

message from attorneys in charge

In this issue we explore how India's connections to the rest of the world are advancing significantly in several spheres:

- Matt Adler, Janaki Catanzarite and Valérie Demont explore changes in dispute resolution methods that may improve the outlook for foreign companies doing business in India.
- Greg Paw illustrates how a culture of corruption is breaking down in India and elsewhere, thanks in part to the reach of the United States' Foreign Corrupt Practices Act.
- Considering business and investing in India, Janaki notes how Indian capital markets are opening to Cayman Island funds, but she and Len Schneidman show how investment in India is still hampered by Indian Tax Code changes that affect how tax treaties are used as a route to investment in India.
- We also link to an online article by Jane Luxton and Bill Walsh, about how worldwide climate-change initiatives may affect Indian commerce in several ways.

We welcome comments, questions and suggestions. If you require more information about our India practice, please contact:

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Keeping with the Times: Recent Breakthroughs in Indian Dispute Resolution

Recent developments in arbitration practices are bringing needed relief to an Indian dispute resolution system that has often concerned and frustrated some foreign companies doing business in India.

Arbitration, typically the dispute mechanism of choice in international commercial transactions because of its lower costs, fairness and efficiency, is controlled by courts in India and can therefore be a very prolonged and frustrating process. Traditionally, parties to arbitration in India frequently use procedures before the courts, such as application for injunctive relief, and challenge adverse awards on technical grounds. Section 9 of India's Arbitration and Conciliation Act (the act) permits a party to petition a court of competent jurisdiction for interim relief, even before an arbitration proceeding is initiated; to restrain the opposing party from selling its property in India during the course of the arbitration proceeding; and possibly even staying the arbitration proceedings on the grounds of "arbitrability" of the issue on hand. Foreign arbitration clauses in contracts involving parties in India are routinely challenged by Indian parties under Section 9 on the basis that Section 2(2) of Part I of the act confers powers on the Indian courts to grant interim measures applied even to arbitrations being held outside India.¹ Whatever the outcome of the Section 9 petition, once a court process is initiated, delay is inevitable.

However, a recent landmark judicial decision in India has clarified when Indian courts could be used, even when the parties have agreed to foreign arbitration, to preserve and protect the subject matter of the arbitration located in India. In July 2009, the Delhi High Court in *Max India Ltd v. General Binding Corporation*, building on a 2002 decision of the Indian Supreme Court in *Bhatia International v. Trading S.A.*, held that an Indian party's petition to restrain its foreign counterparty from implementing a provision providing for international arbitration in Singapore under their agreement

was not maintainable because by expressly submitting any disputes under the agreement to the Singapore International Center Rules, the parties had impliedly excluded the jurisdiction of Indian courts and the application of Part I of the act.

In *Bhatia International v. Trading S.A.* (March 13, 2002), the Supreme Court of India held that absent an express or implied exclusion of the application of Part I of the act, Part I would apply to international commercial arbitrations outside India, and Indian courts would have the jurisdiction to give interim relief in an arbitration held in another country. In *Bhatia International*, the parties had entered into a contract that contained an arbitration clause that provided that any arbitration between the parties would be held in Paris, France, and would be governed by the rules of the International Chamber of Commerce (ICC). Under the arbitration clause, Trading S.A. filed a request for arbitration with the ICC. To ensure that in the event of a favorable arbitration award it would be able to recover its claim from Bhatia International, Trading S.A. applied under Section 9 of the act to seek an order restraining Bhatia International from selling, transferring, creating a third party right or otherwise disposing of its business assets and properties. The Supreme Court held that such an application was sustainable by Trading S.A. even though the arbitration was held in Paris and was subject to ICC rules, because the ICC rules permitted parties to apply to a competent judicial authority for interim and conservatory measures and the Indian courts were the competent judicial authority under Part I of the act. Therefore, the Supreme Court held, by implication, the parties had not excluded the application of Part I of the act to their agreement.

