Between the lines...

January, 2017

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Highlights

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I. Multinational law and audit firms allowed entry into SEZs

The Special Economic Zones (Amendment) Rules, 2017 (the **"Amendment Rules"**), amending the Special Economic Zones Rules, 2006 (the **"Rules"**), issued by the Department of Commerce, Ministry of Commerce and Industry have come into force with effect from January 6, 2017.

Prior to the amendment, under Rule 76 of the Rules, professional services excluded legal and accounting services and such services could not be set-up in Special Economic Zones(**"SEZs"**). Now, the Amendment Rules have done away with this exclusion and there is no bar on setting-up legal and accounting services firm in SEZs. Accordingly, foreign law and accountancy firms can set up offices and advice clients from SEZs.

VA View

This move by the Government can be seen as a small but significant step towards liberalisation of Indian legal market. This move comes at the time when professional bodies and several law firms have shown stiff opposition on liberalising the legal market.

It is to be noted that multinational law and accountancy firms are not the only ones who will benefit from this move. Indian firms are also permitted to set up offices in SEZs which will escalate competition among the firms.

Further, it is pertinent to note that foreign law firms cannot practice and advise on Indian law and are expected to cater to only niche areas like international taxation, international mergers, alternative dispute resolution, or any other advice on cross border transactions.

It seems that this initiative of the Government, though a bold step in the direction of liberalisation of the Indian legal market, may face challenges going forward from several professional bodies and industry associations who are opposed to entry of foreign law firms.

II. Two- tier arbitration gets green signal from the Supreme Court of India

A three- Judge Bench of the Supreme Court of India has delivered a major verdict regarding the validity of a two-tier arbitration procedure on December 15, 2016 in the case of ***M/s. Centrotrade Minerals & Metal, Inc. vs. Hindustan Copper Limited.*** The apex Court has ruled that settlement of disputes through two-tier arbitration procedure is permissible under Indian laws.

Background

The appeal was referred to a larger three-Judge Bench of the Supreme Court as the bench of Hon'ble Mr. Justice S.B. Sinha and Hon'ble Mr. Justice Tarun Chatterjee had delivered conflicting views in this matter on May 9, 2006. The Appellant M/s. Centrotrade Minerals & Metal, Inc. (**"Centrotrade"**) and Respondent Hindustan Copper Limited (**"HCL"**) had entered into a contract for sale of 15,500 dry metric tons of copper concentrate which was to be delivered at a port in two separate consignments. The goods were required for a plant of HCL. The consignments were delivered and payments were cleared. However, dispute arose between Centrotrade and HCL with regards the dry weight of concentrate copper.

Clause 14 which was the arbitration clause in the contract for sale is reproduced below.

"All disputes or differences whatsoever arising between the parties out of, or relating to, the construction, meaning and operation or effect of the contract or the breach thereof shall be settled by arbitration in India through the arbitration panel of the Indian Council of Arbitration in accordance with the Rules of Arbitration of the Indian Council of Arbitration. If either party is in disagreement with the arbitration result in India, either party will have the right to appeal to a second arbitration in London, UK in accordance with the rules of conciliation and arbitration of the International Chamber of Commerce in effect on the date hereof and the results of this second arbitration will be binding on both the parties. Judgment upon the award may be entered in any court in jurisdiction."

As is clear from the clause, there was a two-tier arbitration provided to resolve disputes between parties. Centrotrade invoked the arbitration clause and an award was made. Thereafter, second part of the arbitration agreement was invoked by Centrotrade and arbitrator passed an award on September 29, 2001. The stance taken by HCL was that provision for second arbitration was void and a nullity being opposed to public policy. However, arbitrator held, inter alia, that the arbitration clause of the agreement which provided for two-tier arbitration was neither unlawful nor invalid. HCL was directed to pay certain sums to Centrotrade.

