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India Arbitration Week 2022

Session: Disputes involving long-term agreements and investments: key considerations and quantum issues

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Sanskriti Sidana

Good evening, everyone, and welcome to the final webinar on Day 2 of the India ADR Week 2022 which is being jointly hosted by MCIA and Osborn Partners. I'm Sanskriti Sidana, a Senior Associate at Cyril Amarchand Mangaldas in Mumbai. The panel for today's session will discuss some key issues that often arise in disputes concerning long-term agreements and investments, which might take various forms, such as concession agreements, public private partnerships, supply and production agreements, investments in assets and businesses and construction contracts to name a few. The key questions surrounding this issue are identifying, managing, navigating, allocating and quantifying risks in such agreements and investments.

These questions not only influence the nature and the merits of any claims arising under such situations, but also the monitoring reliefs such as damages and non-monetary reliefs that affected parties may be entitled to. Today's global expert panel will discuss their experiences on this very important topic. And on the panel today, we have Mr. Rajendra Barot, a Senior Partner at AZB & Partners and heading the firm's dispute resolution practice. Mr. Barot is a leading lawyer in the commercial dispute space and has over 24 years of experience. He has advised leading global PE funds, MNCs, insurance companies and global leaders in the telecom and mining sectors. Mr. Barot has also represented several Ad-hoc and institutional arbitration proceedings, and also before various judicial forums in the country in a wide variety of disputes.

We also have with us today Mr. Manish Aggarwal, a partner in the London office of Three Crowns. Mr. Aggarwal is a dual qualified English Solicitor and an Indian Advocate. He has extensive experience of representing clients in both commercial and investment treaty arbitrations across a broad range of sectors such as energy, infrastructure, telecommunications and technology and in arbitration related court litigation.

Next, we have Ms. Dharshini Prasad, Counsel at Willkie Farr & Gallagher in London. She focuses on complex multi-jurisdictional disputes and is triple qualified to practice in Singapore, England and Wales and New York. Ms. Prasad has advised states, state entities and corporations on commercial investment and public international law issues. Ms. Prasad has particular experience with energy, mining, private equity, technology licensing and pharmaceutical disputes. She not only represents clients in Ad-hoc and institutional arbitrations but has also sat as arbitrator.

We also have with us with Ms. Kate Apostolova, a Counsel at Mayer Brown's offices in Singapore. Kate has vast experience in international commercial and investor state arbitration and litigation proceedings and has been recognized repeatedly as a leading arbitration practitioner. She has represented clients in a wide range of industries, including oil and gas, mining, nuclear power and construction. She has been appointed as arbitrator in institutional and Ad-hoc arbitrations and is a certified mediator as well.

Next, we have Mr. Dinesh Pardasani, a partner with DSK Legal's New Delhi office having more than 19 years of experience in dispute resolution. He has advised on multiple infrastructure projects in India and abroad concerning metro, water, road projects, etc., and has extensive experience in electricity and regulatory matters before several courts and tribunals in the country. He also regularly represents clients in domestic and international arbitrations. And finally, we have Mr. Montek Mayal, a partner at Osborne Partners and Practice Head for Asia and Middle East and also our moderator for the session. Mr. Mayal is an expert in the field of assessment of quantum financial, economic, and valuation issues in contentious and non-contentious matters.

He regularly advises on a broad range of issues, including valuation of businesses as its anxious in relation to shareholder and joint venture disputes, private equity investments, investment treaty claims, competition and antitrust matters, etc., Mr. Mayal has been appointed as an expert witness in domestic and international arbitrations, and in competition matters in India as well as globally in over 50 matters involving claims ranging from USD $5 million to almost USD $2 billion. We are indeed in for an enriching session in the company of such stellar panelists. And to begin the discussion I invite Mr. Rajendra Barot to give some opening remarks.

Rajendra Barot

Hi, good evening, everybody. So, actually when Montek spoke to me, and when he told me that there is a one-hour session, and the subjects that we want to cover is long-term disputes that run in three buckets, which is Construction, M&A, and BIT's. I was certainly not envying the panelists for running this marathon in one hour. I haven't heard of a marathon being run in one hour, even when it comes to the world record. But all of these are certainly very, very journal relevant subjects, for the simple reason that in the world that you are living in, in the world that all of us have seen, evolve. And when I say all of us, I mean, more from an Indian perspective, because I'm mindful that I'm speaking at India ADR Week.

India seen a complete transformation in last, I would say 25-30 years. Opportunities have opened up which opportunities nobody could fathom existed. Nobody knew that India would be in a spot where it would draw a lot of attention from global investors. And last 6 months, or last 8 months, have made that opportunity even more real. Given the fact that we've seen global turmoil for a variety of reasons, given the fact that what was originally contemplated as BRIC now has a big capital I there, and all the other letters have become much smaller. I think it's only natural that there will be more business, I think it will only be natural that there would be additional attention that India would get.

Now what's inherent in any business opportunity is a disconnect. I wouldn't call it a dispute already. And that is why we have agreements. So, what's the whole idea of agreements, and the whole idea of agreements that for us to ensure that in case there is a disconnect, in case if there is a dispute, then the parties have to stick to that bargain. And if they do not stick to their bargain, if they do not stick to what was agreed between the parties, the natural consequence has to be either performance, as we call it, or a consequence, as we get into damages. From an approach perspective, I think the reality is that any relationship, which in that sense is an investment is bound to be long-term.

