

Telecom Hotline

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SUPREME COURT CANCELS 122 TELECOM LICENSES WITH GOOD INTENTIONS

Can India's International Investment Agreements rescue affected foreign investors?

Several non-governmental organizations and individual citizens ("Petitioners") had filed a public interest litigation¹ against the Union of India and various private companies in relation to allocation of 2G spectrum. In relation to this public interest litigation, on February 2, 2012 the Supreme Court of India ("SC") criticized the *first come first served* policy of the government for distribution of 2G spectrum and delivered an order against thirteen respondents² ("Respondents") cancelling 122 telecom licenses granted in various service areas for 2G spectrum. The SC has also levied fines against certain telecom operators and directed the Telecom Regulatory Authority of India ("TRAI") to formulate a fresh policy for allocation of 2G spectrum.

Vide this order the SC has not only sent out a very clear message that when a government policy is not transparent or fair, it is liable to be struck down, but the SC has also gone ahead and quashed the very licenses which the government issued under the said policy. As such the order of the SC has resulted in mixed reactions and is bound to have far reaching consequences particularly in the following respects:

- (i) The foremost effect will be on the Respondent operators and their investors whose licenses have been cancelled by the order. This cancellation has resulted in investor uncertainty and while the order is clear that the allocation of 2G spectrum is to be done afresh, it is to be considered whether the operators who were legitimately conducting business in India should be given certain 'grandfathering' treatment with respect to the investments already made by them or be compensated in some other form.

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(ii) The order will also impact the telecom supply chain in the Indian telecom industry. There are various companies which have large orders and commitments from these licensees for supply of various telecom network hardware, software and services; the potential loss of a major customer/s in India is a cause of serious concern to such vendors. It will need to be examined whether the supply arrangements under which such vendors operate would provide them with any contractual remedies. Disputes and litigation may ensue at various levels.

(iii) The SC order does not mention what is to become of the end subscribers of the affected Respondent operators. Such customers may be ported to other service providers as part of the mobile number portability regime introduced in India.

BRIEF BACKGROUND

- The National Telecom Policy 1999 (“**NTP 1999**”) was formulated with one of its main objectives ‘to achieve efficiency and transparency in spectrum management’ and ‘have a transparent policy of allocation of frequency spectrum’
- Guidelines for Unified Access Service Licenses (“**UAS Licenses**”) were announced by the Department of Telecommunications (“**DoT**”) in 2003 that allowed the basic service providers to provide full mobility based services with a stipulated entry fee based on the bid price paid by operators in 2001. The payment of this entry fee enabled the licensee to become eligible for spectrum allocation in specified bands (without the need to pay any additional spectrum fee) subject to availability of spectrum; however the operators paid royalty on spectrum use on revenue share basis.
- Through its recommendations dated August 28, 2007 TRAI recommended that there should be no change in the 2G pricing (“**TRAI Recommendations**”), so as to allow level playing field for all players.
- Meanwhile the DoT continued to receive applications for UAS Licenses. As on September 2007, there were 167 license applications from 12 companies for 22 service areas.
- A note dated October 26, 2007 was sent to the Department of Legal Affairs, seeking the opinion of the Attorney General of India on the mechanism to deal with situation created due receipt of large number of UAS License applications. The reply to the note contained four alternatives to deal with the situation. On November 2, 2007, the Telecom Minister approved the note and recorded on his own that Letter of Intent (“**LoI**”) may be issued to the applications received up to



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September 25, 2007; he also indicated that the DoT has decided to continue the first-cum-first served policy of DoT for processing the applications received before September 25, 2007 and may continue adopt the same policy for the application post September 25, 2007 in the event that the spectrum is available.