In *Max India Ltd. v. General Binding Corporation* (July 16, 2009), the Delhi High Court further clarified the issue of the applicability of Part I of the act with regard to foreign arbitration. In this case, Max India had entered into a contract with General Binding Corporation (GBC) that required the parties to interpret their agreement under Singapore law, refer disputes to arbitration in Singapore and subject their disputes to the Singapore International Center Rules. Max India invoked the arbitration clause and served a notice of arbitration to be held in Singapore upon GBC. Max India also sought to invoke jurisdiction of the New Delhi High Court under Part I of the act, seeking an interim order restraining GBC from implementing the terms of an agreement GBC entered into with another entity regarding a sale of that entity's commercial prints finishing business. The Delhi High Court held that Max India's petition to restrain GBC from implementing the terms of the agreement was not

LCIA India's immediate impact on the Indian arbitration process is not yet known but it is definitely a step in the direction of more speedy and streamlined dispute resolution in India and a new forum that ought to be considered by foreign parties in their arbitration proceedings involving India.

sustainable because even though the agreement between Max India and GBC did not expressly exclude the application of Part I of the act, by subjecting their disputes to the Singapore International Center Rules (which did not have provisions similar to the ICC rules) the parties had "impliedly" excluded the jurisdiction of Indian courts and the application of Part I of the act to their agreement. Note that this decision only applies to arbitrations held outside India and not to arbitrations conducted in India, in which case Part I of the act is mandatorily applicable.

Practitioners drafting international arbitration provisions in contracts involving India should take note of these decisions and make sure they carefully weigh the issue of expressly or impliedly excluding or allowing the jurisdiction of Indian courts and the application of Part I of the act, especially in the context of injunctive and other interim relief. If Part I of the act is not expressly or "impliedly" excluded from the agreement (by expressly submitting arbitration to a foreign forum under a foreign set of rules, for example), according to these decisions Part I could continue to apply to international commercial arbitrations outside India and Indian courts would have the jurisdiction to give injunctive and other interim relief in an arbitration held in another country where the applicable rules so permit. On the other hand, the parties may also want to preserve expressly for themselves the ability to seek interim relief before the courts in India.

Despite these decisions, enforcement of foreign arbitration awards in India can remain frustrating for a number of reasons. While Indian courts will generally recognize foreign awards as court decrees that can be enforced and executed in India by filing appropriate applications and submitting the proper documentations in court, a number of conditions will need to be met. For example, the award will need to be from a country that India has "notified"

under the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958 and the Geneva Convention on the Execution of Foreign Arbitral Awards, which India is a signatory to. Although in theory a member country has to accept and enforce an award passed in another member country, in reality India generally enforces awards only from those countries it has “notified” (only 44 of the 144 countries that signed the New York Convention), which includes the United States, Singapore and England. In selecting a foreign forum for their disputes, practitioners should be sure to choose a forum in a notified country. In addition, before ordering enforcement and execution of a foreign award, Indian courts will test the enforceability of such awards under Indian law and may refuse enforcement on “public policy” grounds, which the courts have interpreted to include awards that are blatantly illegal. Finally, enforcement of foreign awards in India can be long, depending on the court involved and the facts and circumstances of the case, with enforcement periods typically ranging from six months to three years.

In another welcomed development, practitioners should also take note of the recent opening of LCIA India in New Delhi on April 18, 2009. LCIA India is a branch of an arbitral institution, the London Court of International Arbitration (LCIA), which has existed since 1883 and is recognized for its modern and forward-looking practices and outlooks. The opening of LCIA India is expected to open the door to

the establishment of a new “Western-style” alternative to dispute resolution in India itself. LCIA India’s immediate impact on the Indian arbitration process is not yet known but it is definitely a step in the direction of more speedy and streamlined dispute resolution in India and a new forum that ought to be considered by foreign parties in their arbitration proceedings involving India. Ultimately, it will be up to the courts in India to decide whether and to what extent an arbitral award of the LCIA will be respected.

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Endnotes

- 1 The provisions of Part I of the act are compulsorily applicable to arbitration, including international commercial arbitration, that takes place in India and the parties cannot, by agreement, override or exclude the non-derogable provisions of Part I in such arbitrations.

