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# **TATA DOCOMO DISPUTE – A COMPREHENSIVE ANALYSIS OF THE IMPACT OF THE FDI POLICY ON FOREIGN COMMERCIAL TRANSACTIONS IN INDIA**

AUTHORED BY - CHARVI SAHAY\*

## **1. INTRODUCTION**

An arbitration dispute which went on for 4 years before being settled, was finally settled by the Delhi High Court in 2017 in the case of *NTT Docomo Inc. v. Tata Sons Limited*<sup>1</sup>. The judgement of both the International Court of Arbitration in London and the Delhi High Court upheld the validity of a “*put-clause*” while simultaneously holding that the Reserve Bank of India has no right to intervene in the proceedings that are itself subjected to the RBI made Foreign Exchange Management Act Regulations. The dispute started from 2009, when Docomo, a mobile phone operator incorporated in Japan entered into a shareholder’s agreement (hereinafter referred to as “SHA”) with Tata Sons and Tata Teleservices Ltd. through which Docomo acquired a stake of 26.5 % in Tata Teleservices Ltd. The whole investment amounted to around 2.2 billion USD. The dispute surfaced from Clause 5.7 of the SHA which categorically stated that in case Tata Teleservices Ltd. failed to satisfy certain “Second Key Performance Indicators” then Docomo would exit the Indian market. This clause was agreed upon based on the condition that at the time of Docomo’s exit Tata would be obligated to find a buyer or buyers for Docomo’s shares at the Sale price i.e., the higher of (a) the fair value of the shares as of 31<sup>st</sup> March 2014 or (b) Tata would itself buy back the shares at 50% of the price at which Docomo purchased its shares.

In 2014, Docomo made a proposal to Tata to exit the Indian market, and subsequently invoked Clause 5.7 of the SHA calling upon Tata to find a buyer or buyers to acquire the Sale Shares during the Sale Period in terms of Clause 5.7.2. But the Sale Period terminated on 3rd December 2014 as Tata failed to either find buyers for Docomo or itself buy the shares back at 50% of the original price. Failure to execute either option constituted a breach of Tata's contractual commitment. Docomo further declined to accept the offer of Tata to acquire the shares at the fair

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<sup>1</sup> NTT Docomo Inc. v. Tata Sons Ltd. MANU/DE/1164/2017.

market price which was amounting to 0.36 USD. Hence due to failure of performance of obligation by Tata, dispute arose. Tata's contention was that its obligation under the said Clause was directly in violation to the Foreign Exchange Management Act (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (hereinafter referred to as the FEMA Regulations). The pricing guidelines state that the transfer of shares of an unlisted company from a person resident outside India to a person resident in India shall be at a value not exceeding the valuation of the capital instrument in accordance with any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a chartered accountant or a Securities and Exchange Board of India registered Merchant Banker or a practicing cost accountant. According to *Section 9* of the FEMA Regulations, any non-resident investor could not get any guaranteed or assured exit price and would have to exit at the prevailing price. So, this clause was in the nature of a "put-option" clause and the purpose of this clause was to provide 'stop loss' downward protection to Docomo as an investor. The FEMA Regulations also provided for a special permission to be granted by the RBI for proceeding with such a transfer which was rejected by the RBI. The dispute then was further referred for International Arbitration in London. The concern of the RBI was left unresolved.

## **2. ANALYSING THE LEGALITY OF THE AWARD AND ITS ENFORCEMENT**

The arbitration tribunal in London reasoned that Tata was under an unqualified obligation to fulfill its primary obligation under the SHA and such performance did not require any special permissions from the RBI as certain methods of performance were already covered by general permissions. The tribunal was of the view that Docomo was fully entitled to insist on performance and rejected the argument that an award of damages for breach of Clause 5.7 would result in the circumvention of the relevant FEMA Regulations. The tribunal opined that Tata had multiple ways of awarding damages to Docomo, it could have found a purchaser resident in India for the shares followed by compensating Docomo for the price difference or it could have also lawfully performed its obligation to find a buyer at any price, including at a price above the shares market value, through finding a non-resident buyer. These alternatives could have been performed by obtaining only a general permission from the RBI. The Arbitration Tribunal ruled that since the awarded sum to Docomo was categorized as damages, not the sale price of shares, RBI's special permission wasn't necessary. If both parties don't object to the Award's enforcement and the Court finds no obstacles, the award, which addresses RBI's permission requirement, is enforceable. RBI is bound by this determination and cannot deny permission. On the other issue of non-acceptance