- Thereafter there was correspondence between various departments (including the office of the Prime Minister, the then Telecom Minister and the Finance Secretary) debating this issue. On December 26, 2007 Mr. A Raja (the Telecom Minister) sent a letter to the Prime Minister in order to establish that the Prime Minister had provided consent with respect to issuance of LoI to the applicants.
- The DoT issued a press note on September 24, 2007 that no new applications would be accepted after October 1, 2007 ("Press Note"). Between September 24, 2007 and October 1, 2007 over 300 applications were received.
- On January 10, 2008, DoT decided to issue letters of intent on *first come first served* basis, suo-moto bringing forward the cut-off date to September 25, 2007 from October 1, 2007. Later on the same day, DoT posted an announcement on its website saying those who apply between 3.30 PM and 4.30 PM of the same day would be issued LoIs in accordance with the said policy.
- Subsequently the Respondent operators were granted UAS Licenses.
- S Tel who had applied for grant of license pursuant to the Press Note but was ousted because of the advancing of the cut off date filed a writ petition in the Delhi High Court wherein the Court held that the DoT had in effect changed the rule of the game 'after the game began'. While the Union of India had challenged this order in the SC, a compromise was reached between the parties and the SC disposed of the appeal.
- Currently there are pending criminal investigations into various allegations of corruption against various persons and irregularities in the allocation of spectrum to the Respondent operators.

GROUND OF CHALLENGE:

The Petitioners have questioned the manner of grant of UAS Licenses to the Respondent operators on the ground that the procedure adopted by the DoT in granting of the UAS Licenses to them was arbitrary, illegal and in violation of Article 14 of the Constitution of India (which guarantees equal treatment). The submissions made by the Petitioners *inter alia* include the following:

- (i) Spectrum is a national asset and a policy of distributing it on a first come first serve basis

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with no defined criteria (such as advertisement and auction) is fundamentally flawed.

- (ii) The DoT violated the recommendations made by the TRAI that there should be no cap on the number of service providers in a service area.
- (iii) The Petitioners relied upon reports prepared by the Comptroller and Auditor General ("CAG Report") and claimed that a large number of 'ineligible applicants' were considered.
- (iv) The TRAI Recommendations of 2007 in fixing of entry fee as per prices determined in 2001 was arbitrary and unconstitutional.

QUESTIONS RAISED BY THE SUPREME COURT

We provide below the gist of the SC decision and our analysis on some of the pertinent points raised and answered by the SC.

1. **Whether the Government has the right to alienate a natural resource other than by following a fair and transparent method? Whether the TRAI Recommendations were flawed?**

Decision of the SC: The SC concluded that spectrum was a natural resource and national asset and belonged to the public at large. It referred *inter alia* to the SC's decision in *Sachidanand Pandey v. State of West Bengal*³ where the SC had opined that one of the best ways of securing the public interest when disposing of a public property is to sell the property by public auction or by inviting tenders. The SC opined that the auction method was the only rational transparent method of distribution of national resources.

The SC held that the TRAI Recommendations had overlooked not only the main objectives of NTP 1999 of achieving a transparent process of frequency allocation but also basic constitutional principles of equality by effectively preventing a majority of people from participating in the distribution of spectrum. The SC held the TRAI Recommendations to be flawed.

Analysis: The decision on treating spectrum as a national asset is in keeping with the past policy of the government, judicial precedent and international trends.

However the comments of the SC that auction method seems to be the only rational and transparent method for distribution of national resources appears to be simplistic. This may not be true of all resources and in all cases. In the case of *Sachinand Pandey v State of West Bengal*⁴ the government of West Bengal had not floated a tender for granting government land for construction

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purposes but had negotiated with interested parties. While the SC in this case had opined that auction is a preferable way of disposing of public property, the SC had also held that the absence of auction does not necessarily nullify the grant and that auction is not the invariable rule in distribution of resources. Whatever process is selected by the government to distribute national resources needs to follow a sound and transparent policy.

In the case of spectrum while auction may be a preferred market driven method (especially in scenarios where spectrum is scarce and there are a large number of applicants), it is a policy level decision to be taken by the government. In this order the SC has directed the TRAI to make fresh recommendation for grant of license and allocation of 2G spectrum. The TRAI has since issued a pre-consultation paper on the allocation of 2G spectrum on February 6, 2012⁵.

While the SC may have made broad remarks about the distribution of national assets, the underlying point which the SC seems to be making is that where the government policy for distribution of a national asset is not transparent or clear, it may lead to corruption and nepotism and is liable to be struck down. This stand taken by the SC is also in keeping with the objectives of NTP 1999 which stresses on the need for transparency in spectrum management.

