



ANALYSIS >>

REUTERS/Ajay Verr

# Dial S for scam

## THE INDIA 2G SCAM TIMELINE

A Raja takes over as India's telecom minister.

India's Department of Telecommunications (DoT) under Raja begins the process of allotment of 2G spectrum licenses.

DoT decides to issue the licenses on first-come, first-serve basis instead of the market-determined auction route.

The Central Bureau of Investigation (CBI) registers a corruption case against DoT officials and some private companies for irregularities in the allocation of 2G spectrum.

The country's anti-corruption watchdog Comptroller and Auditor General (CAG) submits a report to the government stating that the 2G scam has resulted in a loss of 1.76 trillion rupees (\$33 billion) to the exchequer.

Kapil Sibal takes over the telecom ministry after A Raja resigns

MAY 2007 >>>

AUG. 2007 >>>

JAN. 10, 2008 >>>

OCT. 21, 2009 >>>

NOV. 10, 2010 >>>

NOV. 15, 2010 >>>

India's infamous 2G spectrum scam has resulted in \$33 billion of lost revenue, numerous high-profile imprisonments and immeasurable government embarrassment. But it may not be all bad for the nation's mobile operators, as it has resulted in a proposed brand-new telecom policy that promises to alleviate some of their present distress.

**F**or a country that is no stranger to either political or corporate corruption, the 2G spectrum scam — which has seen an ex-government minister, a member of parliament, and various corporate tycoons thrown into jail — has been a white-collar scandal like no other. The scale of fraud is unprecedented — the Indian exchequer lost 1.76 trillion rupees (\$33 billion) in potential revenue, according to an audit by the anti-corruption watchdog Comptroller and Auditor General (CAG), when second-generation spectrum licenses were sold in 2007 at throwaway prices to allegedly benefit some companies cherry picked by the former telecom minister A Raja.

The "gravity of the offence" — cited by the judges to consistently deny bail to the 14 high-profile accused, who face charges of criminal conspiracy, bribery, forgery, and abusing government office — has deeply embarrassed the Indian government. The 2G trial, which began in November under the arc lights of the media, has exposed the arduous risks of doing business in a weak regulatory

environment. Jilted investors have since threatened to pull out of India — and those aren't just empty threats.

But the scam has had at least one positive fallout for India's burgeoning telecom industry. In its aftermath, the government expeditiously took up the mandate to revamp its old telecom policy. The much-needed reform is aimed partly at plugging some of the policy loopholes that led to the scam, but mainly to revitalise the ailing telecom sector — once a metaphor for India's economic dynamism but now increasingly buffeted by fierce competition and regulatory woes.

#### A tale of two policies

The new telecom minister Kapil Sibal released the draft National Telecom Policy 2011 in October, which is expected to be finalised by early next year after consultation with the Telecom Regulatory Authority of India (TRAI), telecom companies and various stakeholders. The draft policy has been posted on the website of the country's department of telecommunications for public perusal, and will accept

feedback until mid-December before the final policy is formulated.

The previous policy, unveiled in 1999, kickstarted India's first telecom revolution. It took away myriad government strangleholds on the market, unshackling private telecom companies from the country's labyrinthine bureaucracy, and offered them the opportunity to compete on an equal footing. Regulators allowed a wave of new entrants into India, and industry tariffs nosedived to an average of one U.S. cent per minute — one of the world's lowest. The results were astonishing: India now ranks as the world's second-fastest growing cellular market after China, with 850 million mobile subscribers today from fewer than six million in the early 2000s.

"The purpose of NTP 99 was to herald a telecom revolution in India," says Vivek Kathpalia, partner and head of the telecom practice at Nishith Desai Associates. "Prior to that, even getting a simple landline phone connection was a huge challenge. The policy increased tele-density, provided more choices to the Indian consumer, and at the same time prevented cartelization in the market."

But now the market has matured, he adds, and further reform is vital to sustain growth and unleash the next wave of the telecom revolution.



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VIVEK KATHPALIA, NISHITH DESAI ASSOCIATES

#### The need for consolidation

Many telecom companies in India have evinced an urgent need for market consolidation as investment in telecom plummets and profit margins are squeezed in a hyper-competitive market. There are more than a dozen players in each telecom circle, or zone, and companies say the market should be pared to four or five operators in each circle for business to be profitable. At the moment, networks face declining average revenue per user (ARPU), rising network operating and subscriber acquisition costs, not to mention large debts acquired by

Raja and several other DoT officials are arrested. In the following days, various corporate tycoons accused in the scandal are also arrested.

The Delhi High Court sets up a special court to deal exclusively with 2G cases.