What's inherent be it a joint venture, be it a partnership, be it a long-term supply agreement, obviously, Construction Contract, it's a no brainer, it's long-term, or be it a BIT, what you're talking about is long-term. And when you talk about long-term, what has to happen is the contract has to have a mechanism where either the intent of the parties to have a long-term relationship is not faced with a hurdle. Or alternatively, one of the parties is not stuck in a situation where the defaulting party ends up benefiting and as we say, having premium on dishonesty. So that is where what we've seen is, we've seen several consequences. And at the end of the day, we cannot be oblivious to the fact that the moment you enter into a long-term contract, there are things which you can foresee and there are things which you can't.

For instance, if you just rewind, like two, maybe three years back, I'm sure nobody who, unless you believed in Nostradamus, believed that there would be a black swan event where all of us would sit in front of a computer for months, all of us would be scared, from my home, I can see my office, it's about half a kilometer away. And when I done up my new house, the whole intent was that I do not want to work from home. So, I could finish my work in office and go to come back home, and little did I know that I'll be able to see it, but not go there. And therefore, it is precisely for those unforeseen events. It's precisely for people having second thoughts on long-term contracts that you need consequences.

There are several intangibles, and I was talking to one of my colleagues when I was preparing for this session. And we just took Construction Contracts as one example. And the kind of issues that came up in our discussion are issues which the panelists will obviously take you through. But just to list a few, there are political influences, which cannot be accurately predicted. We've seen that happen very close in Mumbai, where for development of a Metro, the issue always has been whether what is the heart of Mumbai, the Aarey Forest would be available or not available. And we've seen swinging stands, as political parties change. We've seen issues like inflation, again, nobody had thought of inflation becoming such a big hurdle as it has become now.

We've seen the struggle to have sustainability. We've seen struggle to deal with what we call the project affected people. And all of these issues ultimately would have to be factored in not only in the contract, but also in case of a dispute. So, therefore, how would you keep drawing from your experience? How would you as a lawyer, how would you as an in-house counsel, how would you as a damage expert, deal with some of these issues as the rubber hits the road? Let's jump to the next bucket, which is Bilateral Investment Treaties. And again, I'm seeing it from an India paradigm. India, it was very critical to have Bilateral Investment Treaties when we were attracting investment.

There was structures that were put into place, there were friendly jurisdictions where those investments were structured to come in through jurisdictions where there was strong Bilateral Investment Treaties and we've seen a lot of that change. Obviously, it'll continue for the Sunset Clause, but the government today. So, for example, if you were to set up an insurance company, and if you were to come in through Mauritius, the insurance regulator will not allow you to do it. And these are issues which we've seen from experience. Obviously, there would still be BITs until the renegotiated Bilateral Investment Treaty kicks in.

But there are issues which people have not thought of, there are issues like the fair and equitable treatment, how do we give protection to investors, how do we balance it with ever moving national interest, ever evolving national interest? And so therefore, quite obviously, for a lot of us, who, in that sense, breathe arbitration, what's been very critical also is the judgment like white industries, which is what resulted in revolutionary changes to the law. M&A, I think, again, and we've seen our R&W Insurance has come in, we've seen a lot of tug of war when it comes to negotiating reps and warranties. But these are issues which are bound to come in any long-term contract. And therefore, how do we resolve these issues? Up to you, Montek, why don't you take it forward?

Montek Mayal

Thank you so much, Rajendra. I think you've set the right tone and you're right, it's an ambitious task to go over these subtopics in the next, now 45 minutes. But hopefully, we can give a flavor of these issues to the audience and then have another conversation at some later date to explore them more. Thank you. Thank you, as always. So, I'm going to not waste any time. Time is short. Very briefly, we have three subtopics, which we'll try our best to get through. We're going to start with discussing how investment treaties and investment agreements are often used to manage risks concerning foreign investments, then we will discuss, like Rajendra mentioned, construction risks and other contractual risks that often arise in the context of long-term agreements.

And finally, risk management and M&A transactions. So, without further ado, I'm going to start straight off. And Kate, you're off first. So obviously, it is often said that treaty planning is almost as important as tax planning in managing long-term investments and the value of such investments. So based on your experience, what is the importance of investment treaty planning in how might companies access protections available under such treaties feed?

Kate Apostolova

Thanks. Thanks, Montek. Hello, everyone. Thanks for having me today. So, in my experience, investment treaty planning is still despite what we just heard quite critical for long-term projects and for agreements and it's an effective way to manage risk that arises from bad conduct, bad action by the host government where the project is located. So, I think it's still quite important. And the way investors access that protection is through Bilateral Investment Treaties or

Multilateral Investment Treaties. So, investment treaties are agreements between two states, the host state and the home state of the company and the states agree that they will provide certain protections to investments made by the investors of one state into the other state.

But in order to benefit from that protection, the company investing has to qualify as an investor as defined in the relevant treaty. And it has to make a qualifying investment and the treaty as well. And if the investor meets those two main requirements, but in addition to their other requirements as well, then the investor can bring an investor state arbitration under the Dispute Resolution Clause of that treaty and hold the whole state accountable for any bad actions that it has committed in relation to the project or against the investor. So, practically speaking, what that means is that the investor, the company, has to look into how to invest in the country.

