

**ANALYSIS OF ‘FAIR AND EQUITABLE TREATMENT’
PRINCIPLE APPLIED IN THE VODAFONE ARBITRATION
CASE**

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Summary Of The Case

In September, 2020 the international arbitral tribunal in the case of Vodafone International Holdings BV v. The Republic of India (“**Vodafone case**”) held that the ‘fair and equitable’ treatment guaranteed to Vodafone International Holdings BV (“**Vodafone Holdings**”) under the Bilateral Investment and Protection Agreement (“**BIPA**”) was violated by India. The case primarily deals with the concept of retrospective taxation of transfer of shares of an Indian company held by a foreign company to another foreign company.

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Brief Note on The Parties Involved In The Case

VIH	Vodafone International Holdings BV is the <u>purchaser</u> of one share of CGP. It is a company incorporated in <u>Netherlands</u> .
HTIL	Hutchison Telecommunications International Ltd. was the <u>seller</u> and hence subject to capital gains. The company was incorporated in <u>Cayman Island</u> (2004) and is listed on the New York and Hong Kong Stock Exchange
CGPIL	CGP Investments (Holdings) Ltd. - The company whose share has been <u>transferred</u> . It is a company incorporated in <u>Cayman Islands</u>
HEL	Hutchison Essar Ltd. is the main company in which the <u>controlling shareholding has been transferred</u> through a Share Purchase Agreement (SPA). It is a company incorporated in <u>India</u>

Factual Matrix of The Case

HTIL (Parent Company) formed a subsidiary company in India named Hutchison Essar Limited (HEL) with 67% stake in the company. Such 67% stake was transferred and controlled by the holding company of HTIL i.e., CGPIL at Cayman Islands.

In 2007, HTIL decided to exit the Indian market. At the same time, VIH wanted to make an entry into the Indian market. As a result, it was agreed that CGPIL would transfer the 67% stake it held in HEL to VIH based out of Netherlands. The agreed consideration for the transaction was approximately 11 billion dollars. As a result, VIH had entered into the Indian market. Later, a show cause notice was issued by the Income Tax Department as the transfer of shares by CGP had the nature of indirect transfer of assets within India.

Major Issue In The Case

The major issue in this case is whether the transfer of shares between two foreign companies which results in the extinguishment of interest in the Indian Company which is held by a foreign company amounts to transfer of capital assets and if yes, whether it is chargeable as capital gains under the Income Tax Act, 1961.

Decision Of The Supreme Court And Insertion Of Retrospective Tax Legislation By The Indian Parliament

The Supreme Court of India held that VIH had no tax liability and hence discharged their burden. The decision was based on the transfer not being a capital asset and hence it would not amount to capital gains under the Income Tax Act, 1961. The amount of interim deposit made by VIH was asked to be returned and the claims of capital gains were dismissed.

After the Apex Court judgement, the Indian Parliament through the Finance Act, 2012 inserted relevant clauses which resulted in the drastic alteration of the meaning of the word 'transfer' which proved disadvantageous to VIH as the transaction done by them would now amount to transfer of capital assets and hence they would be subject to capital gains tax. Tax was imposed on VIH, through retrospective application of tax legislation.

Invocation Of Arbitration Clause And Suit For Antil Arbitration Injunction By Vih And The Indian Government Respectively

Due to the retrospective application of the tax legislation, VIH invoked the

arbitration clause as required under the India-Netherlands Bi-Lateral Investment Treaty or BIT since the Indian Government contended that disputes which wholly or partially relate to taxation were outside the scope of such BIT. The arbitration challenged the retrospective application of tax on VIH.

At the same time, Vodafone Group Plc. (Parent Company of VIH) filed for arbitration against India under the same BIT challenging the application of the amendment retrospectively.

As a result, the Indian Government filed a suit before the High Court of New Delhi seeking an anti-arbitration injunction against the arbitration proceedings initiated by VIH. The Court also examined if two separate claims could be made by the parties under the same BIT.

The Court held that the parallel claims brought by both the entities were of the same nature and the relief that was sought was identical. Allowing the same would cause abuse of process of allow. Further, the Delhi High Court in its final hearing dismissed the suit against the Indian Government.

The Arbitration Award And Its Implications

The International Arbitration tribunal passed an award in favour of VIH for violation of the fair and equal treatment under the BIT and India was asked to reimburse approximately 850 Million INR to Vodafone as legal costs.