of Tata's offer to buy the shares at fair market price, the tribunal held that Docomo acted in good faith by insisting on performance as it had the reasonableness to not accept the amount on the offer. Therefore, the tribunal ruled out in favour of Docomo by making Tata liable for an amount of US\$ 1,172,137,717 payable within 21 days. However, the tribunal expressed no view on the question whether or not special permission of RBI was required before Tata could perform its obligation to pay Docomo damages in satisfaction of the award.

Further, Docomo took the dispute to the Delhi High Court for enforcement of the arbitral award, wherein the court gave the proper analysis of the law at hand. Through negotiations, Tata had agreed to deposit the amount to Docomo by way of fixed deposit receipts (FDR's). Both the parties drafted certain consent terms mutually which reflected an interest to put an end to the dispute which relating to the Arbitral Award dated June, 2016 passed by the Arbitral Tribunal in London. These consent terms also reflected Tata's good track record in adherence to contractual commitments which it has upheld in both India and abroad, and Tata withdrew its objections to the enforcement of the Award in India. RBI submitted an intervention petition in the proceedings of the Delhi High Court and contended that in as much as the impugned Award requires remission of money to an entity outside India, RBI's role cannot be negated "*for any reason whatsoever.*" Further contentions of the RBI were that the impugned Award in as much as it concluded that the FEMA Regulations need not be looked into was illegal and contrary to the public policy of India. Therefore, notwithstanding that Tata may have no objection to the enforceability of the Award, the Court should refuse to act on the consent terms on the ground that the Award sought to be enforced was opposed to the public policy of India. RBI consistently viewed Clause 5.7.2 of the SHA as violating FEMA regulations. It contravened Regulation 9 by not ensuring transfers at a price determined by internationally accepted valuation methods supported by a CA or SEBI-registered Merchant Banker. Additionally, it infringed upon Section 6(3) of FEMA, granting RBI authority to regulate securities transfers outside India. Foreign Investment Promotion Board's (FIPB) approval in 2009 mandated compliance with SEBI/RBI guidelines for share issues, valuation, and transfers. Hence, the Award bypassing RBI permission for transmitting damages to Docomo contradicted India's fundamental policy and couldn't be enforced. Tata clarified that it withdrew its request to RBI for permission on July 1, 2016, as it retracted its objection to enforcing the Award.

Tata argued against RBI's claim of consistent opposition to Clause 5.7.2 of the SHA. Referring to FEMA Regulations, Sections 3 and 6, it highlighted that repatriation of funds abroad was permissible with RBI's special permission, and there was no blanket prohibition. Even if

restrictions existed, they could be overcome with RBI's subsequent or even post-facto approval, citing the precedent of *Life Insurance Corporation of India v. Escorts Ltd*<sup>3</sup>. Internal RBI notations and correspondence with the Ministry of Finance contradicted RBI's stance presented in court. The Delhi High Court first took up the legality of RBI's intervention in the proceedings. Reference to Section 2 (h) of the Arbitration and Conciliation Act 1996 (hereinafter referred to as the "act") was made. The section defines "Party" as a party to an arbitration agreement. Sections 48 and 34 give the same conclusion, that only a party to an arbitration agreement can file an application for setting aside the arbitral award, and since RBI was not a party to the agreement, under Section 48 its application was liable to be set aside.