So, it's important for the company to identify a relevant treaty that will provide protection to the company and to the investment made in the whole state and look into the requirements for the investor. And most of the treaties have broad requirements for investor to be a legal entity that is incorporated in the whole state of the project. But treaties sometimes and especially now, the new treaties, require that the headquarters and the business of the entity investing has to be carried out in the contracting state. So, they have a requirement for substantial business activity in the state. And what that in effect means is that the company cannot be a shell company, it can be a special purpose vehicle, it has to be a company that has substantial business activities in the state.

The investor has also had to look at the meaning of investment. And again, the treaties generally have very broad definitions of what investments is and they include any kind of assets, which means what it says any kind of assets or shares in a company, property, title or claim to money, contractual rights, concessions, licenses, etc. And then the real teeth of that protection of the treaty is that it provides for investor state arbitration. So that way, the investor can bypass domestic courts, which may be perceived as being biased, which may be ineffective. It also provides protection for the investor in or provide some assurances that the dispute will be resolved by independent and qualified arbitrators.

And the award at the end of the process is final and binding on the state and states usually voluntarily comply with those awards, but if they resist their ways to enforce the award as well.

So, this sort of planning, structuring the investment to get treaty protection is accepted. And that's called treaty planning. And it's, I think, quite important, just to give one example of a successful structuring in Saluka versus Czech Republic, where Nomura, the Japanese company, invested in the Czech bank through a Dutch subsidiary, so there is no treaty between Japan and the Czech Republic, but Nomura invested in the Czech Republic through a Dutch subsidiary, Saluka, and there is an investment treaty between the Netherlands and the Czech Republic. So, the Nomura was able to bring an arbitration through Saluka against the Czech Republic and get damages for wrongful actions committed against this investment in investor state arbitration.

It's also accepted that investors can restructure their investment during the life of the investment to benefit for protection. And that has also been done successfully. But companies have to be quite careful about that, because that cannot be done if there's a foreseeable dispute. And a case in point is Philip and Morris versus Australia, with Philip Morris trying to bring a claim through a Hong Kong entity, but the tribunal there found that that was an abuse of process, because the Hong Kong entity was inserted into the group company structure after there was a foreseeable dispute with Australia. So, investors still need to be quite careful about how they structure the investment. But ultimately, I think treaty planning is still important and provide protection to investors.

Montek Mayal

Thanks Kate. Manish coming to you. So, Kate was talking about structuring long-term investments to benefit from treaty protections. I know you've been involved in cases where the tribunals have had to consider the scope of the protections against legislative and regulatory changes in particular. And it's very particularly relevant in the context of renewable energy or climate change investments. Can you share some insights with us on this topic based on experience?

Manish Aggarwal

Sure. Thanks, Montek. As you and Rajendra both noted, the interplay between a whole state's right to regulate, and the substantive treaty protections for foreign investments is not only an academic issue, it's a question of great practical relevance for both investors and states. And here just to illustrate, I can give you a few examples based on real life cases in which I have been involved as counsel. Let's say, you are an investor with long-term investments in the mining industry or in the fossil fuel industries and you may well be concerned about changes in laws and regulations that now favor new types of energy, that are aimed at environmental protection.

So, you can see changes, like introduction of stricter emission standards, phasing out of certain kind of fuels such as coal, we've seen such measures that are being taken in both developed and developing economies in the Netherlands, Italy, Canada. I think India would have to grapple with that, is already having deal with that as it moves towards its own climate change goals. Or you may be a long-term investor in new forms of energy, who may have benefited from various kinds of investment incentives, tax paid, subsidies, feeding tariffs, and you may be concerned about states actually revoking those incentives, because they're no longer notably sustainable. And we've seen those kinds of issues arise in the context of Spain and several other EU member states.

But in either scenario, if you're an investor, who has been careful about structuring your investments in the way Kate just described, the question you often have is, well, to what extent is my long-term investment protected under the PG against a legislative and regulatory changes, in effect, who should be the economic burden of such a change, the whole state of investor, and similarly, if you're a state looking to make some changes, you're also grappling with similar issues. I think the key takeaway here is that you can't make any assumptions. You can't assume as an investor that investment treaties will act as insurance policies against any adverse regulatory change.

You can't assume as a state, that you have an unfettered, unconstrained right to regulate, and therefore, you can implement any kind of changes, you really have to analyze the terms of the applicable treaties, you have to analyze how arbitral tribunals have interpreted and applied, the kinds of protections that Kate described, to really better understand the scope of protections you have against regulatory change. And I'll just give one example and Rajendra mentioned the fairly broad standard of fair and equitable treatment, which is really the main treaty protection on which investors rely in the context of such claims.

And if you leave aside the new generation treaties, where the seeds have started carving out regulatory measures taken in the public interest, from the purview of the treaty, a large number of treaties still in force, still have way broad fair activity in a standard in varying qualified terms. And in the context of those provisions, the key issue for the tribunals is where you then draw the line. On the one hand, you have states arguing in favor of a legitimate exercise of regulatory clause, which they say cannot be a breach of any treaty standard, cannot entail any obligation or compensation.

And on the other hand, you have investors arguing that there should not be made to be an economic burden and therefore, to the extent there has been a bait and switch, a breach of fair legitimate expectations, there must be compensation. And I'll conclude by just calling very briefly the analytical framework, which again, both in **[Inaudible 00:24:51]** carefully consider in understanding the scope of the protection they enjoy and in terms of assessing the prospects of success of any claim that may be brought. In the context of regulatory changes and FET, I think it's fair to say that most tribunals now recognize that the FET standard does not prevent the state from making regulatory changes.

