of benefit and economic use of the property was recently affirmed by an ICSID tribunal<sup>72</sup> and has been affirmed by the Iran-U.S. tribunal in various cases.<sup>73</sup> In another case, it was held that the acts of the regulatory authority forcing an investor to give up its exclusive licensing rights and changing other key terms of the joint venture agreement amounted to expropriation.<sup>74</sup>

Furthermore, it is to be noted that Sistema had a legitimate expectation that SSTL held a valid operating license that was granted to it under a government policy. In a statement, SSTL alleged that it is being penalised for acting on good faith and placing reliance on the procedures established by

<sup>66</sup> *Goetz and Others v. Republic of Burundi*, Award, September 2, 1998, 6 ICSID Reports 5.

<sup>67</sup> *Id.*, ¶ 124. See *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, Award, April 12, 2002, 7 ICSID Reports 178, ¶ 107 (Held that revocation of a free zone license through the prohibition of import of cement had the effect of depriving the investor of the use and benefit of its investment even though it retained the nominal ownership of its rights).

<sup>68</sup> *Goetz and Others v. Republic of Burundi*, Award, September 2, 1998, 6 ICSID Reports 5, ¶ 124.

<sup>69</sup> *Id.*

<sup>70</sup> *Middle East Cement Shipping v. Egypt*, Award, April 12, 2002.

<sup>71</sup> *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, Award, May 29, 2003, 43 ILM 133 (2004), ¶ 114.

<sup>72</sup> *Compañía del Desarrollo de Santa Elena, S.A. v. Costa Rica*, ICSID Case No. ARB/96/1 Award of February 17, 2000, (2000) 43 ILM 1317, 1330, ¶ 77 (Citing *Tippets*, 6 Iran-US CTR. at 225-6).

<sup>73</sup> *Tippets v. Tams-Affa Consulting Eng'rs*, (1984) 6 Iran-US CTR 219, 225-6 (The Iran-U.S. Claims Tribunal, for example, has repeatedly held that "intent of the government is less important than the effects of the measures on the owner and the form of the measures of control or interference is less important than the reality of their impact"); See also *accord Int'l Sys. & Control Operations v. Indus. Dev. and Renovation Org.*, (1986) 12 Iran-US CTR 239, ¶ 97; *Payne v. Iran*, (1986) 12 Iran-US CTR 3, ¶ 22; *Phelps Dodge Corp. V. Iran*, (1986) 10 US CTR 121, ¶ 22.

<sup>74</sup> *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, Partial Award, September 13, 2001; LexisNexis Mealey Publications Doc. No. 05-011127-013A, ¶¶ 551, 554-555 and 591.

Indian telecommunication authorities.<sup>75</sup> It has been held that expropriation is also proved in cases where government measures interfere with an investor's legitimate expectation that the state will honor the assurances it initially offered to induce the investment; and those measures substantially deprive an investor of the use or enjoyment of its investment.<sup>76</sup> With the facts presented, and substantiated with decisions of international tribunals, it can be logically deduced that the cancellation of licenses amounted to indirect expropriation of Sistema's investments. That said, the next question which arises is whether India would be liable to pay compensation in the event of its actions being struck down as causing an indirect expropriation of Sistema's investment?

## VI. IS INDIA LIABLE TO PAY COMPENSATION?

Customary international law and BITs do not prohibit expropriation *per se*.<sup>77</sup> According to Brownlie, states are entitled to expropriate foreign property for a public purpose in exercise of their sovereignty over natural resources or in exercise of their police powers provided certain conditions are fulfilled.<sup>78</sup> The right to expropriate is a part of the economic sovereignty of states.<sup>79</sup> Hence, it is erroneous to state that India cannot raise a defence to refute Russia's claim of expropriation of its investments and India's failure to protect the same. Even after expropriation is proved as valid and subsisting, causing a huge financial loss to this foreign investor, it can be allowed as long as it is non-discriminatory, for a public purpose, compensated for, and carried out in accordance with due process.<sup>80</sup> However, the distinction between non-compensatory regulatory measures taken by the state and measures amounting to indirect compensable expropriation remains, till date, vague and unclear.<sup>81</sup> On one side of the coin, certain regulatory measures are considered to be outside the purview of claims of indirect expropriation.<sup>82</sup> On the other hand, it is also widely asserted that any substantial deprivation of value should be characterised as expropriation, regardless of its purpose.<sup>83</sup>

<sup>75</sup> Bureau, *Sistema Invokes Indo-Russian Treaty Pact to Protect 2G Investments*, THE HINDU BUSINESS LINE February 28, 2012.