Sustainable Energy, CleanTech and Climate Changes

Vigorous activity related to climate change legislation, regulation, litigation, and treaty negotiation preparations are underway in the United States, as the clock ticks down toward the December 7-18, 2009 international climate change treaty meeting in Copenhagen. While India is making it clear that it will not sign on to binding international limits, but will move to adopt domestic programs that manage greenhouse gas (GHG) emissions, U.S. domestic initiatives are also in motion. Indian business leaders should care about U.S. climate change developments because U.S. climate change requirements may increase demand for or create barriers to the import of Indian products and, more generally, the shape and extent of the U.S. commitment to climate change will influence the level of commitment demanded by the inter-

national community of all developing nations. Thus, the old adage that to be forewarned is to be forearmed applies.

An update on these new developments is provided by our recent Sustainability, CleanTech and Climate Change Alert, available at http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1635.

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Enhancing Anti-Corruption Efforts in India: Lessons from Recent FCPA Enforcement Actions

In recent days, newspapers in India have featured stories about reports by the Indian ambassador to the United States, drawing the Indian government's attention to several recent U.S. Foreign Corrupt Practices Act (FCPA) cases involving "illegal payments having been made to officials in India." The ambassador recommended that the Indian government "may like to take appropriate action" against those accepting bribes, and voices across India echoed this call for accountability. A government spokesperson assured that "[w]hat is important is that the government will take action." Along with other anti-corruption efforts, including creation of new trial courts and a recent statement by India's chief justice condemning the "pervasive culture of graft [that] provokes pessimism about the quality of governance," there seems to be a new push for anti-corruption enforcement in India.

The backdrop for this push comes from several recent corruption enforcements against U.S. companies operating in the lucrative and fast-paced Indian economy. For example, Pioneer Friction, with corporate roots tracing back to the first air brakes used by the Pennsylvania Railroad in the 1870s, most recently grew through sales of train braking devices to the state-owned railway system in India. But Pioneer, a subsidiary of a U.S. company traded on the New York Stock Exchange, also discovered the high price of operating in a business environment challenged by corruption issues. To ensure that product acceptance tests would be scheduled and performed by staff of the state-run railroad, Pioneer made payments to officials, sometimes

as little as \$67. More bribes had to be paid to receive documents proving delivery of goods. Even more bribes followed to cut the frequency of excise tax audits.

Upon discovering these payments, Pioneer's parent company conducted an investigation for violations of the FCPA, which criminalizes payments to foreign officials to obtain business or gain some improper advantage. The FCPA and other similar international anti-corruption laws also have important provisions intended to deter companies from hiding corrupt payments on company books.

Pioneer's parent company voluntarily disclosed its findings to the U.S. Justice Department, and instituted remedial measures. The Justice Department credited these efforts and agreed not to prosecute provided that the parent company agreed to substantially improve its compliance efforts and pay a fine. These events make clear that understanding international anti-corruption laws is critical for companies doing business in India. Other cases, such as the civil enforcement against the former president of A.T. Kearney India, teach that anti-corruption laws can result in fines and, in some cases, even a prison term for individuals. In India, multinational companies must run a compliance program designed to deter and detect improper payments. Companies also must take necessary steps to ensure they have formed business relationships with reputable and qualified business agents and partners, and that they review business practices of potential merger partners before entering a transaction. These protections will help to reduce the risks of operating in India, drawing on the following important lessons from recent cases and business surveys:

In India, companies must take necessary steps to ensure they have formed business relationships with reputable and qualified business agents and partners, and that they review business practices of potential merger partners before entering a transaction.

Bribes in India Often Are to Obtain a Service Due.

When DE-Nocil Crop Protection sought to register insecticides made with ingredients widely used and registered in other countries, it discovered a roadblock in the Central Insecticides Board (CIB) and the state regulatory boards. DE Nocil, a subsidiary of Dow Chemical Company, then made more than \$32,000 in payments to an influential CIB official, and made petty cash payments – well under \$100 per payment – to state inspectors. While a laudable voluntary inspection by Dow revealed these payments, which Dow promptly reported, the company nonetheless paid a civil FCPA fine. The frustration leading to these

payments is not an isolated story, as one survey said that bribes in India most frequently relate to obtaining a service already due, rather than obtaining new business. Indeed, India is distinctive among other top emerging economic powers, where bribes to obtain business can be four times more likely than in India.