The High court held that what was awarded to Docomo were damages and not the price of the shares. As long as the arbitral award stands, there is no need for any special permission for RBI for remission by Tata of the amount awarded thereunder to Docomo as damages. The refusal by RBI of such permission which is not required in the first place, or the fact that such refusal has not been challenged, would therefore not affect the enforceability of the Award. It was held that the contract was valid and enforceable as Sub- Regulations 9 (2) of FEMA Regulations permitted the transfer of one non-resident to another non-resident at any price. The court further held that there was nothing even in the consent terms which violated Indian Contract Act and such honour of its contractual obligations by an Indian entity would only have a bearing on its goodwill and reputation in the international arena.

### 3. ANALYSIS

While it is very true that maintaining India's image as an attractive destination for foreign investment is of paramount importance, circumventing primary laws on the basis of technicalities should not be regarded as a "good practice". It should be kept in mind by the courts enforcing such international commercial arbitration awards involving high stakes and vast sum of money the intent of the act. While determining, the present case at hand, the courts nowhere discussed the aim and objective of the FEMA Regulations, and what it actually sought to achieve through its provisions. The interpretation's provided by both the London Court of Arbitration and the Delhi High court seemed mechanical at best. Nevertheless, it is important to methodically interpret the contractual terms of the agreement at hand but from a foreign exchange regulatory perspective, it is not correct to compromise domestic rules and laws. Transactions between residents and non-residents are primarily governed by the FEMA Regulations, and it is common

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<sup>3</sup> Life Insurance Corporation of India v. Escorts Ltd. MANU/SC/0015/1985.

for foreign investors while entering such transaction to seek clarity on issues that they might face while exiting their investments. While the FEMA Regulations make it clear that exit clauses providing parties an “assured return” is prohibited, the case of *Banyan Tree Growth Capital LLC v. Axiom Cordages Limited & Ors.*<sup>4</sup> held that a “put option” was valid under both the FEMA and SCRA<sup>5</sup> regimes and enforced an award granting the petitioner damages for the respondents’ failure to honour the said put option. The Court *inter alia* held that if the put option price at the time of exercise of put option was less than the fair market value of the put securities, the transaction was permissible under the FEMA framework. A pro-exit approach jurisprudentially is becoming a norm that the Indian high courts are following. What can be concluded, is that while a “put-option” clause is prohibited by FEMA Regulations a “downward-protection” can be conferred to foreign investors and that investor can get an assured price above the market value of the shares. It is true that Delhi High Court has shown a very pro- arbitration outlook, but attention should be drawn to the pending clarity regarding ‘capital account transactions’ in relation to debt instruments from foreign investors. It is very important to note, that while in this case the court held the transaction from Tata to Docomo to be in the nature of ‘damages’ and not in the nature of sale of shares, but if the nature was different, then how will the existing law be applied in this scenario? In the case where the put-option price is higher than the market value, will it still be awarded? Even if such amount is awarded in future will that amount be also considered to be damages as in this case or will be considered as the sale price? As capital account transactions involve the exchange of assets and debts between countries, including financial and non-financial assets, the transaction under such shareholder agreements will definitely fall under the definition of “capital account transactions” under Section 2 (e) of the FEMA Act 1996. While recently the Supreme Court did hold a challenge to the enforceability of a foreign award on the ground that the contract violates the provisions of FEMA and regulations made thereunder and/or if the award is enforced it may violate the provisions of FEMA is no more **res integra**, for successfully challenging an award on the grounds of violation of fundamental policy of Indian law, one has to prove that the award amounts to any breach of core values of any Indian Law which cannot be compromised<sup>6</sup>. There is still considerable confusion regarding the blurry nature of compliance with the law and a concrete rule regarding the validity of “assured returns” should be formalized. The vague representation of making a contract void, or enforcing a contract just based on public policy of which also there are no defined terms will be disadvantageous for FDI growth in the future of India as it may lead to conflict of interest. While Tata took a softer stand

<sup>4</sup> Banyan Tree Growth Capital L.L.C. vs. Axiom Cordages Limited and Ors. MANU/MH/0552/2020.

<sup>5</sup> Securities Contracts (Regulation) Act, 1956, No. 42, Acts of Parliament, 1956 (India).