“Fair And Equitable Treatment” In The Context Of Arbitration

The concept of fair and equitable treatment is an obligation of protection by the host countries of any foreign direct investment. It is a standard that is set which is both absolute and non-contingent. The first instance of equitable treatment can be found in the 1948 *Havana Charter For International Trade Organisation* which states that any kind of foreign investment must be assured of just and equitable treatment.

In *Loewen Group, Inc and Raymond L. Loewen v. United States of America*, the Loewen Group and its Chairman brought arbitration claims against the United States of America claiming that the United States was liable for damages due to a previous jury verdict in 1995-1996. The Arbitral Tribunal in this case held that the trial courts which pronounced the jury verdict did not comply with

the minimum standards of “*fair and equitable treatment*” and the minimum standards that were prescribed by International law. However, the Court contended that the United States did not violate the treatment since no lapse on part of the country was established.

Note : Under North American Free Trade Agreement (NAFTA), it contains provisions for protection for cross border investors to settle their investment disputes. The investors may initiate an arbitration against the NAFTA party under the United Nations Commission on International Trade Law (“UNCITRAL”)

In ***SD Myers Inc. vs. Canada***, a company in the United States claimed that Canada had violated a certain remediation facility provision by banning of a certain waste material. The claim was submitted under the UNCITRAL Arbitration Rules. The Tribunal, in its award stated that the terms “fair and equitable” and “full protection and security” must be read together to give effect to international law. The Tribunal opined that a minimum standard provision must be inserted to avoid any kind of complication.

Further, in the case of ***Pope and Talbot v. Canada***, the Court held that the “fair and equitable treatment” was an additive to the international minimum standard.

Relationship Between “Fair And Equitable Treatment” And “Minimum Standards Of Treatment”

Minimum Standards of Treatment (MST) is usually referred to in FET clauses which is a set of norms that deal with the treatment of aliens. It is part of the international law. The most important judgement with respect to MST is *LFH Neer and Pauline Neer (United States v. Mexico)*.¹ in which a claim was brought before the Mexico-United States General Claims Commission where it was alleged that the Mexican authorities had failed to exercise due diligence in finding the murderer and prosecuting him and hence he had committed a denial of justice. The Commission rejected the claim and stated that the treatment of an alien to constitute a delinquency must amount to outrage, bad faith etc. that every reasonable man would recognise as insufficiency.

The *Neer* case has however evolved and the Arbitral Tribunals have interpreted the concept of MST from a different perspective. In the case of *Mondev International Ltd. Vs. United States*², the Arbitral Tribunal differed from the *Neer* case and held that the *Neer* case dealt with physical security of the alien while not with foreign investment. Further, it was held that it cannot be assumed that NAFTA will be confined to the *Neer* case where it involves the treatment of

¹ Legal.un.org. 2022. [online] Available at: <https://legal.un.org/riaa/cases/vol_IV/60-66.pdf> [Accessed 11 March 2022].

² ICSID Case No. ARB (AF)/99/2

foreign investment by the State itself. It was held that the State may treat a certain foreign investment in an unfair manner without necessarily acting in bad faith.

In *Waste Management II vs. Mexico*³, the Arbitral Tribunal had noted that the MST is breached in case the treatment that is accorded to the investment is grossly unfair, unjust or discriminatory in nature or if such involves the lack of due process which leads to the outcome which would offend judicial propriety.

Hence, the concept of MST and FET will be breached when the conduct of the State is harmful, grossly unfair, discriminatory, based on prejudice or lacks due process which has the potential to offend judicial propriety.

Application Of The Fair And Equitable Treatment In Investment Arbitration

The FET principle has evolved with time. The Arbitral Tribunals have consistently applied this principle while also expanding its horizons into giving new perspectives with respect to the meaning and the application of the FET principle. It is a standard with a wide scope and has several aspects of protection to it under international law.

³ Waste Management II vs. Mexico, ICSID Case No. ARB(AF)/00/3

In *Swisslion Doo Skopje Vs The Former Yugoslav Republic Of Macedonia*⁴, it was held that the Arbitral Tribunals have used the FET principle to ensure that the foreign investor is not and shall not be treated unfairly and it would be a means to guarantee justice to these foreign investors.