But at the same time, it's also recognizing the state's power is not unfettered, for example, if a state breaches a contractual stabilization clause, or an individualized representation when investor that it would not make certain kinds of changes, for example, in relation to existing investments, but the state then goes in and makes those kind of changes, that I think it's quite likely that the tribunal will find that, that is the kind of conduct that has crossed the line. I think that position becomes far more complex, where you don't have those kinds of contractual stabilization clauses, or individualized representations. And that is where, you find reading tests and jurisprudence, some tribunal say, well, you have to look at that big view of change is a drastic radical auto. **[inaudible 00:25:59]**

Others say well, you have to also look at the proportionality of the measure. Is the measure reasonable? Is the measure discriminatory? And again, the scope of protection can really vary depending upon the treaties. And also, whether you have a contractual protection in the form of a civilization clause. I'll pause here, Montek.

Montek Mayal

Thank you. Thanks, Manish. That nicely brings me. You run my job for me actually, you gave me the segue to ask my question to Dash. Ash, I want to pick it up where Manish left off, stabilization clauses. Can you tell us what they are and why do they matter, and more importantly, how do they allocate risk between the investor and the host state?

Dharshini Prasad

Sure. So, I should start by saying that probably barely going to scratch the surface today much like Kate and Manish. So, for anyone interested in the topic there's a very good book by Peter Cameron called International Energy Investment Law pursuit of stability, it's part of a prescribed reading for a course that I teach on stabilization clauses as well. So, highly recommend that. But the short answer what they are, I think Manish touched on this, they are essentially contractual clauses that provide a measure of stability for long-term investments by preserving the regulatory framework in which the investment is made.

And as the type of protection that we're speaking to probably already tells you that it's a very probably small subset of investors that can probably use these types of benefits because it presupposes the existence of a contract with a state Counterparty, either the state itself, a state - organ or a state-owned entity. So, you're largely looking and historically, I should say that these clauses actually, these types of protections actually preceded what you see today in investment contracts. So, they're sort of the original form of investor protection, and you'd historically sort of see them. In the energy sector today, you see them more broadly extractive industries, long-term PPP contracts, but they're largely at the upstream end.

So, if you're further down the supply chain, you're unlikely to have these benefits. There are various forms of stabilization clauses. Again, when I talk about historically and how these clauses evolved, we're looking way back in the late 1800s, early 1900s, the concession contracts that one would see, for instance, with Saudi Arabia, Aramco, Liamco, Texaco, those sorts of contracts. Historically, the way in which investors sought to protect their investments was to try and just grease the law that bind the state's hands completely by preventing them for regulating. So, you had sort of the classic freezing clauses. Of course, today, you don't see that anymore, because it's as Manish said, broadly recognized as a matter of customary international law as well, that states do you have the right to regulate.

So, they've evolved over time to adopt varying forms. So, for instance, one example might be rather than preventing the law from being changed, you just freeze the law as it applies to the contract. You might prohibit unilateral changes that the state will be required to negotiate with the investor. What you see much more commonly today are what you'd call rebalancing of benefits or economic equilibrium clauses. So essentially, if there are certain trigger events that change the regulatory framework or change the broad return on investment that investors had anticipated at the outset, it would either ask the state to come. The state would either be required to renegotiate the contracts with the overall returns are preserved.

Or they might be required to compensate the investor either by indemnifying them for any losses, or essentially, if any changes happen the burden just shifts automatically to the state. So, there's varying forms sometimes you see, a single contract layering different types of stability provisions. But I think the question that's really interesting is really why do they matter, a lot of it is what Manish said, when you look at long-term contracts, particularly in extractive industries, there's huge amounts of capital investment that happens at the outset, hundreds of millions, sometimes billions of dollars. But you only realize these investments over the lifetime of the project, sometimes 20-25, even 30 years, although that degree of length, I think you don't see as much as more now more in the 15 to 20 range.

And the returns are calculated on certain assumptions about investors being able to retain title or interest in the investment, ability to repatriate funds that or revenue streams as well as, and most importantly, taxes, because that's largely the biggest sort of shock that happens to an investment as a state suddenly decides they want to change the taxation regime from 5% to 20%.But of course, it's hard to bind the state. And so, you often have to get these sorts of stability provisions in a contract. So, I'll probably stop there. There's much more to be said, read the book. But I'm going to stop there right now. There's lots of case law as well, dating back to the 70’s that still gets cited today. But I'll stop there for now.

Montek Mayal

Thanks, Dash, I think we're going to come back to this later as well, because we might go by a different name in India, but you have change in law clauses even in the concession agreements in India, and they often give you protections, which are quite important. And we'll come to that when we discuss concession agreements in the context of Indian investments. But just moving from there. So, we've discussed some of the protections available to investors. Now, Kate when things go wrong, and unfortunately, they go wrong very often, what might be the monetary remedies that investors might be able to seek if a host had breached the various substantive protections been discussing today?

Kate Apostolova

So, the monetary remedies will vary. They will depend on the type of investment made, they will depend on the type of breach that's being alleged, is it lawful expropriation, is it unlawful expropriation. The guiding principle is that the state, if the state has committed a wrong, it should compensate the investor for any loss arising of that wrong. The specific level of compensations is sometimes set out in the treaty. So, for example, for expropriation, some treaties say that the compensation should be fair market value. But fair market value is pretty broad term. So, tribunals really have a lot of flexibility to determine the exact compensation depending on the facts of the specific case, and the nature and extent of the losses.