<sup>76</sup> International arbitral tribunals have held that government assurances and undertakings create 'acquired rights' for investors. See REDFERN, HUNTER, BLACKBAY & PARTASIDES, *supra* note 28, 495.

<sup>77</sup> Reisman & Sloane, *supra* note 21, 115. For e.g., U.K.-Pan. BIT, Art. 5(1); U.S. Arg-BIT, Art IV, section I; compare, e.g., INA Corp. v. Iran, (1985) 8 Iran-US CTR 373 ("It has long been acknowledged that expropriations for a public purpose and subject to conditions provided for by law. . . are not per se unlawful").

<sup>78</sup> IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 70 (1998) (If it is done in a non-discriminatory manner and accompanied by payment of 'prompt, adequate, and effective' compensation).

<sup>79</sup> GA Resolution 1314(XIII), December 12, 1958.

<sup>80</sup> India-Russia BIT, Art. 5.1.

<sup>81</sup> DOLZER & SCHREUER, *supra* note 39, 102.

<sup>82</sup> REINISCH, *supra* note 23, 433.

<sup>83</sup> *Id.*

However, there has been considerable consensus on the notion that exemption from payment of compensation would lie for reasonably necessary regulations passed in the furtherance of “protection of public health, safety, morals or welfare” or for non-discriminatory government regulations within the police powers of the state.<sup>84</sup> Property may also be forfeited if it stems from criminal activities.<sup>85</sup> That said, India would have a valid defence to Russia’s claim for compensation provided that the justification on grounds of legitimate public interest can be proven. In the present case, the requirement for public interest is fulfilled since the judgement in the 2G case has been welcomed as a laudable effort of the judiciary to penalise corruption and illegal policies framed by the ministry. The corruption-tainted licenses gave an unfair advantage to a few ineligible telecom companies and their consequent cancellation should be upheld as a public policy measure. This can be further buttressed by the decision in *Methanex Corp. v. United States*<sup>86</sup> which held that the regulation passed for a public purpose is not expropriation even if there is a diminution in value and no compensation is paid.<sup>87</sup> The UNCITRAL tribunal, in *Saluka v. Czech Republic*,<sup>88</sup> further stated that no compensation needs to be paid by the state in exercise of its regulatory powers which are non-discriminatory, for *bona fide* regulations, and in the interest of general welfare.<sup>89</sup> However, there have been decisions to the contrary as well. It has been asserted that it is difficult to rebut a claim for compensation on grounds purely buttressed in public interest.<sup>90</sup> This is evident from the ICSID tribunal’s decision which laid down the notion that the legitimacy of public purpose invoked to justify expropriation does not obliterate the obligation of the state to provide compensation.<sup>91</sup> In an ICSID award, it was held that a state is permitted to expropriate foreign-owned property within its territory for a public purpose and against payment of adequate and effective compensation.<sup>92</sup>

Against this backdrop, it would be interesting to see how this issue would play out in the actual proceedings. At this stage, it is difficult to gauge the claims<sup>93</sup> which would be brought forth by both the parties and the

<sup>84</sup> Newcombe, *supra* note 28, 22. See the Restatement (Third) of the Foreign Relations of the United States which states that, “bona fide taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police powers of states.”

<sup>85</sup> *Id.*, 23.

<sup>86</sup> *Methanex Corp. v. United States*, Final Award, 44 I.L.M. 1345 (2005) (NAFTA Ch. 11 Arb. Trib. 2005).