2. Whether the grant of UAS Licenses to the Respondent operators is flawed due to arbitrariness and malafides and is contrary to public interest?

Decision of the SC: The SC held that various actions such as bringing forward of the cut-off date, the manner of issue of the licenses were tinged with irregularities and contrary to public interest and hence the grant of the UAS Licenses to the Respondent operators was illegal.

The Respondents had argued that if the exercise undertaken for the grant of UAS Licenses was flawed in the case of the Respondents then such irregularity should actually be extended to all UAS Licenses which were issued since 2001 under the said first come first served policy and before issue of the Press Note (and not be restricted to solely the Respondent operators). The SC dismissed this argument by stating that operators who got the licenses prior to issue of the Press Note are not respondents in this case and hence the legality of their licenses is not in question.

Analysis: It is interesting to note that though the Petitioners relied heavily on the CAG Report; since the CAG Report is currently under review by certain government committees, the SC did not find it proper to refer to the findings and conclusions drawn in the CAG Report. That being the case, the fact remains that the Respondents had followed the extant policies of the government and had applied for licenses as per the declared government policy. They and their investors have made huge investments for creating infrastructure in the country. Cancellation of their licenses at this point

could be held to be against the doctrine of legitimate expectation insofar as it relates to the expectations of such players to operate in a field of regulatory certainty and protection from unjust expropriation.

3. Whether the principle of first come first served followed by the DoT for grant of the UAS Licenses to the Respondent operators is *ultra vires* Article 14 of the Constitution.

Decision of the SC: The SC held that there is a fundamental flaw in the principle of first-come-first-served inasmuch as it involves an element of pure chance or accident and may be misused. The SC further observed that it is essential for the government to adopt a rational method for disposal of public property and no attempts should be made to scuttle the claim of worthy applicants. Accordingly the SC held that the principle of first come first serve violates constitutional principles.

Further while admitting that the courts have limited judicial review in policy decisions particularly in financial matters, the SC opined that the courts were justified in exercising their jurisdiction when it is abundantly clear that any policy framed by the government is against public interest.

Analysis: While the principal of first come first served and its constitutional validity requires deeper study, it is also important to analyse whether alternate methods such as auction would always be fair and equitable. There could be an argument that an auction process would work in the favour of those who have deep pockets and itself therefore be in some way in violation of Article 14.

4. Whether the licenses granted to ineligible applicants and those who failed to fulfill the terms and conditions of the license are liable to be quashed?

Decision of the SC: The Supreme Court held that all licenses granted to the Respondent Operators on or after January 10, 2008 and subsequent allocation of spectrum to the licensees were declared illegal and are quashed. The reason for this quashing was limited to the fact that the policy of the government was illegal. The SC did not go into the merits of each license.

Analysis: Whilst the intention of the SC in ensuring a fair and transparent framework is laudable, the cancellation of all 122 licenses without going into the merit of each case raises many questions. Since the Central Bureau of Investigation is seized of criminal proceedings in the 2G spectrum case, it may have been preferable for any decision on cancellation of license to be based on proven criminal culpability. It is interesting to note the SC's view that this order should have no bearing on the pending criminal investigations.

POSSIBLE REMEDIES

Review: The first remedy that is available to the Respondent operators is to file an application for review of the SC's judgment.

By virtue of Article 137 of the Constitution of India the SC has the power to review its judgment on the grounds of error apparent on the face of record and also in unusual cases to avoid injustice.

It is further settled law that the SC is not powerless to correct its error which has the effect of depriving a person of his fundamental rights. It can do so in exercise of its inherent jurisdiction in any proceeding pending before it without insisting on the formalities of a review application. Powers of review can be exercised in a petition filed under Article 136 or Article 32 or under any other provision of the Constitution if the Court is satisfied that its directions have resulted in the deprivation of the fundamental rights of a citizen or any legal right of the petitioner.

The review under law is placed before the same judges who passed the earlier judgment and hence an administrative order by the Chief Justice of India to appoint an alternate judge to replace Justice A. K Ganguly (now retired) would be necessary.