What we usually see in investor state arbitration in terms of monetary losses are, monetary compensation for the full loss of the investment. So, that's their market value of the investment that's been lost as a result of the state strong pull act. Diminution in the investment value, so that would be the difference between the market value of the investment before and after the breach. Sometimes the monetary compensation is based on the loss of the invested amounts. So, whatever the investor put into the state, it will get back from that state. Sometimes, depending on the particular case, the monetary compensation might be based on taxes wrongfully being charged, loss of dividends by a shareholder.

So, it all really depends and varies on the particular type of case. I think one certain thing we have seen more recently is that we are seeing larger and larger amounts being awarded to foreign investors. So, in the early 2000s, awarding 10s of millions of US dollars was considered large. And today we're talking about billions of dollars Yukos award being $50 billion and a lot more hundreds of millions of dollars as well. And what we're also seeing is a monetary compensation for planned investments. So, these investments were planned, some limited work was done, but they were never built. Still, the tribunals have found that the investor should be compensated as if the project was completed. And that's an example of a compensation of planned investment. So, again, it varies, but the trend is larger and larger amounts.

Montek Mayal

Thank you. Dash or Manish, anything to add to that? Manish?

Manish Aggarwal

I was just going to make a quick remark, Montek. I think, in investment treaty cases the question about the date of valuation of damages, is becoming increasingly important as well. Because there's a whole kind of debate around whether in the context of unlawful, expropriations and other breaches of the substantive protections in the treaty, and where the customary international law standard applies, or whether, you should be valuing as at the date of the alleged breach of the date of expropriation, for example, or whether, you as an investor have the option to choose between the date of expropriation and the date of the award.

And the thinking there is that a state should not really benefit from its illegal acts, and to the extent that the value of the investment has increased due to market conditions as between, say, the date of the expropriation and the date of award, then the higher value should belong to the investor. There's a whole kind of controversy around whether a similar analysis should also apply in the context of breaches other than expropriation, I wouldn't go into that. But I just wanted to mention that this is something that you have to consider quite carefully as counsel. Whether for states or investors when you're kind of faced with these kinds of claims of damages.

Montek Mayal

Thanks, Manish. And [**inaudible 00:36:32]** me my job much easier. I had some of the points I wanted to cover, which you've already covered. So, which is great, but I think what I'll just quickly add, as a non-lawyer on this panel is when you're thinking about quantifying your damages, all of you should like to consider all the points Kate and Manish have mentioned. And like, Kate said, often, especially in the context of expropriation, those are standards, which are defined in the investment treaties themselves. Usually, it's called fair market value. So, essentially, what's the value of the business that you've lost and, of course, the traditional valuation methods, you might apply to us to estimate the value.

And I think the only point I would leave for the audience in that context is, tribunals are divided, I feel in the context of how you value businesses and that quite critically depends on how much history does the business have. Right? Early-stage businesses in which might be expropriated early in their life, have different considerations and characteristics which might affect the approach tribunals might be willing to apply. Whereas mature businesses which are operating, tribunals will be less reluctant to apply forward looking measures of value, like an income approach or DCF based approach. So, when you're thinking about quantification of the losses of the value of the business, keep these considerations in mind that become hotly debated. And there's no, I think, single precedent, or at least a single line of thinking on that issue. And, of course, on other breaches more generally, principles are quite similar.

You don't think about how the business would have performed, absent those breaches, what's the financial impact of those breaches, and essentially, that impact is what ends up being your claim. We can cover that later in a separate topic. So, it’s a topic by itself. But I just thought I’ll add a quick few remarks on the quantification side. Now, moving on to the second subtopic. And this is, I think, very familiar and very close to people's heart in India is construction risk and other contractual issues that often arise in concession agreements or long-term agreements in the context of infrastructure investment, especially in India.

And, of course, these also are long life assets or investments often your investments could take form of a BOT agreement or a similar nature. And the problem there is, you also have to build the asset, of course, operate it, so you have different risks you're exposed to during the lifecycle of the investment of a project. So, Dinesh, starting off first, could you just give us some insight into what are the main risks that are involved in long-term projects, especially during the construction phase?

Dinesh Pardasani

Thanks, Montek, and good evening, everyone. So, it is not that people are not aware of these risks, because FIDIC standard drafts, NEC standard draft, we have standard draft for concession agreements PPAs and they provide for proper risk allocation. But because of adventurous approach of stakeholders, they deviate from the structures. And while these deviations are fine, so far as the scheduled contract period is concerned, and everything goes fine, it's only when the project gets delayed, which in my view, more than 90% of the projects get delayed. And when they get delayed, that's where these risks pop out. And that's where you have to deal with it. Now, there are a number of risks of course involved, but I would put them under two buckets.

One would be contractual risk that parties get into or come across in construction projects. And the other one I would highlight is political risk. Now, under contractual risk, I would say, price variation risk. Now, usually we see contracts do provide for proper price variation compensation, but because of these deviation, as I mentioned, they'll always be a complicated price variation clause, which would either provide that price variation will not be payable after, say, contract period, or it'll be provided to a threshold of say, 10%, 15% and not more than that. And sometimes price variation clause is completely absent from the contract. Now, when the contract gets extended due to obviously defaults for multiple reasons.