The CBI files its first charge sheet in the scam.

Trial of the 17 accused begins in the special court.

FEB. 2, 2011 >>>

MAR. 14, 2011 >>>

APR. 2, 2011 >>>

NOV. 11, 2011 >>>

## news in brief >>

### ALLENS OPENS MONGOLIA OFFICE

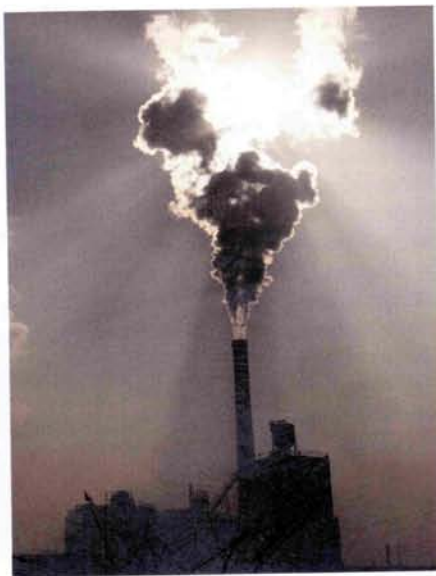
Keen to broaden its existing Asian network, and tap into the breakneck growth of Mongolia, Allens Arthur Robinson opened an office in the nation's capital of Ulaanbaatar in Nov.

The Australian firm currently advises numerous multinational companies in the country, including Rio Tinto, whose joint venture Mongolian Oyu Tolgoi project is the world's largest undeveloped copper and gold mine. Other clients that Allens has done work for in Mongolia include the First Reserve Corporation, one of the world's largest PE consortiums, Extract Resources and Calibre Global.

Erin Feros, energy and resources partner at Allens, said the firm's decision to establish a formal presence in Mongolia was "very much client-driven." "Having had a number of partners and lawyers working on the ground for some time, we've been approached by a range of other international clients, with existing or planned operations in Mongolia, who have asked us to assist them," she said.

While the new office will primarily focus on energy and resources, it will also advise on corporate, capital markets, construction, infrastructure and project finance matters in Mongolia. "We have one of the largest energy and resources teams in Asia and we'll naturally be drawing on that expertise. In the past few weeks alone we've had partners and lawyers from our Perth, Brisbane, Melbourne, Singapore and Hong Kong offices meeting and working with clients in Ulaanbaatar," Feros added.

More than 200 foreign-owned companies and joint ventures operate in Mongolia, where the IMF predicts growth will be faster than China's in 2011. Mongolia is among the top 20 countries globally in terms of land mass. It has vast mineral reserves (of which 15 per cent have been mapped) and 6,000 deposits of 80 different minerals. Additionally, it is estimated that 30 to 40 strategic assets and projects will 'come to market' during the next 12 to 18 months.



REUTERS/David Gray

many companies to fuel expansion. The existing rules prevent new operators from selling their licenses or merging with others in the first three years of procuring a license.

NTP11, the government says, is expected to relax such restrictive M&A rules, making it easier for carriers to merge or share and trade spectrum. The policy will "facilitate consolidation in the converged telecom service sector while ensuring sufficient competition," Sibal said when he unveiled the draft, without offering details on the new M&A guidelines. He also mentioned the need to frame an appropriate exit policy for licensees who may not find business viable.

But in a November report reviewing the draft policy, the global credit ratings agency Fitch Ratings denounced TRAI's recommendations for the policy to require a minimum of six operators per circle and for telecom players to not have more than 30 percent market share, all moves it said would "effectively block consolidation in the sector."

"Consolidation among the existing 10-13 telcos in each circle is inevitable," the report said, adding that the Indian telecom industry is still an "overcrowded market with high regulatory risk." "The draft NTP," it added, "provided no relaxation of restrictive M&A regulations."

"For the continued growth of the telecom sector it is important to establish an appropriate mechanism to achieve balance between competition and consolidation, while benefiting both providers and consumers," says Rajat Kathuria, a professor of economics at the International Management Institute in New Delhi and a former consultant with the TRAI.

Even if the policy framed achieves that objective, Kathuria says, implementation of M&A will depend on the regulatory institutions. "History however does not inspire much confidence" that the policy will be executed smoothly and transparently, he says.

### Seeking transparency

In its report on the scam, the CAG accused the telecom ministry of selling 2G spectrum licenses at well below market prices on a first-come first-served basis rather than

through the more lucrative auction mechanism. It allowed companies to use two competing technologies — the global system of mobile (GSM) communications and the Code Division Multiple Access (CDMA) technology — using the same license. And it allocated more spectrum — in addition to the contracted 6.2 MHz — to companies than what their licenses specified. "The entire process lacked transparency and objectivity and has eroded the credibility of the DoT," the CAG said, adding that the licensees did not meet basic eligibility conditions, as some provided incomplete information and submitted fictitious documents.