HCL filed a suit praying for a declaration that the arbitration award was void and a nullity, and for permanent injunction and damages. Meanwhile, Centrotrade moved an application for enforcement of the award which was allowed. HCL had filed an appeal against this judgment allowing the execution petition and succeeded. The matter then reached the apex Court. As noted above, the two-Judge Bench of the Court had dissenting views so the matter was referred to a larger Bench comprising Hon'ble Mr. Justice Madan B. Lokur, Hon'ble Mr. Justice R.K. Agrawal and Hon'ble Mr. Justice D.Y. Chandrachud.

Issue

One of the questions which the Court proposed to address was whether a settlement of disputes or differences through a two-tier arbitration procedure as provided for in Clause 14 of the contract between the parties is permissible under the laws of India.

Arguments

Learned counsel for HCL argued that the second part of clause 14 of the contract, under which the aggrieved party from first arbitration was entitled to appeal to a second arbitration in London, was contrary to the laws of India. It was further submitted on behalf of HCL that the right to file an appeal could only be created by a statute and not by an agreement between the parties.

Learned counsel for HCL based his arguments on three counts:

I. Provisions of the Arbitration and Conciliation Act, 1996 (the **"Act"**) do not sanction an appellate arbitration;

ii. There is an implied prohibition to an appellate arbitration in the Act; and

iii. An appellate arbitration is contrary to public policy.

Observations of the Court

The Court took note of certain decisions of the Bombay High Court and the Delhi High Court which embraced the two-tier arbitration system. With regard to statutory appeals, the apex Court noted an observation made in an earlier judgment that if an appeal was not provided for by a statute, then the filing of an appeal was not permissible. The Court pointed out that it was concerned with a non-statutory process in this case and not a statutory appeal. The Court also declined to fully subscribe to the view that acts mentioned in a statute are permissible but acts not mentioned therein are impermissible. According to the apex Court, it could very well be the converse.

The Court referred to the views expressed in the Analytical Commentary on Draft Text of a Model Law on International Commercial Arbitration - Report of the Secretary-General (dealing with Article 34(1) of the Model Law on International Commercial Arbitration) in which it was stated, inter alia, that Article 34(1) would not exclude recourse to a second arbitral tribunal, where such appeal within the arbitration system was envisaged. The Court further referred to the views in the Explanatory Note by the UNCITRAL Secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006, in which it was stated, inter alia, that a party was not precluded from appealing to an arbitral tribunal of second instance if the parties have agreed on such a possibility (as is common in certain commodity trades).

The Court went ahead to point out certain recent judgments like ***Shri Lal Mahal Ltd. v. ProgettoGrano Spa (2014) 2 SCC 433,*** wherein an award by the Board of Appeal of the Grain and Feed Trade Association, London was considered and upheld. It was observed regarding the importance of party autonomy in arbitrations that the two-tier arbitration system was mutually agreed by the parties and was therefore valid, party autonomy being the backbone of arbitrations.

The Court found nothing against public policy in accepting a two-tier arbitration structure. Court commented, *"there is nothing in the A&C Act that prohibits the contracting parties from agreeing upon a second instance or appellate*

arbitration – either explicitly or implicitly. No such prohibition or mandate can be read into the A&C Act except by an unreasonable and awkward misconstruction and by straining its language to a vanishing point." The Court was of the view that HCL had voluntarily agreed to the clause in the contract providing for two-tier arbitration and was bound by it.

Decision

It was finally held that settlement of disputes or differences through two-tier arbitration procedure between the parties is permissible under the laws of India. The Court was of the opinion that parties have the autonomy to mutually agree to a procedure whereby an arbitral award can be reconsidered by another arbitrator or a panel of arbitrators by way of an appeal and the result of that appeal is accepted by the parties to be final and binding. However, the issue of enforcement of an appellate award was not considered in this judgment.

VA View

This judgment sets to rest the uncertainty on the validity of two-tier arbitration clauses in contracts. However, the two-tiered arbitration model has to go through the test of time as this procedure has its own advantages and disadvantages. It is expected that two-tiered arbitration will help reduce pressure on Indian Courts and will help give finality to arbitration awards which are more often than not subject to challenge in Courts.