That's where contractors start feeling the pain of not being able to claim the price variation. So that's, I would say is a quite a pain point for quite a few contractors in India. Second, is extension of time, same problem, you have complicated clauses, where contracts provide that all right employer will give you extension of time, but so far as compensation is concerned, or monetary claim is concerned, you're not entitled to it. Now, it is completely absurd, that even employer is delaying the project, or the contract is not at fault, the contractor will not be entitled to compensation.

So that becomes another pain point and it's always a bone of contention between the parties, that extension of time and compensation becomes an issue and obviously ends into an arbitration. On political risk, I would say it could be fatal or non-fatal. Let me talk about the non-fatal one first, and I would say, Rajendra did mention about this project in Mumbai, where they were talking about setting up the depot in a forest area land. Now political party changed, they changed the location to some other place. But the earlier political party again came back, they took it back to the forest area. Now, this is obviously a more of a political turmoil, which contractor is obviously cannot take care of in at the time of bidding.

But I would say it's non-fatal, because at the end of the day, employer would be willing to compensate or tribunal would compensate, this is not something that the contract would terminated or the contractor will lose the entire investment. So, these can still be taken care of. I remember when we were doing a project in Delhi, which is Airport Express Line, the concession agreement provided complete flexibility to provide security services. But when it came to completion, the concessionaire or government said that, look, you can't have private security in a metro project, you need to have the government security like CISF in India. Now, this is, of course, a political change.

But because of those attacks, which unfortunate events that happened in India, but that, of course, can still be taken care of, because it's a question of just getting additional compensation. But I would say fatal would be where the government terminates a contract, or it's a case of expropriation. Now, a live example which I came across was when GMR took airport in Maldives. Now that project was driven by World Bank and IFC, and it was awarded through a proper bidding process, international competitive bidding process. But within eight months, the contract was terminated, I would say, not termination, it is expropriation. And the unfortunate part was, there was no political risk insurance taken.

Now, of course, GMR had to fight for almost 7-8 years to get that termination compensation. So, those are the risks that are involved in these long-term projects. And considering the present environment where it's so radical and these sudden changes in global environment, like, COVID, or Russia-Ukraine war, I would say China-Hong Kong conflict, China-Taiwan conflict. So, all these volatile geopolitical environment situations which we are living in, it becomes very important that we need to have identified these risks and take all those measures to protect us from political insurance. So, I think that is what I would say broadly are the risks, which I would like to highlight, Montek.

Montek Mayal

Thanks, Dinesh. Just sort of, very quickly as a follow up. Now, we've discussed the risks. Now, the claims you might see especially in these holistic agreements, which I says essentially self-enforcing agreements, they all they cover essentially all permutations possible often. What kind of remedies can both, I mean, we're been discussing, obviously, the contract is perhaps the owner, sort of the runners of the project, but also persons providing these contracts or sort of bidding, giving these contracts a way to contractors. What kind of remedies can they see of in your experience? Right? So, you talked about delays, you talked about overruns. So, what kind of remedies are available to them under such for such risks, and any sort of any insights into how you can make those claims robust, especially in these contracts.

Dinesh Pardasani

Sure, Montek. I think, let me take up price variation first. As I said, obviously, the either clauses are not providing for price variation or they provide for some threshold, some convoluted clauses, which makes life difficult for a contractor to claim these compensation. But at least under law, or there is no legislation for such claims in India. So, it is Contract Act that you have to rely on, or judicial precedents that do help, because tribunals have recognized that if the contractor has suffered delay because of employer, it can't be without compensation. So at least, that those precedents do help. And of course, we being lawyers will always look for loopholes in the contract to claim that amount.

And thirdly, I think it's the groundwork that has to be done by the contractor during contract execution, that will make the claims robust, because if you have not raised those price variation clauses or extension of time compensation, during the course of the contract execution, but at the time of completion of the project, and then go for arbitration, obviously tribunal would say that look, you are sleeping over your rights, you have done nothing, therefore, it becomes difficult for contractors to claim. So, I think it is, I would say, twofold exercise, one, of course, you have to look at your contract carefully and keep exercising your rights.

Second, your correspondence with your employer should be clear that you are reserving your right to claim compensation for price variation or for extension of time. And if the employer is still asking you to complete the project that forms the foundation of your claims, where you can claim these amounts from before the tribunal. So, I think that I would say is important. And as I was mentioning about these political situations, of course, we have to do carry out your due diligence properly, you have to figure out whether the political insurance is available, because that has become very imperative in today's world, where it's a dynamic world, you don't know what will happen tomorrow.

And it is not that something will happen in your country, or the contractor say if it is from UK, something is happening in UK, no, if something happens in US or Russia or China, it will definitely have impact on your project. So, I think it all becomes very important. It's a dynamic world. It has cascading effect. You never know where it will hit you from where. So, I think it's important to carry out the due diligence and take all your precautions or political insurance that is available in the market. And of course, we understand that has also become expensive, because larger risks involved but yes, it is still worth doing it rather than living with that risk.

Montek Mayal

Thanks, Dinesh. I mean, only I would add is perhaps, and you know, and this is building on the earlier point that Dash made. For many of at least the change in law events and Dinesh you can correct me if you think I'm wrong, on changing law events, not the long-term agreements, let's talk about like, think about toll roads, and think about ports. Actually, have an NPV protection clause. So, if there's a change in law, and affects the going back to the first principles we're discussing early on damages, it affects the financial position of the operator, then you can actually seek the reduction in value, diminished in value arising from the change in law event. Right?