<sup>6</sup> Renuagar Power Co. Ltd vs General Electric Co. MANU/SC/0195/1994.

and agreed to pay Docomo damages, it may not be the case for some other investee company in the future.

#### 4. WAY FORWARD

When the Tata Docomo dispute first came to the notice of the then RBI governor, Raghuram Rajan, he acknowledged the need for amendments in the existing FEMA Regulations. The acknowledgement was made in a report titled "Report of the Committee on Financial Sector Reforms". Such deliberations remained unenforced and the regulations were not amended. While the verdict of the Delhi High Court has set a precedent, it has the ability to influence thousands of pending foreign capital account transactions impacting India's investment. Many pending cases on similar lines and governed under the same FEMA Regulations like 3i private equity, Krishnapatnam Ports, Navyuga Engineering, GMR Airports, JM Financial, Macquarie, and Standard Chartered Private Equity would be governed on the same lines. Hence, it is important to keep in mind that this judgement does have a very big impact on for India in the global framework. Presently, there is an apparent conflict of interest between following Indian law *stricto-senso* and striving to uphold one's own promise under a shareholder's agreement. In my opinion, amendments need to be made keeping in view of the general global trend as what is practised in places where FDI investments are booming, for example in Singapore or the UAE. While the global trend points towards the validity of such "put-option" clauses keeping in mind easy exit for the investor, deliberations and amendments are necessary syncing Indian law with the current global trends and requirements. While, agreements including such clauses, are seen to be opposed to the public policy in India, in the case of *Shree Lal Mahal Ltd. v. Progetto Grano SPA*<sup>7</sup> Supreme Court clarified that a mere contravention of law would not attract the bar of public policy. Further in *Cruz City Mauritius Holdings v. Unitech Ltd*<sup>8</sup>. the Supreme court opined that public policy considerations are to be balanced and courts need to consider whether refusal to enforce the foreign award might be more offensive to the public policy. The court examined Indian and foreign legal precedents and determined that the scope of the public policy defense against enforcing foreign awards is very limited. After considering the significant changes in exchange control policy from FERA<sup>9</sup> to FEMA, the court concluded that violations of FEMA would not justify challenging the enforcement of foreign arbitral awards on public policy grounds. The court considered the potential for resolving such errors through a process of compounding, as well as the option of seeking retroactive authorization from the RBI, in order to

<sup>7</sup> *Shree Lal Mahal Ltd. v. Progetto Grano SPA* MANU/SC/0655/2013.

<sup>8</sup> *Cruz City Mauritius Holdings v. Unitech Ltd.* MANU/DE/0965/2017.

<sup>9</sup> Foreign Exchange Regulation Act, 1973, No. 46, Acts of Parliament, 1973 (India).

reach its findings. Further, in *Shakti Nath and ors v. Alpha Tiger Cyprus Investment*<sup>10</sup>, the Court clearly stated that the one who accepts the contract with open eyes must bear the burden of the contract along with its benefits. After analysing these precedents in lieu of the Tata Docomo dispute, wherein the counsel appearing from Tata also contended on similar lines, regarding obtaining a post-facto approval from RBI, the current judicial bias seems to be much more favourable to circumventing such public policy objections based on FEMA Regulations on account of pro-arbitration models, it is also important to keep in mind the deliberate avoidance of the central role played by the RBI. Even while it was crystal clear that permissions from RBI were required in the Regulations, they were downplayed somewhat by both the Arbitration tribunal and the Delhi High Court. While RBI is clear in its stand and has stood by its rules and regulations, there is an urgent need to bring judicial sync with both the FEMA Regulations and the prevailing international trend of validating the “*put-clauses*”. Clarification on this question of law is dire as it can manifest itself in the form of an amendment, or a ruling by the Supreme Court. Till then, any such clarification is much awaited as major foreign investments are in line to be enforced in India, keeping in mind the need of attracting foreign investors in India, and making India an attractive, safe and viable investment destination.

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<sup>10</sup> *Shakti Nath and ors v. Alpha Tiger Cyprus Investment* (2020) 4 SCALE 1.