As pointed out, the two-Judge Bench of the Supreme Court had difference of opinion on the issue leading to referral to a larger Bench. While Hon'ble Mr. Justice Tarun Chatterjee was in favour of a two –tier arbitration clause, Hon'ble Mr. Justice S.B. Sinha had observed that the Arbitration and Conciliation Act, 1996 did not contemplate that an arbitration award could be an admixture of domestic award and foreign award. Justice Sinha was of the view that the fundamental legislative policy brought out by the Arbitration and Conciliation Act, 1996 was not in consonance with two tier arbitration. Interestingly, he had observed that if the appeal was provided within the set-up of Indian Council of Arbitration probably the agreement would have been valid.

The Courts in India have recently delivered series of pro-arbitration judgments which are boosting the investor sentiment (some of them were given due coverage in our earlier editions). The recent tide of judgments having an arbitration friendly approach, we believe, will change the alternative dispute resolution landscape in the country.

III. Clarifications on Indirect Transfers for Foreign Portfolio Investors

The indirect transfer provisions were retrospectively incorporated in the Income Tax Act, 1961 (the **"Act"**) in 2012 to clarify that any transfer of an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

It was further clarified by way of explanation 6 that for a share or interest to derive its value "substantially" means that (i) the value of the Indian assets must exceed INR 100 million; and (ii) represent at least 50% of the value of assets owned by the foreign company whose shares are being directly or indirectly transferred. Further, explanation 7 was

also inserted to carve out an exception for transfers of shares of a foreign company deriving substantial value from Indian assets by investors who hold less than 5% of the interest in such foreign company.

FPIs and overseas transfers

In this background, the Central Board of Direct Taxes (**"CBDT"**) recently vide Circular No 41 of 2016 issued clarifications on the doubts raised by various overseas investors including the Foreign Portfolio Investors (**"FPI"**) on the implications of the provisions of indirect transfers under Section 9 of the Act. Some of the key areas which are addressed in the circular are:

a) Redemption by investors:

CBDT has clarified that income from redemption of investments by investors of such funds would be subject to tax in India unless the investor falls within the exceptions carved out by Explanation 7. The gains made by the investor (based on NAV calculation) is on post tax basis. It is pertinent to note that FPIs are already subject to capital gains tax and securities transaction tax on the gains earned on transfer of shares. Such a dissonant interpretation issued by CBDT not only amounts to double taxation but is also destructive for our economy which is in need of foreign direct investment.

b) Sub Funds specific to India:

The CBDT has further clarified that the provisions of indirect transfers will also apply where a sub-fund is created by an offshore fund for investing exclusively in Indian securities even though the sub-fund constitutes only a small portion of the main fund and the main fund majorly invests in countries other than India. This is contrary to the basic interpretation of the provisions of the Act. Had the investment been made directly by the main fund, tax liability may not have arisen in view of exceptions carved out in explanation 6. Such an implementation of the indirect transfer provisions may also result in double taxation when the sub-fund remits money back to the main fund.

VA View

This circular has caused unrest within the offshore investment community as these provisions were not practically applied to FPIs till date. The scenarios addressed by the CBDT circular have not considered the practicality of the fund structures functioning in the market. Overall, it can be said that the circular is counterproductive to the government's ambitious program of regulatory reform aimed at making it easier to do business in India.

As already stated above, the application of this circular will lead to double taxation on the investors. Further, in jurisdictions where an assessee does not get set off of Indian taxes, it may even lead to multiple taxation of the same income. Also, it may be noted that since gains of foreign investors may also be taxable, they will now need to file income tax returns in India and comply with procedural requirements which may be cumbersome for global investors.

The circular has categorically stated that provisions of withholding tax, interest and penalty would also be applicable to FPIs in accordance with the position of law as existing at the time of redemption / transfer, thereby increasing the onus of compliances on FPIs and exposing them to penal interest and other penalties under the Indian tax regime.

