

### Tata-Docomo case: Is RBI right in opposing settlement?

On February 28, Tata Sons announced that it was ending its dispute with NTT Docomo and agreed to enforce the award announced by the London Court of International Arbitration. However, eight days later Reserve Bank of India (RBI) opposed the consent terms because the payment of the agreed amount of USD 1.17 billion to Docomo would breach the current foreign exchange rules.

However, the court raised two questions to RBI. Does it have the right to oppose an arbitral award? And is it opposing the consent at the behest of the Finance Ministry or autonomously? RBI reply is still awaited.

To give us more insight into the legal standings CNBC-TV18 spoke to experts – eminent jurist Abhishek Manu Singhvi, Vaibhav Parikh, Partner, Nishith Desai Associates and Sandeep Parekh, Founder of Finsec Law Advisors.

Experts believe much will depend on whether the court buys RBI's argument that public policy will be hurt by allowing Docomo an exception to its current policy. Secondly, it also depends on whether the court believes that Tata's are paying damages and not an assured return, and thirdly if RBI's initial okay to Docomo payment is important enough to make a distinction between assured return and downside protection.

#### The case history:

In 2009, Docomo bought 26 percent stake in Tata Teleservices at USD 2.7 billion. It bought the shares from Tata Power and Tata Communications on the understanding that if the value fell below half the purchase price, the Tata Communications and Tata Power will have to find new buyers for its stake at a minimum value of USD 1.17 billion. The shares fell below the protection price and the put option was triggered. Tatas had to find new buyers or pay up.

Opposition came from RBI. The RBI and the Indian government have traditionally put no limits on equity investments from foreigners but have capped debt investments since over-indebted countries often see a run on their currency. But what if equity investors add put options such that their money will automatically be called back if the return on investment fell below say 8 or 10 percent.

RBI disallowed all these assured return products as debt in the guise of equity.

However in 2014, when the Tatas made a request to RBI that they pay Docomo, RBI agreed, saying this was not an assured return product but a downside protection. However, their recommendation was struck down by the government.

A year later on February 3, 2015, Governor Raghuram Rajan said RBI will amend rules to allow foreign equity investors to add clauses that assure them a return below the sovereign yield. The promise was never fulfilled, the rules were not changed.

This was partly because in the same month the budget announced that henceforth the government will make all rules on capital account transactions with respect to equities, while RBI will make rules on the capital account transactions with the respect to debt instruments. This clause was passed along with the Finance Act but was never notified.

#### Below is the verbatim transcript of Abhishek Manu Singhvi, Vaibhav Parikh and Sandeep Parekh's interview to Latha Venkatesh on CNBC-TV18

**Q: Prima facie if Docomo wanted half its capital protected, wouldn't it amount to an assured return on an equity instrument and RBI, as we know, has always opposed assured returns on equity instruments? So does it have a case?**

**Singhvi:** As I said I am speaking in the capacity with disinterested observer and a legal person not as a participant. So, I don't know the exact fact. Let me tell you two-three things, first of all, I think the entire community of industrialists and the business community should applaud the fact that this is a rare occurrence. Let us step back a moment and just see that how rare an occurrence it is that such a large amount has been amicably at least attempted to be settled.

Second, to your question, this case has some very peculiar features which need to be underlined. One is that the RBI doesn't seem to have found initially at least in a very strange, very detailed recommendation anything wrong with it. That should be given a lot of weight. Now the second issue which you raise, which I am sure lawyers had been addressing in the case, if it goes through that is that whether that RBI return specific recommendation which you rightly mentioned can at all be overwritten by the government, is there any specific power?

Third, you may change the government policy for the future but when this happens and an RBI gave in understanding in recommendations, there is much weight in the fact that it should be looked into and honoured.

Lastly a provision for capital -- this is very important -- erosion protection which is admittedly seen as not collusive or illegal in that sense should be seriously considered because ultimately in the larger policy perspective, it is a huge help to India to receive and to encourage investments in India and at the end of the day the larger story is that people want investments in India.

Now investments in India especially in top blue-chip situations will increase considerably if these kind of policies are tweaked to specify that these are not held to be illegal because you want to protect your capital, you are not asking for rapacious rate of interest, you are not asking for a guaranteed return, you are only saying that I must get a reasonable thing which maybe below the sovereign rate but I should not be losing capital. This is what encourages investment.

**Q: There would be several interpretations of both the government and the RBI in several cases, which they would have disagreed but nevertheless, some weight should also be given to the fact that this is in a sense an assured return. No matter what happens to this investment, I should get at least USD 1.2 billion back. That assured return is not something which the law of the land on that day allowed. Therefore, would not the RBI have the right -- no matter what the arbitration said, this is not the law of my country -- to set aside an arbitration order which was against the law of the land?**

**Singhvi:** It is absolutely clear that if an award is judged by the court to be contrary to public policy, not the law of the land -- that is a different phrase -- but contrary to public policy of India, it would be liable to be set aside. There is no doubt about that.