If the Respondents in their review petition can prove that the inference by the SC in the government's policy decision is contrary to the principles laid down by the SC in its past judgments or there is any other conflict between other precedents set by the SC and the present judgment they also will have an opportunity to request the court to place the matter before a larger bench of the SC for adjudication.

This process of review will be available to all Respondent operators and other entities who had a direct interest in the license and who deserved to be heard before the license could be canceled.

Investment Arbitration: The remedy which could be available to foreign investors is that of invoking an Investment Arbitration under the International Investment Agreement ("IIA") India has with their parent states. This remedy may be available not only to the foreign investors holding direct interest in the entities whose licenses were cancelled such as Telenor, Sistema and Bahrain Telecommunications but also to those foreign investors who have indirectly lost their business due to the sudden cancellation of the licenses.

The foreign investors may have various claims which might be available to them on case to case basis. But the important ones would be claims of breach of legitimate expectation; denial of justice and expropriation which would in turn entitle the foreign investors to compensation equaling the value of loss to investment.

The investor whose parent jurisdiction does not have an IIA with India but has routed their

investment through any other jurisdiction which might have an IIA with India could use those treaties to invoke such claims.

An important takeaway is that, if the home state of a foreign investor investing into India does not have an IIA with India it is advisable to revisit India's IIAs with other nations before making an investment and make use of the available window of corporate structuring to ensure full protection and security of one's investment.

Approach the TDSAT: In accordance with the TRAI Act, the TDSAT (i.e. the Telecom Disputes, Settlement And Appellate Tribunal) is the appropriate jurisdiction for any dispute between the DoT and a licensee.

It is to be noted that while the SC has declared the licenses granted to the Respondent operators to be illegal, the method of cancellation/ termination is not clear. It is not the case against the Respondent operators that they are in breach of the terms of the UAS License; as such it is not clear under what ground the government would terminate the license. The terms of the UAS License have the following provisions with respect to cessation of the license:

- (i) The DoT may terminate the license in cases of breach of license conditions and breach of applicable law;
- (ii) The DoT has the right to suspend the operation of the license if it is of the opinion that it is necessary to do so in public interest;
- (iii) The DoT may revoke the license at any time.

Keeping the above in mind, the Respondent operators may approach the TDSAT to claim compensation from the DoT.

CONCLUSION:

Legal, tax and regulatory certainty is a non-negotiable pre-requisite in today's investment environment. The recent judgment of the SC in the Vodafone case⁶ on taxation of cross-border transactions involving investments in India provided some much needed certainty to investors. This order may dampen investor confidence.

While the SC seems to have been aggressive in penalizing entities for following existing policies, it is not to be doubted that the SC has to be commended for passing a courageous judgment upholding the need for transparency in government policies which paves the way for ensuring that all policy decisions should be reasonable and clear.

1 Writ Petition (Civil) No 423 of 2010

2 Respondents in this matter are as follows (1) Union of India through its Secretary, Department of Telecommunications, (2) Etisalat DB Telecom Pvt. Ltd. (Swan Telecom), (3) Unitech Wireless Group (4) Loop Telecom Pvt. Ltd. (ShippingStop Dotcom P. Ltd.), (5) Videocon Telecommunications (Datacom Solutions Pvt. Ltd.) (6) S Tel Ltd., (7) Allianz Infratech (P) Ltd., (8) Idea Cellular Ltd. & Aditya Birla Telecom Ltd. (Spice Communication Pvt. Ltd.), (9) Tata Teleservices Ltd., (10) Sistema Shyam Tele Services Ltd. (Shyam Telelink Ltd.) (11) Dishnet Wireless Ltd. & Aircel Ltd., (12)Vodafone Essar South Ltd. & Vodafone Essar Spacetel Ltd., (13) TRAI

3 (1987) 2 SCC 295

4 1987 AIR 1109

5 <http://www.trai.gov.in/WriteReadData/trai/upload/ConsultationPapers/277/Consultation%20Paper.pdf>

6 Please see our analysis at http://www.nishithdesai.com/New_Hotline/Tax%20Hotline_Jan2312.htm

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(**special thanks to Nandi Kumar– intern with Mumbai office for her contribution)

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