"There are loopholes in the way the regulatory process works," says Rahu Matthan, partner at Trilegal. "The 2G scandal showed how the government can use discretionary powers to exploit these loopholes."

Kathpalia at Nishith Desai — which is advising some clients accused in the mammoth 2G case, whom he did not wish to name — says it will be difficult to quantify and establish with hard evidence the notional loss to the exchequer if the spectrum had been auctioned.

But the legal nuances aside, he says the 3G and broadband auctions last year were a completely different experience compared to the 2G spectrum sale. Nishith Desai represented Qualcomm Inc in the broadband auctions. The bidding process — which brought the exchequer record revenue of 1.06 trillion rupees (\$20 million) — was smoothly conducted online, tamper proof, well documented and made it easy for foreign bidders like Qualcomm to participate without any bottlenecks.

"In the 2G spectrum sale, the decision making was opaque, there was a lot of arbitrariness," he says. "The 3G and broadband auctions were conducted transparently and efficiently."

Sibal has said that NTP11 will introduce similar transparency in how spectrum is allotted and used by mobile firms. It would consist of separate spectrum acts outlining clear policies on "spectrum sharing, pooling and trading."

### Spectrum concerns

The new policy aims to allocate telecom licenses and spectrum

## news in brief &gt;&gt;



### GIANNI ORIGONI MAKES MIDDLE EAST FORAY WITH ABU DHABI OFFICE

Italian law firm Gianni, Origoni, Grippo and Partners has opened its Abu Dhabi office, its first in the Middle East.

The 350-strong Rome-headquartered firm, which was established in 1988, has offices in Italy, Brussels, London and New York. Gianni has moved three lawyers to the Abu Dhabi office, which aims to assist Italian companies operating in the region.

"The Abu Dhabi office represents a further step towards our firm's internationalisation process and will serve as a hub for the European clientele in the region," said founding partner Francesco Gianni in an interview with local media. "The UAE... has also shown astounding resilience to worldwide economic turmoil. This has made Abu Dhabi and the UAE an apt choice in our strategic plans to penetrate the MEBA market and to establish strong ties that will allow us to expand further into the region."

Reports say that services will include mergers and acquisitions, investment banking, oil and gas, private equity, arbitration, infrastructure, corporate governance and corporate finance.

### SULLIVAN & CROMWELL KICKS OFF HONG KONG LAW PRACTICE

Sullivan & Cromwell, which opened its Hong Kong office in 1992, has completed the regulatory measures necessary to commence practice of law in Hong Kong.

The firm, which opened its Beijing office in 1999, making it among the first top-tier Wall Street firms to have an office in China, has been so far serving the Greater China region through these two offices. The Hong Kong office currently boasts a strong team of lawyers, including partners William Chua, Michael DeSombre, Kay Ian Ng, Chun Wei and Gwen Wong.

"S&C has been committed to the Asia-Pacific region for many decades, with an integrated practice advising clients in their inbound and outbound investments, M&A and capital raising activities," said Joseph C. Shenker, chairman of Sullivan & Cromwell, in a statement. "Having the ability to offer clients advice under Hong Kong law is a natural extension to our diversified, global practice."



**"Regulation in India is less than crystal clear, it is unpredictable. In matter of fact, it isn't. But in execution, it often times can be"**

RAHUL MATTHAN, TRILEGAL

bandwidth separately rather than bundling them together, as is the case currently. It means that operators will have to pay for excess spectrum — which is in addition to the contracted 6.2 Mhz.

"The new policy draft envisions that spectrum is a valuable commodity and every Mhz of it should be auctioned for a price," says Matthan. "In the long term that will mean that spectrum will be acquired by those companies who can afford to pay for it. Only companies with deep pockets will have the ability to provide a better network."

Industry watchers say that with the new policy, it isn't clear how the government will deal with those telecom companies that have reached a stage where they are entitled to complimentary additional spectrum under the previous guidelines. Neither is it clear whether the government will cancel 2G licenses to 85 companies that were given the approval even though they did not, according to the rules have the required capital to seek bandwidth. Most of these companies have made significant investments since procuring the licenses.

Fitch Ratings says paying for excess spectrum, spectrum renewal fees, and other ancillary charges will hurt telecom companies, many of which could face "significant cash outflows over the medium term due to regulatory decisions."