<sup>87</sup> Mariles, *supra* note 29, 276.

<sup>88</sup> *Saluka Investments BV (The Netherlands) v. The Czech Republic*, UNCITRAL Partial Award, March 17, 2006.

<sup>89</sup> *Id.*, 255.

<sup>90</sup> Newcombe, *supra* note 28, 30.

<sup>91</sup> *CompañiadelDesarrollo de Santa Elena, S.A. v. Costa Rica*, ICSID Case No. ARB/96/1, Award of February 17, 2000, (2000) 39 ILM 1317,1329.

<sup>92</sup> *Id.*

<sup>93</sup> It would be interesting to note that Sistema was faced with the allegation that it ought to have conducted due diligence on the licenses processed by SSTL. Against this, Vsevolod Rozanov, the then CEO of Sistema’s telecom business stated that, “People say we should have done

stance that the Indian government would take in regard to its obligation to compensate Russia under Article 5.2,<sup>94</sup> of the India-Russia BIT. The only option available is to wait and see if any fruitful outcome emanates from the conciliation efforts between the parties.<sup>95</sup>

## VII. CONCLUSION

The judicial decisions and arbitral trends as discussed in this paper point towards the fact that tribunals have generally shown their willingness to condemn expropriatory measures, in situations where such measures resulted in substantial infringement upon the foreign investor's proprietary interests. Albeit certain regulatory measures have been recognised wherein no compensation needs to be paid, it is difficult to recognise the nuanced distinction between indirect expropriation and *bona fide* regulatory measures in exercise of a state's police powers. Moreover, the general judicial trend is testimony to the fact that tribunals are generally unwilling to accept this defence in cases where a substantial harm is caused to the foreign investment.

At this juncture, it would not be an overstatement to say that the balance could tilt in favour of either of the parties, depending on the claims put forth by them. India's public interest argument could fall flat if Sistema succeeds in proving the ingredients of indirect expropriation of its investment. Alternatively, a finding to the contrary would act as a shield against all claims for compensation.

It is, however, relevant to note that holding India liable to pay compensation in this case would open up a Pandora's Box of similar claims for compensation by other foreign players who suffered due to the cancellation of their 2G licenses. Russia's threat to enforce international arbitration is set against a backdrop of a turbulent climate for investor-state arbitration in India. With Telenor following Russia's suit to invoke its right under the India-Singapore Comprehensive Economic Cooperation Agreement to protect its

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better due diligence but how can you do due diligence of government policy?". See Thomas K. Thomas, *Sistema Shyam Needs Fresh Blood and Fresh thinking*, THE HINDU BUSINESS LINE June 6, 2013, available at <http://www.thehindubusinessline.com/industry-and-economy/infotech/sistema-shyam-needs-fresh-blood-and-fresh-thinking/article4788368.ece#comments> (Last visited November 20, 2013). See also, A related article with respect to Telenor, Shalini Singh, *Is Telenor More a Sinner than Sinned Against?*, THE HINDU May 6, 2012, available at <http://www.thehindu.com/business/article3387928.ece#comments> (Last visited November 20, 2013).

<sup>94</sup> Art. 5.2 states that "The compensation provided for in paragraph 1 of this Article shall be equivalent to the market value of the investment immediately before the date on which the actual or impending expropriation becomes public knowledge. The compensation shall be paid without undue delay. It shall carry interest from the date of expropriation until the date of payment at the commercial rate established on a market basis."

<sup>95</sup> At the time of authoring this paper, the conciliation process was underway.

investments,<sup>96</sup> India's obligations under its bilateral treaties are certainly being tested. However, it would be a price (albeit, a hefty one), which would be required to be paid in order to ensure that a pro-investor climate is maintained in India. Ending on this speculative note, only subsequent developments in this case would show how the matter plays out before the UNCITRAL.

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<sup>96</sup> S. Arun & K. Thomas, *2G Mess: Telenor May Invoke India-Singapore Bilateral Pact*, THE HINDU BUSINESS LINE March 22, 2012, 2.