The judge of that will not be the RBI. The judge of that will not be the arbitral panel and the judge of that will not be the parties. The judge of that will be ultimately the court to which that award is brought for enforcement in this case, the Delhi or whichever court is involved.

Third, that process is under the arbitration act provided in a particular section which uses the phrase public policy. Public policy is not merely law, it has to be law plus, it has to be a violation which affects the underlying basis of the legal system. I agree with you that it is an open question as to whether the court will go this way or that way and there is certainly a strength in the argument of RBI that this affects Indian public policy because it is not a case of only Docomo and Tata but across the board, it would affect foreign exchange outflows if people started giving guaranteed returns of this kind.

Therefore, I think it is a very important issue for the government to sit back and take a relook, the government should seriously consider modifying this policy and putting caveats, which allow such kind of clauses to a limited extent where they are not found collusive, they specify a rate below a certain specified rate by the government, they are clearly intended to protect your thing. So that would be a much happier solution than doing a case-by-case court adjudication. This is what is going to happen in this case.

As things stand today, yes, there is a 50-50 chance that a strong argument on each side, interestingly Docomo and Tatas will be on the same side for this argument and RBI on the other, there is a lot to be said that this may or may not follow public policy exceptions.

**Q: The court brought up an issue, are you doing it on your own will or is it at the behest of the finance ministry? Isn't that a moot point, is that a relevant point at all, after all in all countries capital account and current account transaction rules are made by both in consultation with each other?**

**Singhvi:** I think it is a very relevant question from the court. The question is intended to elicit factual information to suggest whether the parties consider it genuinely against public policy. Suppose you and I have a transaction in which we have this clause and the RBI makes the recommendation saying it is okay, you can take this money, it is a clear indication that the RBI does not take it as a default of public policy. However, subsequently RBI changes its view, so the court is asking what made you change your view, was it government pressure or something else and did you have sufficient reasons to change that view? That will be a factor in the calculus of deciding whether it affects public policy which is the only basis on which the RBI can stop it.

**Q: In case the finance clause of 2015 had been made into law then this point would not have risen because in that case the government does make all the rules with respect to capital account convertibility on equity instruments?**

**Singhvi:** That would correct. It would depend on the date of the transaction also because the 2015 law would normally not have retrospective effect to an earlier transaction but I don't know the exact dates but certainly that law for all transactions after 2015 would pull in different colour had it been made.

**Q: Can the Tatas, under the circumstances, pay Docomo at all unless the law is amended?**

**Parekh:** I do not think so. Before we start, I would like to take us up 30,000 ft. and why this policy is in place for so many years. I think it is broadly to do with exchange control, as you mentioned. India has been hesitant to completely free debt in investments into India and one of the main reasons is concept of carry trade in which people come from zero interest economies, get a guaranteed return if they invest in developing economies which has a huge – flows would be massive and they can inundate rates, they can change rates, they inundate the market with cheap money, cause worries on inflation. So there are a lot of macroeconomic reasons.

**Q: Basically, disturb macros?**

**Parekh:** Exactly. So, there is a good policy reason for doing that, particularly last few years when we have had zero interest rates in almost all the western economies.

**Q: So, capital control on debt instruments is a good idea?**

**Parekh:** I think it is a good idea at least for the time being till the time we achieve the scale in which we believe that the markets can self-correct and the flows will not disturb the economy per se.

**Q: But this is a fine distinction between allowing assured returns and allowing someone downside protection. Should that distinction be made?**

**Parekh:** I do not think that is really a distinction at all. It is a distinction without a difference really because ultimately what matters is what is the market price. If the market price is Rs 1 and you are giving Rs 20 to somebody, that is 20 times the market price of that. It has no relationship with 50 percent of the price paid, etc. So, essentially, it is a debt-like component, it is a put-like option and it is essentially guaranteeing something, even if it is return of capital or part of capital, it is still a guarantee and therefore it has debt-like features.

**Q: Has the time come to make that distinction? India is not in that state of the emerging market that it was probably in the 1990s and early 2000s and the world has gone on with other equity hybrid instruments. So, has the time come or do we have that much confidence in our foreign exchange (FX) reserves to allow foreign investors to just ensure downside protection of their capital?**

**Parikh:** First, I just want to take a shot at little bit of the first question because I have a slightly different view from Sandeep. My view is that if the court considers this judgement or arbitration order as damages because that is the way they have actually, the way the order is worded, what I understand from public sources is that it is worded as damages and not as a transfer of shares, payment for transfer of shares. Damages actually come under current account. So, there is some possibility where high court may actually say it is a payment of damages, it is a current account and I will be really as ano-say in this particular payment. So, there is a possibility of court taking that view.