Mauritius and Singapore were always a preferred jurisdiction for investment to India for FPIs due to the exemption from tax in the case of capital gains under the existing tax treaty.With the recent amendments in the Mauritius and Singapore Tax Treaties, the tax cost of such investors will now increase. Accordingly, all investors in FPIs who have investments in India may need to revisit their structures prior to 31 March 2017 to maintain the tax efficiency obtained till date.

It may be noted that at the time of publication of this update, the operation of the aforesaid circular had been put in abeyance by the CBDT owing to the concerns raised by the various stakeholders. It could only be a temporary measure to soothe the nerves of the FPIs and it is yet to be seen whether the government would bring out a beneficial amendment/clarification in the coming Budget to put the controversy at rest.

IV. Division Bench of the Delhi High Court pronounces on the applicability of amended provisions of the Arbitration Act

The Division Bench of the Delhi High Court in the case of ***Ardee Infrastructure Private Limited vs. Miss Anuradha Bhatia*** (decided on January 6, 2017) has given clarity on the applicability of amendments brought about by the Arbitration and Conciliation (Amendment) Act, 2015 (the **"Amending Act"**) to the Arbitration and Conciliation Act, 1996 (the **"Act"**) with regards arbitral proceedings that commenced before October 23, 2015.

Background and issues

Notice invoking the arbitration clause was given by the Respondent on June 7, 2011. Arbitral Tribunal made an award on October 13, 2015. Petition for setting aside the arbitral award under Section 34 of the Act was filed in January, 2016. During the course of these events, the Amending Act came to be notified and thereby amended the Act. The amendments were given retrospective effect *w.e.f.* October 23, 2015. Sections 34 and 36 of the Act were amongst the various provisions under the Act which were amended by the Amending Act. Section 34 deals with application for setting aside an arbitral award while Section 36 deals with enforcement of awards. As per Section 36 of the Act, the very filing and pendency of a Section 34 petition for setting aside an arbitral award operated as a stay on the enforcement an arbitral award. However, this position was altered by the amendment brought to Section 36 by the Amending Act. The position after amendment is that there can be no automatic stay on the enforcement of an arbitral award. A separate application is to be filed for the grant of stay on the enforcement an arbitral award and the Court may grant the stay subject to conditions as the Court may deem fit.

Learned Single Judge of the Delhi High Court applied the amended provision to impose a condition on the Appellant to deposit a sum of ₹ 2.7 Crores and on deposit being made, notice was to be treated as issued to the Respondent on the objections filed by the Appellant under Section 34 of the Act. Learned Single Judge had also directed that in case of failure to deposit the said amount, the objections filed under Section 34 of the Act were to be treated as dismissed.

Reference must now be made to Section 26 of the Amending Act, which states as under:

"Nothing contained in this Act shall apply to the arbitral proceedings commenced, in accordance with the provisions of section 21 of the principal Act, before the commencement of this Act unless the parties otherwise agree but this Act shall apply in relation to arbitral proceedings commenced on or after the date of commencement of this Act."

The crux of the matter was the applicability of amended provisions of the Act in this case leading to the interpretation of terms *"to the arbitral proceedings"* and *"in relation to arbitral proceedings"* as used in Section 26 of the Amending Act.

Arguments

Learned Counsel for the Appellant, while contending that the amendment should not affect vested rights accruing under the repealed provision, brought the attention of the Court to Section 6 of the General Clauses Act, 1897, as under:

"6. Effect of repeal. – Where this Act, or any [Central Act] or Regulation made after the commencement of this Act, repeals any enactment hitherto made or hereafter to be made, then, unless a different intention appears, the repeal shall not–

(a) revive anything not in force or existing at the time at which the repeal takes effect; or

(b) affect the previous operation of any enactment so repealed or anything duly done or suffered thereunder; or

(c) affect any right, privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed; or

(d) affect any penalty, forfeiture or punishment incurred in respect of any offence committed against any enactment so repealed; or

(e) affect any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid,

and any such investigation, legal proceeding or remedy may be instituted, continued or enforced, and any such penalty, forfeiture or punishment may be imposed as if the repealing Act or Regulation had not been passed."