So, if the regulatory legal changes that directly affect the investment, you can see compensation for those measures, for example, often to the contraction mechanisms as well. I think that's quite important because in that scenario, obviously, you have to isolate the effect for which you're claiming losses for. But because this part is often long term, right, your net present value, the value of the project that you are operating, small changes can make substantial differences to that evaluation question.

Dinesh Pardasani

Let me give an example. In fact, you rightly mentioned. During COVID time, obviously, the traffic was low and these toll operators losing money and the regular traffic was not there. So, they've obviously started arbitrations where they're claiming compensation for that change in law, because it was more of a direction from the government. So, we already had these claims before arbitral tribunal right now where they are seeking compensation so that there is no reduction in the revenue that they're contemplated.

Montek Mayal

Yeah, exactly. I've had the pleasure of working with certain firms on this on multiple occasions. The tricky issue there again, for just the audience to keep in mind is estimated value can be a tricky situation, because you're trying to project in a toll road obviously traffic, road traffic in a port, the goods that will be transported over a long-term period. So, tribunals need to have robust analysis for this long-term projections that then form the basis of your claims. But thanks a lot Dinesh. So, we've covered to some degree, some of the issues that you see in construction contracts. I want to move to the third subtopic and I'm also conscious about time. And we want to discuss very quickly risk management and M&A transactions.

Now, when I say that aloud, you might all think that no one thinks of an M&A transaction document to be a long-term agreement, actually quite short-term agreement. These often close in 6 to 12 months. But they clearly relate to long-term investments. Right? The underlying asset of the business that you're acquiring is for the long-term value. Right? And the characteristics of the business that are being acquired, including the risks attaching to the asset of the business, will obviously affect the long-term value, you can extract from that. So small changes in those risks or the wrongful understanding of those risks can of course change the value that you start to extract from the business and possibly the price you might have paid for that business.

So, for today, given again, time constraints, we focus on representations and warranties that are often given and taken in the context of this M&A transactions, but can be critical in allocation of risk between the buyer and the seller. So that's short background. Dash, I want to come to you very quickly. But can you just walk us through one of the type of risks and issues that might be covered through these reps and warranties?

Dharshini Prasad

Sure. I think before that maybe it might just be helpful for the benefit of some of the audience to explain just what they are. So, reps and warranties are sort of fairly standard in M&A transactions including actually even see them outside of M&A complex sale transactions. A warranty is essentially a promise that you may get the time of the contract, that a particular statement is true as at best date. A representation is a statement that you make typically in the run up to a contract, it's largely designed to sort of induced in a way the entry into the contract by the counterparty, while they're usually made before a contract, they can be repeated in the contract itself. So, you'll often see representations and warranties in the contract as well.

Why do you need them? It's because you essentially use it as a way to flush out disclosure from the other party so to try to get them to give you information about the counterparty. You don't want to be in a data room with a million documents. So, you might try to as a buyer, ask the seller to give you a representation that all its financial statements are accurate. And then, if the seller pushes back, okay, there's a problem there, I maybe need to look a bit closer, it can also just work very effectively as a risk allocation mechanism as the description of the clauses themselves indicate, obviously, if it's a term of a contract, it turns out not to be true.

You can then 6 months, 12 months, sometimes years after the contract go back into for breach of contract of course bearing in mind limitation periods. Manish will go into this in a bit more detail. But the key difference between a representation and warranty is really the remedy that you can get. A representation will allow you to get damages, and you can also essentially rescind the contract. So, you can be put back in the position you were in, if the contract had never been entered into, whereas a warranty would just give you damages, to put you in the place if the warranty had been true. So, what are the types of reps and warranties that you see, the classic ones are capacity to enter into a contract?

So, warrant and represent that you do have the corporate authority to enter into the agreement. Compliance with law is a huge one. And it's a very, very important one, particularly in certain jurisdictions that are considered high risk to know that the counterparty or the asset that you're buying, if it's a target company has not engaged in conduct that would not be compliance with law that the business had been run in compliance with law. Tax Compliance is another big one. Accuracy of financial statements because obviously the due diligence that you do, the evaluations of the company are based on financial statements that's an important one, titled to assets, whether real or personal, including any encumbrances on assets.

Montek is nodding vigorously because he knows all about this based on a recent case. Status of inventory, intellectual property ownership, environmental liability. So, these are the sort of big ticket items, but they can be more bespoke depending on what the nature of the assets businesses.

Montek Mayal

Thanks, Dash. That was a really good summary in a very short amount of time. So, thank you very, very much. Manish, now coming straight to you, Dash has already asked the question in our answer to you. So, what are the remedies available for the breaches of such mis-reps for such representations and warranties in M&A contracts?

Manish Aggarwal

Thanks, Montek. In the interest of time, I'll just focus on remedies for the breaches of warranties. And I'll of course address this from the perspective of English law, although I understand the Indian law position and this perspective is quite similar. And of course, the question is of critical importance, because as Dharshini mentioned, a lot of time is spent up on negotiating these warranties in the context of any M&A transaction. And, you know those warranties are only kind of work what you can do to get in terms of remedies in case of a breach. And typically, what you find is that the contracts the SPA’s are silent as to the measure of damages. So, you kind of fall back to the legal breaches for that.

And the starting point, as Dharshini mentioned, is that damages for breach of warranty should put the buyer in the same position it would have had been in had the warranty been true. So that what you're essentially doing as a practical matter is you're looking at the difference between the value in a context of a share sale that the shares would have had if the warranty had been true. And the actual value of the shares both has at the completion date. Now, for the warranty value, it's relatively presumed that this is the same as the purchase price that an actual buyer paid on the assumption that the warranty is true.