Bribes in India Often Are Low-Value/High-Frequency.

A commercial trucker survey in India found drivers face a daily labyrinth of bribe requests at toll plazas, check points, state borders and other stops. The bribery is highly institutionalized, and drivers even get “receipts” for bribes paid. Stoppages add up to 40 percent to shipping times, delaying goods by as much as three days between Delhi to Mumbai. Another survey similarly found that corruption caused the typical taxpayer in India to make four trips to a tax office each year, with more than 20 percent of people paying bribes averaging about \$50 to expedite their cases. More troubling, more than a third of those paying bribes did so through professionals, like a chartered accountant.

Cumbersome Bureaucracy in India Fosters an

Atmosphere of Bribes. Several scholars have stated that the complex Indian bureaucracy gives rise to a frustrating system in which corruption can thrive. For example, one recent study found that enforcing a commercial contract through Indian courts requires a company to go through an average of 46 administrative procedures, takes an average of 1,420 days and costs more than 39 percent of the claim. The effect of this bureaucracy is evident in cases like Pioneer’s, in which the company bribed inspectors at the Ministry of Railroads’ Research Designs and Standards Organization and at the Rail India Technical and Economic Services, all to ensure that Pioneer’s products would be accepted. Further, in the DE-Nocil case, licensing officials in each state had to give necessary approvals for producing, storing and selling products. Up to 40,000 inspectors could prevent the sale of product. Rather than face a sales suspension and a long court fight, the company made petty cash payments to some of these state inspectors.

Control Systems Are Crucial. The FCPA cases from India demonstrate a host of ways that improper payments can be concealed on company books: accumulating off-book funds, adding fictitious “incidental charges” to bills, and fabricating invoices for “consulting expenses” and “supplies.” The Pioneer case revealed that the company generated fictitious invoices for a marketing agent, who received checks for the bogus invoices and then

returned cash to Pioneer, less a service commission. Pioneer maintained the cash in a locked metal box, and documented each improper payment on a voucher. Pioneer kept track of the improper payments on a spreadsheet, all of which were kept off Pioneer’s official books and records. The result under the FCPA’s books and records requirements is clear.

Understanding these risks and designing effective compliance measures are critical steps to protecting a company seeking to thrive in the Indian marketplace. The experienced professionals at Pepper Hamilton, working closely with the Freeh Group International, can provide invaluable guidance on these issues. Our staffs include people experienced and seasoned from years of running law enforcement agencies and prosecutor offices. Our teams also include former federal judicial officials with years of problem-solving experience. We have guided companies through a host of issues, providing expertise, reputation and judgment to our clients.

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Path to Indian Capital Markets Opened to Cayman Funds

For several years, the Cayman Islands has been one of the preferred foreign jurisdictions to U.S. investors and U.S. hedge funds. However, investment funds domiciled in the Cayman Islands historically have faced challenges when seeking to invest in Indian capital markets.

The main prerequisite for an investment fund to access the Indian capital markets is registration as a foreign institutional investor (FII) with the Securities and Exchange Board of India (SEBI). The SEBI only grants FII status to applicants who are regulated by an “appropriate foreign regulatory authority.” SEBI does not consider the Cayman Islands Monetary Authority (CIMA) as an appropriate foreign regulatory authority. However, on June 10, 2009, CIMA was admitted as an “ordinary member” of the International Organization of Securities Commissions (IOSCO), which is recognized by SEBI as an appropriate foreign regulatory authority.

CIMA’s admission to IOSCO has opened the doors to the Indian capital markets for CIMA-registered Cayman Islands

investment funds. This represents a tremendous opportunity for investors who wish to access the Indian markets and at the same time take advantage of having a Cayman Islands investment fund.