The Appellant contended that the vested right of automatic stay was available in case of arbitrations which commenced prior to October 23, 2015.

The Respondents cited recent judgments delivered by the Calcutta High Court and the Madras High Court in which Courts have held that Section 26 of the Amending Act had a limited scope (as expression *"to the arbitral proceedings"* instead of expression *"in relation to arbitral proceedings"* is used in the first part of the provision) and Section 26 could not be extended to take within its scope the post-arbitral proceedings (including court proceedings).

Observations of the Court

The Court was clear on the second limb of Section 26 of the Amending Act which uses the expression *"in relation to arbitral proceedings"* as Court rightly noted that every type of situation in relation to arbitral proceedings was within its scope including court proceedings and hence, amended provisions were to apply in case of all arbitration proceedings which commenced on or after October 23, 2015.

With regard to the first limb of Section 26, the Court took the view that the amendment to Section 36 of the Act was taking away the accrued right of the party against whom arbitral award was given after the arbitral proceedings were conducted under the provisions of the Act i.e. prior to the amendment. Court observed that since an accrued right was getting affected, in absence of contrary intention in the amending statute, the amendments were to be prospective in operation.

Court held, *"All the arbitral proceedings (and here we mean the entire gamut, including the court proceedings in relation to proceedings before the arbitral tribunal), which commenced in accordance with the provisions of Section 21 of the said Act prior to 23.10.2015, would be governed, subject to an agreement between the parties to the contrary, by the unamended provisions and all those, in terms of the second part of Section 26, which commenced on or after 23.10.2015 would be governed by the amended provisions."*

Decision

The Court ruled that the unamended provisions of the Act will apply in case of petition filed by the Appellant under Section 34 of the Act. As a result, the Appellant was held to be entitled to automatic stay of enforcement of the arbitral award till the disposal of the petition.

The Court provided relief to the Appellant by setting aside the order of the Learned Single Judge whereby sum of ₹ 2.7 Crores were to be deposited by the Appellant.

VA View

Section 26 of the Arbitration and Conciliation (Amendment) Act, 2015 has been quite a controversial provision when it comes to interpretation of this provision by the Courts of the country. Several High Courts have delivered divergent views and there seems to be no unanimity on the interpretation of said Section.

With this latest judgment of the Delhi High Court (Division Bench) joining the fray of judgments on this subject, the view that has been taken is that the unamended provisions of the Arbitration and Conciliation Act, 1996 would continue to operate and apply even with respect to court proceedings commenced after October 23, 2015 which are related to arbitration proceedings commenced before October 23, 2015, till the enforcement of the arbitral award.

V. Competition Commission gives clarity regarding notification on creation of a joint venture

The Competition Commission of India (the **"CCI"**) has issued frequently asked questions (**"FAQs"**) in which it has clarified on notification requirement in relation to formation of a joint venture.

The CCI's stated duty is to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade in the markets of India. In a nutshell, it works to create and sustain fair competition in the economy. The principal enactment in India on competition regulation is the Competition Act, 2002 (the **"Act"**). Besides the Act, there are several rules and regulations made under the Act.

Section 5 and 6 of the Act and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (the **"Combination Regulations"**) mainly govern certain acquisitions, mergers or amalgamations which exceed the prescribed thresholds triggering the requirement to notify the CCI. However, no person or enterprise can enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination is void.

The CCI has come out with FAQs on combinations and has dealt with aspects like notification trigger, assets and turnover to be considered in order to ascertain if a transaction meets the thresholds, determining value of assets and turnover, etc. On the issue of notification upon creating a joint venture, the CCI has provided a major clarification that the formation of joint venture is treated as a notifiable combination if one or more enterprises transfer its assets to a joint venture company and the jurisdictional thresholds are met. The CCI has also made reference to its orders passed earlier in the case of Johnson and Johnson Innovation, Ethicon Endo-surgery, Inc. and Google, Inc., which involved transfer of certain assets to the joint venture.