But you can lead evidence to the contrary, in some cases, as to the actual value, which becomes quite contentious in these cases. The real question is, what kind of adjustments would have been made to the valuation of the shares, had the true facts been known as the completion date? Now, it's an objective test. But I think as a practical matter, the adjudicators often look at how the actual purchaser valued the shares, and how it would have adjusted that valuation hadn't been armed with knowledge of the two facts.

And the time look at that as kind of the best concrete indication of how the market would have valued the shares and adjusted the value. So, if you have a buyer, value your shares by reference to EBITDA multipliers, it's quite likely that the court may adopt a similar approach in assessing damages. I think there, I would conclude by just noting, kind of a practical takeaway. I think it's absolutely critical, from the party's perspective, because of that framework, that a proper record is maintained as the basis for valuing the company of the business. And we know that with large acquisitions, these valuations often reflected in internal working papers, you know both presentations to investment committees.

But the fact is that at the time, people are not really thinking about disputes. We're just thinking about kind of proceeding with investments. But I think what you have to bear in mind, in the context of warranties as if that there is a future dispute regarding breaches of warranties. And the question is, how would that breach have impacted the price that the buyer would have paid for the business, the court or the tribunal looking at your claim for breach is going to look very closely at how the valuation was undertaken. So, your valuation papers that were designed for more internal decision making, may certainly find themselves making their way into the record before a tribunal. So, you have to think about that even then you kind of preparing for an acquisition. But I'll stop there and conscience of time.

Montek Mayal

No. Thank you, Manish. I think the only thing I would add to that is, of course, as Manish said you end up claiming damages in the form of the value, value is warranted, assuming the warranties were true and value as received given this actual status of the warranties, the only I would point here and this is why I was nodding, when Dash was speaking, is because, you know sometimes things are warranties on specific assets might seem quite trivial. But if they are a very fundamental power down line business, they actually can affect the business in larger ways. Right? Let's say there was a mis-rep or sorry, there's a warranty around the factory. And that factory turned out to be useless after you bought the business.

Right? One might say, well, your loss is only the cost of building the factory. But what about the business has come to a complete halt in the interim period? So, what can you claim in that context? Right? So, it also depends on specifics of the assets that will be affected by some of these breaches. What does that mean for the business at large? And therefore, how might you assess the value as received, given some of these positions are not to be false. So, it's quite critical and as a value of course, we think about these questions. The question is, how do you know the true picture of the business? How would you have indeed value this business to start with?

The general assumption is you're valued at a lower price, because certain things have turned out to be riskier or false in principle. You assess the value, and the damages ends up being the difference between what you paid and what essentially you would have paid for the actual value. The only other point I would make building on what Manish said, it's also very critical. And sometimes this becomes a tricky issue, we won't go into the judgments here, there is some legal precedents in some form or judgments was discussed this at fuller length. But usually valuations, especially in this context is obviously as at a point in time, right?

So, as of valuation made. Now, the question we all have to grapple with, especially in legal context is, what do you do with information that comes to be known much later, much after the valuation date. And, you know as a valuation practitioner, there are guidelines, including the international valuation standards, which are quite clear, right, you don't use hindsight in estimating value. You use information that would have been known or knowable as the valuation date. But again, I'm just pointing it out, we don't have enough time to get into the specifics and the details about it. But the valuation becomes quite critical question in some of these assessments, because often, and perhaps there's only one to two forecasts.

And that truth is that forecast will always be wrong, and the world in that we different than you expected. So, the question becomes in valuation is how much or to what degree if at all? Do you take into account information at postdates, your valuation date? And the legal questions around that, but I won't flag that for now. And that's quite important to bear in mind. But usually, the standard in principle is, I think, quite simple. You need to think about what you paid, obviously, for the business and why you pay that sum. What's the value that you came to? And that, what Manish was talking about looking at the valuation papers, what was the reason, and why did you value the business in particular way that becomes quite critical?

And of course, when you look at the valuation analysis and think about, okay, how would have changed the valuation analysis, had I known the true picture of the business and make the specific adjustments for the breaches that have been found, or are alleged. And once you do the calculation, you get the actual value, and the difference becomes a loss. So we are, and I'm getting messages, disciplining messages from Neeti on the side. And I think for good measure. But I think we've covered quite a bit. And we are four minutes over time. Rajendra, so I'm going to come back and stop at you. Because you had mentioned and given the analogy of a marathon. I don't think we've covered as much as we should have. But hopefully, we've done some justice to the topic. Is that fair, Rajendra?

Rajendra Barot

Absolutely. I think we raised the right issues. We even in that sense made people conscious of what are the issues that they should think of, and a lot of it, and I said this earlier, also depends on when the rubber hits the road. So, I'm sure that this is a good broad spectrum of issues that one needs to look at, when you're dealing with a long-term contract, and we’ve only identified three buckets. And I'm sure there is a lot more, I mean, if I allow any of the panelists 15 more minutes, there is so many more issues on the table, but I certainly found this helpful. There were certain things which I was not aware of, to be honest. So, I personally have found this very, very helpful. Thank you very much.

Montek Mayal

Thanks, Rajendra. And with that, thank you very much to the panel from all different time zones from Singapore to London, across India. Thank you very, very much. And we hope the audience found the conversation to be interesting and see you next time. Thank you