Further, in *Indian Metals vs Indonesia*⁵, four concrete principles are covered by the FET principle as per the Arbitral Tribunals which are as follows -

A. The protection of the legitimate expectations of the investors - The investors usually place reliance on the framework - legal and administrative to make an initial investment. As a result, many arbitral tribunals have accepted that legitimate expectations are within the ambit of the FET principle. In **Southern Pacific Properties vs. Egypt**⁶, it stated that certain acts of the officials of the State were as good as the Governmental authority on whom the foreign investors relied on to make their investments. Further in the case of *Duke vs. Ecuador*⁷, the Arbitral Tribunal observed that these legitimate expectations must be assessed at the time when the investment is made with respect to those

⁴ Swisslion Doo Skopje Vs The Former Yugoslav Republic Of Macedonia, Icsid Case No. Arb/09/16

⁵ ICSID Case No. ARB/04/19

⁶ (ICSID Case No. ARB/84/3)

⁷ ICSID Case No. ARB/04/19

circumstances prevailing.

B. *The freedom from harassment and coercion* - Another aspect of the FET principle where the Arbitral Tribunals have applied it are in prevention of any kind of harassment by the State and its organs. In the case of *Pope and Talbot*⁸, a government regulatory authority had launched a verification review which was found to be aggressive. The Tribunal held that such review amounts to the violation of the FET principle. Further, in case of *Tecnicas Medioambientales vs The United Mexican States*⁹ a licence granted for an unlimited period was converted to a limited period licence. Due to this, the business had to be shifted to a different place. The Tribunal held that this is in violation of the FET principle.

C. *Due process and procedural propriety* - The Arbitral Tribunals have consistently held that any arbitrary measures would go against the FET principle. An arbitrary measure was defined in the case of *EDF vs. Romania*. where it was held that it could mean the following -

- a) Inflicting damage without any legitimate purpose ;
- b) Reasons taken are different from those that are intended ;

⁸ 2022. [online] Available at: <<https://www.italaw.com/cases/863>> [Accessed 11 March 2022].

⁹ 2003, 43 I.L.M 133

- c) Not based on legal standards but are based on prejudice or personal preference ; and
- d) Wilful disregard of the due process of law and the proper procedure to be undertaken.

D. Good faith and Transparency - Through various precedents the Arbitral Tribunals have held that transparency means all the relevant legal requirements for completing the investments including all the formalities should be known to the investors or capable of being known and there should be no uncertainty or doubt in the cases. Hence, the transparency and good faith form an important part of the FET Principle.

“Fair And Equitable Treatment” In The Vodafone Arbitration Case

As seen from above, the FET Principle holds great significance especially in cross-border transactions involving investments. The Vodafone Arbitration case is a classic example of how the FET Principle was applied in order to guarantee each other fair and equitable treatment in the adjudication of disputes. As a result of this, the Government of India made policy changes to remove the topic of tax from the scope of BITs which will help in avoidance of further disputes.

The series of events that would have persuaded the Arbitral Tribunal to apply the FET Principle are as follows. Immediately after the ruling of the Supreme Court in favour of VIH, the Indian Parliament made an amendment to expand the scope of the definition of ‘transfer’. If it applied retrospectively, the Supreme Court decision would have to be struck down since the transfer would then come into the ambit of the new definition of transfer.

Another important point to note here is that, the time gap between the Supreme Court ruling and the amendments were not too long. It looked as if the Government was trying to amend the provisions without detailed analysis to bring VIH into the taxation regime. The above points illustrate on what the Arbitral Tribunal would have considered as not being FET from the Indian Governments’ perspective.

The aftermath of the Vodafone Arbitration case with respect to the FET Principle was very strong as the Indian Government immediately brought in a revised BIT model¹⁰ which removed the concept of taxation. Further, the designation of whether the matter was taxation or not shall be the sole prerogative of the State along with other measures such as non-justiciable matters, treating jurisdictional

¹⁰ 2022. [online] Available at:
<https://dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf>.

challenges as a preliminary issue and dismissing frivolous claims, mandatory publication of information etc.

The FET principle hence played a vital role in the Vodafone Arbitration case. It provided an important basis for the Arbitral Tribunal to rule in favour of Vodafone. The case has hence led to the change in the policy stance of the Indian Government. It has ensured that the principles under international law assumes great importance especially in cases of cross border transactions and the application of such principles are very important and necessary.

Conclusion

The FET Principle has become a vital part of the Arbitral Tribunal's awards today. The Tribunals are increasingly applying this principle to ensure that there is no grave injustice meted out to any other party like in the Vodafone Arbitration case. The concept of the FET Principle has not evolved completely. As new precedents emerge, new perspectives and angles emerge. As a result, it is important to note the ever evolving nature of the principle and apply it as per the relevant prevailing circumstances. States and the respective Governments must take active steps to ensure that there are no disputes and there is fair and transparent investment done by the parties. The application of the FET Principle will help achieve this motive.