Having said it, this is not a simple damages situation because there is also relinquishment of equity in favour of Tatas, so to some extent, I also agree with Sandeep that RBI's position is that what you cannot do directly, you cannot do indirectly too. So, it really depends on how court views it, whether it looks at it as a situation of damages or whether it looks at it as a transfer of shares above fair market value which is against the RBI regulation.

Now coming to your point what you asked whether India has reached and my answer is unequivocal yes. Things have changed here. Now if India has to compete with global economies, if they want to attract investment and a world class capital investment, you need to have laws which are similar to laws which exist in other countries. And if you really look at it, in other countries, such restrictions do not exist. In fact, if you look at the developed world, there are no restrictions, there are no capital controls.

Now, I agree with Sandeep saying that India has not reached the stage where there cannot be a capital control. There should be a capital control, there should be a capital control until India reaches a stage where it becomes more like a developed nation. But, till then, regular liberalisation where it actually provides downside protection, in my view is a good policy to attract foreign investment.

**Q: Sandeep, do you think that distinction can be made prospectively?**

**Parekh:** I do not think so. We again go back to the mother-question of capital account convertibility. Till that happens, I do not think we can really revisit this question. The real issue here do you want to amend it anyway because you will have all kinds of dubious prices coming in. You have market prices of Rs 1,000 being traded at Rs 40 and then again next day being again traded at Rs 5,000. Do you want that kind of market, particularly in the listed space where there is a market price, you know we have ballpark figures, so you could have probably relaxation for 5-7 percent to account for controlled premium itself. But having completely funny prices being traded in listed space is – I think it will be manipulative in the first place and it will be unfair both in the inbound side and on the outbound side.

**Q: What about this other issue itself? The court telling RBI that are you doing it at your own behest or is it at the Finance Ministry's behest. Does it have any bearing because in capital account cases, even if the RBI makes the rules it is in consultation with the government?**

**Parekh:** I do not think it is a relevant query at all whether the government has asked RBI to do or RBI has done it on its own, etc. The relevant question to ask is what is the law?

**Q: The court has told RBI that it is opposing an arbitral award and does it have the power to do so. Is that also a moot question?**

**Parikh:** That is a moot question. I believe RBI can oppose and the court has actually allowed them to oppose, to intervene. Basically, under Indian law, the court can set aside an arbitration award if it is against public policy. One of the public policy is that it is blatantly against the law and if RBI has said that this award is against the law then it is fair for the court to hear why it is against the law and if the court gets convinced that it is against the law, they can set aside the arbitral awards.

**Q: While the finance act has passed the rule that capital account transactions on equity instruments will henceforth be governed by the government, it is not yet amended. So, what is the current position? RBI continues to make the rules?**

**Parekh:** Yes. The laws are never effective till they are notified. So, obviously it is the position which was always there. Additionally, one last point I would like to make here is also there is a 1969 circular under Securities Contracts Regulation Act (SCRA) which is also very relevant because that completely prohibits any puts, calls, other options in not just listed securities but also public limited companies. So that is actually one step further. It actually prohibits, makes it illegal, you can go to jail for actually entering into these kind of contracts.

**Q: But then a lot of companies would be guilty in that case.**

**Parekh:** Yes. It is enforced in the breach, that is true, but the fact is something which is illegal automatically becomes void and if it is void, then it is certainly not enforceable.

**Q: So would you say that that SCRA rule needs to be amended?**

Parekh: I have been advocating that. SEBI has relaxed it a little bit for private equity transactions in certain circumstances. Since 1969 to four years back they amended it. So, it was an absurd position for a long time. But, again, we should argue for policy changes but not say that the law is invalid when it is in fact in the books.

**Q: It looks like Docomo cannot get that money?**

**Parikh:** I again go back to the point where it depends really on how the court looks at it, whether court looks at it as a damages case or they look at a transfer of shares over and above fair market value which is against Indian law and that is the way I look at it. Now again, if you look at from perspective, I do not believe the way the contract was worded from what you have told and what I have read that it was actually a put option. I believe the obligation on Tatas was to find a buyer at either a fair market value or at 50 percent, whichever is higher. What arbitration order says is that Tata failed to find a buyer at the agreed price and as a result, there is a loss which was suffered by Docomo and the damages is equal to whatever the amount they have given. Obviously if someone can question whether the amounts have been properly arrived to or not.

**Q: I do not think the court is questioning that part of the contract. I thought the court is questioning the fact that in the event you do not find a buyer, then you will have to buy back the share at an assured price. It is that assured price that is being disputed.**

**Parikh:** I was just saying that the contract what I understood from market sources, the contract did not have obligation for Tata to purchase the shares of Docomo. I do not think that was also mentioned in the arbitration award. What I understood is arbitration award said you failed to find a buyer to purchase Tata Docomo shares and because you failed to meet your obligation, there is a loss which Docomo has suffered and you need to pay damages and damages end up being equal to USD 1.17 billion.