VA View

With this clarification coming from India's competition regulator, it becomes clear that the CCI approval is required if there is transfer of assets to the joint venture company and the jurisdictional thresholds are met. As regards creation of a joint venture, it may be interpreted that in view of the target exemption, no CCI approval is required in a case where there is absence of any asset transfer on creation of a joint venture.

Firm members registered as Insolvency Professionals

The Insolvency and Bankruptcy Code, 2016 (**"Code"**) which was enacted last year has paved the way for India to have a new bankruptcy law that will ensure time-bound settlement of insolvency, enable faster turnaround of businesses and create a database of serial defaulters. The Code has mandated a new class of professionals called Insolvency Professionals as intermediaries who would play a key role in the efficient working of the bankruptcy process. In the resolution process, the Insolvency Professional verifies the claims of the creditors, constitutes a creditors committee, runs the debtor's business during the moratorium period and helps the creditors in reaching a consensus for a revival plan. In liquidation, the Insolvency Professional acts as a liquidator and bankruptcy trustee.

Two members of our Firm have registered themselves as Insolvency Professionals under the Code. Their brief profiles are as under:

Bomi Daruwala, Joint Managing Partner

Mr. Bomi Daruwala heads the Mumbai office of the Firm. He has been associated with the Firm since 1988 and has a corporate experience of over 28 years. Primarily a transactional lawyer, he specializes in mergers & acquisitions, restructuring of business, asset and share purchase deals, takeovers, divestitures, securities offerings, structuring of complex debt and equity investments and general corporate advisory. He also has a wide range of experience in cross-border business transactions, private equity, angel and venture capital round financings, joint ventures, strategic alliances and business divorces. His extensive business law and transactional experience includes corporate finance, corporate reorganizations, corporate governance, exchange control regulations advisory, entity formation and maintenance, and the drafting and negotiation of a variety of commercial agreements. He advises clients in a variety of sectors and has represented several large Indian companies and multinationals.

Satwinder Singh, Partner

Mr. Satwinder Singh heads the Corporate practice of the Firm at New Delhi. He has been associated with the Firm since 1998 and has a corporate experience of 27 years. He has extensive experience in handling mergers and acquisitions, corporate restructuring, joint ventures, collaborations, private equity, takeovers, acting as legal advisor to initial public offerings, rights issue, FCCBs and GDRs, open offers, conducting legal due diligence, drafting agreements, rendering opinion on diverse issues under Companies Act, Foreign Exchange Management Act, SEBI Act, SEBI Takeover Regulations, Stamp Act and other Corporate and Industrial laws. He has extensive experience in diverse types of banking & finance transactions and has represented clients in matters relating to syndicated lending, structured products, project finance, external commercial borrowings and bilateral lending deals. He has advised several multinational and Indian companies on various matters involving, inter-alia, strategy, negotiations and implementation of the transactions in the areas of mergers and acquisitions, corporate restructuring, banking & finance and private equity.

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Contact Details :

www.vaishlaw.com

NEW DELHI
1st, 9th & 11th Floor
Mohan Dev Bldg. 13 Tolstoy Marg
New Delhi - 110001, India
Phone: +91-11-4249 2525
Fax: +91-11-23320484
delhi@vaishlaw.com

MUMBAI
106, Peninsula Centre
Dr. S. S. Rao Road, Parel
Mumbai - 400012, India
Phone: +91-22-4213 4101
Fax: +91-22-4213 4102
mumbai@vaishlaw.com

BENGALURU
565/B, 7th Main HAL
2nd Stage, Indiranagar,
Bengaluru - 560038, India
Phone: +91-80-40903588 /89
Fax: +91-80-40903584
bangalore@vaishlaw.com