The lack of a tax treaty between India and the Cayman Islands remains an issue, however. To overcome this challenge, Cayman Islands investment funds typically need to invest in India through a Mauritius entity or another entity in a jurisdiction that has a tax treaty with India. Under this structure, the Cayman Islands investment fund will register with SEBI as an FII, and the Mauritius entity will then invest in the Indian capital markets by registering with the SEBI as a sub-account of the FII.

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India Makes Another Attempt at the India-Mauritius Tax Treaty

In yet another attack on the India-Mauritius Tax Treaty (a time-honored route for inbound investment into India), several provisions in the new draft Indian Direct Tax Code (Draft Code), announced on August 12, 2009 and scheduled to come into force on April 1, 2011, could have a significant effect on the continued use of income tax treaties, including the India-Mauritius Income Tax Treaty (Treaty), for direct investments into India. In a significant departure from current tax rules, the Draft Code provides that neither a tax treaty nor the Code would have preferential status by reason of it being a treaty or a law and that, in the case of a conflict between the provisions of a treaty and the provisions of the Code, the one that is effective later in time prevails. Since the Treaty dates back to 1983, the Draft Code would (absent a later renegotiation of the Treaty) be later in time and its provisions would prevail.

Of particular concern to a potential Treaty claimant, Section 5(1)(d) of the Draft Code provides that any income from the transfer, directly or indirectly, of a capital asset situated in India would be deemed to accrue in India and thus would be taxable in India to a nonresident taxpayer. The practical effect of these provisions in the Draft Code would be to eliminate the use of the Treaty and subject the capital gain on the sale of stock of an Indian company to capital gains tax in India.

In addition, the Draft Code provides for the introduction into Indian tax law of a general anti-avoidance provision (GAAR). The GAAR would allow a commissioner of income tax to declare any transaction as an “impermissible avoidance arrangement” and disregard, combine or recharacterize any step in a transaction or the whole transaction. The discussion note to the Draft Code specifically states that the GAAR provisions will override the provisions of a treaty. Thus, the use of the Treaty to protect against the imposition of Indian capital gains tax would, depending on the specific facts and circumstances, be subject to being disregarded by a tax commissioner as an impermissible avoidance arrangement. The taxpayer, however, would be able to demonstrate the commercial substance of the transaction.

But if past precedence is anything to go by, one can safely bet that the concern about the negative effect on foreign investments coming to India if the lucrative routes through Mauritius did not exist will cause India to take some mitigating steps that will eventually uphold the Treaty.

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Indian Webinar Series: National Security and other U.S. Government Regulatory Requirements for U.S.-India Inbound or Outbound Sales, Joint Ventures, Mergers and Acquisitions

There are a number of U.S. regulatory requirements that can affect business transactions between the U.S. and Indian companies involving sensitive and classified technology services and goods. This webinar discusses two of these regulatory requirements and the steps that companies must take to comply with them.

Exon/Florio and CFIUS Review. The Exon/Florio Amendment to the Defense Production Act of 1950 may require review by Treasury's Committee on Foreign Investment in the United States (CFIUS) if the acquisition has national security implications. Although this process is straight forward, it is an extremely important step since CFIUS has the authority to stop a proposed acquisition if found by the committee to be detrimental to the national security of the United States.

Export Controls. Exports of technology and services to the foreign parent company may require export approvals under the International Traffic in Arms regulations (ITAR) of the Department of State and the Export Control Regulations

(EAR) of the Department of Commerce. Failures to obtain export approvals have negative consequences. License denials may keep the foreign acquiring company from receiving export-controlled technology or even discussing the technology with its U.S. employees. Failure to comply with the ITAR or EAR may also result in hefty fines and criminal penalties.

When: January 13, 2010 from 11:00 A.M. - 12:00 P.M. EASTERN

Moderator: Valérie Demont, Partner, Pepper Hamilton LLP

Speaker: M. Peter Adler, Partner, Pepper Hamilton LLP

Register for this complimentary online webinar at <https://www.regonline.com/US-India>.

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