NTP11 also will introduce a "one-nation one-license" rule, doing away with roaming charges levied by operators for using mobile phones outside a user's home territory. Fitch Ratings says the move is "negative for Indian telcos as the loss of roaming revenue — 4 percent to 7 percent of overall revenue — is likely to more than offset any positive effect of lower subscriber churn."

### A raft of exits?

Industry insiders warn that NTP11, however well intentioned, may not be

able to prevent many large players from exiting the telecom business altogether. The country head of Vodafone in India — the largest overseas corporate investor in India, which is currently battling the government over a \$2.5 billion capital gains tax bill that didn't accrue in India — was recently quoted in media as saying that he expected a shakeout to begin soon that would winnow the dozen-plus player market in the next year or two, as weaker players exited and the upcoming policy enabled mergers.

The company has invested nearly \$19 billion in the country — including \$2.6 billion for 3G licenses last year — has suffered disappointing returns since it entered India in 2007 with its 11.1 billion acquisition of a 67



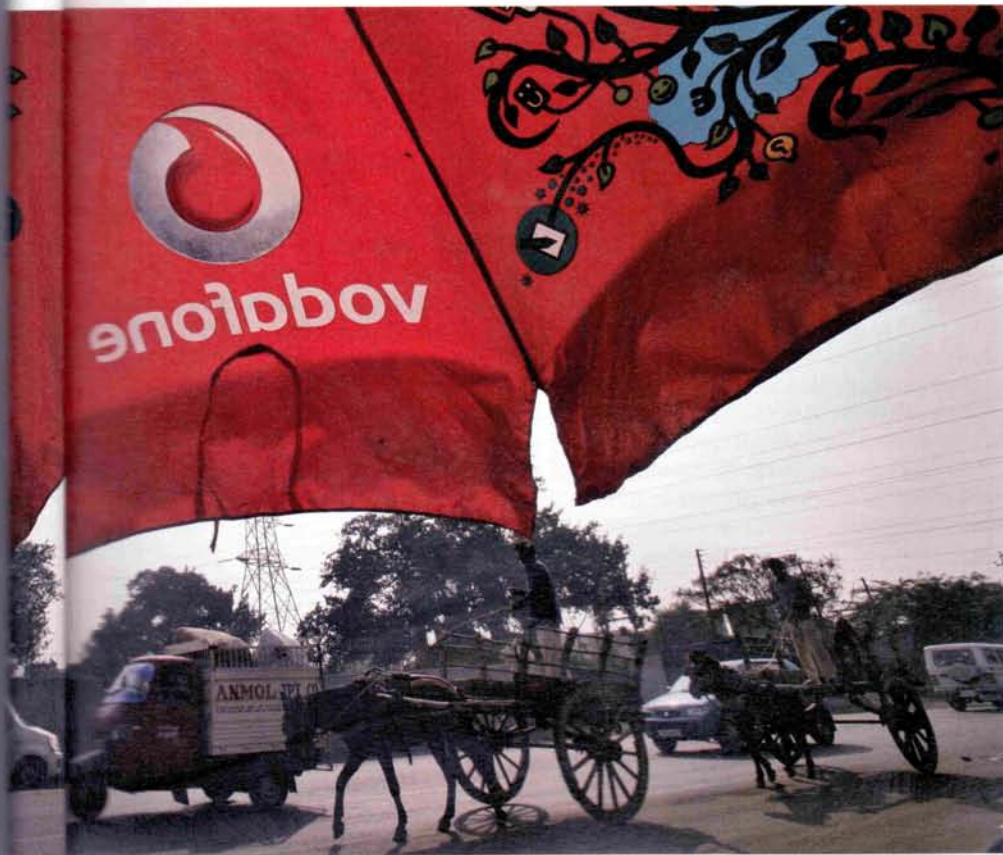
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REUTERS/Mukesh Gupta

percent stake in Hutchison Telecom. The government, observers say, needs to address the tax uncertainty faced by foreign investors — not just in the telecom space — lest there be large scale foreign capital flight.

The problem isn't that regulation in India is tough, says Matthan of Trilegal, which advised Vodafone when it bought control of Hutchison. "Regulation in India is less than crystal clear, it is unpredictable" he says. "In matter of fact, it isn't. But in execution, it often times can be."

Overall, says Katuria, the former TRAI adviser, the NTP11 draft is weak on implementation details — often the bugbear of India's developmental efforts. But it certainly is a step in the right direction. It seeks to tackle structural issues plaguing the market and open up the market to millions of unconnected Indians, especially in rural areas. It also proposes to accord the telecom industry the status of an infrastructure sector, which will offer fiscal incentives and help ease credit flow to companies facing a cash-crunch to fund roll-out and expansion plans. **ALB**