

## Basics of investment arbitration: An Indian context

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### Abstract

Topic: Basics of Investment Arbitration: An Indian Context

Investor State Dispute Mechanism (ISDS) is an International law mechanism through which foreign investors seek redressal of investment treaty rights violation by the host country. Bilateral Investment Treaty (BITs), with ISDS, are perceived to be important tools in encouraging the influx of foreign investment. BITs are agreement between two countries /states for reciprocal promotion and protection of investments in each other's territories by individuals and companies situated in either state. Some of the essential clauses are:

- Most favoured Nation (MFN)
- Dispute settlement mechanisms, both between an investor and a state and between states (Investment State Dispute Resolution).

The United Nations Conference on Trade and Development (UNCTAD) provides that BITs spur an increase in Foreign Direct Investment by providing investor security, in particular for developing countries like India. Under a BIT an investor can directly initiate arbitral proceedings against a state without approaching its own government. India not being a party to the ICSID, established by the Convention on the Settlement of Investment Disputes between States and Nationals of other states, which provides facilities for arbitration and conciliation of investment disputes between contracting states and nationals of other contract states.

Though there is a possibility of having arbitration under the additional facility rules of ICSID, it still remains different from a proper ICSID Arbitration and a party will nevertheless have to enforce the award under the New York Convention. India adopted its first model BIT in 1993 which was revised in 2003 and further in 2016. The Indian Model BIT retains the ISDS mechanism to settle disputes with foreign investors though it adds a number of conditions that an investor needs to meet before accessing ISDS.

It shows that India has rejected the extreme option to walk out of the system but to be a part with different terms of engagement. Consequently, India has changed the scope and content key provisions in the Model BITs to limit challenges to its actions.

**Keywords:** BIT, MFN, FDI, ISDS, ICSID, investment, investment arbitration

### Introduction

Concept of Investment and Investment Arbitration

#### Investment & Investment Arbitration: Meaning & Concept

The economic debate assumes that a direct investment involves

- a. The transfer of funds;
- b. A long-term project;
- c. The purpose of regular income;
- d. The participation of the person transferring the funds;
- e. A business risk

These factors distinguish Foreign Direct Investment (FDI) from a Portfolio Investment; from an ordinary transaction of sale of a good, service and short-term financial transactions. The ICSID Convention had referred to 'investment' for defining the types of disputes that could be settled by ICSID Tribunals<sup>[1]</sup>.

Therefore, the term 'Investment' has been provided in

Article 25 of the Convention, which also defines the jurisdictional requirements and procedure for a dispute before ICSID. BITs providing for ICSID jurisdiction do not refer to Article 25 for the definition of Investment, instead they contain their own definitions of the same mostly at the beginning of the agreements. The treaty-based definitions are usually drafted in an elaborative way along with illustrations and general definitions altogether.

This 'dual' approach has led to distinct questions of application and interpretation. Some issues raised were:

- The interpretation of the terms not defined under Article 25 of ICSID Convention.
- Whether the term used in the Article 25 was subject to the definition set forth in the treaty referring to ICSID. This issue also arose in case of National laws granting consent to the part of the host state to ICSID jurisdiction.

The approach of the tribunals has been inclined to interpret the term in Article 25 of the ICSID Convention autonomously in the applicable BIT. This autonomous understanding led to the practice of a dual examination of

<sup>1</sup> Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* 60(Oxford University Press, 2018).

the notion of ‘Investment’, also sometimes called the ‘Double-keyhole Approach’<sup>[2]</sup>.

Investment arbitration has emerged as a platform for seeking redressal to foreign investors by the Government of India. Such arbitration, usually available under Bilateral Investment Treaties signed by India with various countries, gives individual investors access to protection under international law, for various acts of omission and commission on part of the Government of India. The impact of such proceedings first came to light in November 2011, when an ad-hoc arbitral tribunal delivered the first ever published award against the Republic of India, in an International Investment Arbitration<sup>[3]</sup>.

The proceedings were initiated by *White Industries Australia Limited*<sup>[4]</sup>, under the provisions of the Bilateral Investment Treaty (BIT) between India and Australia. In this landmark case, White Industries, an Australian investor, filed this investment treaty arbitration against the Government of India in order to enforce an ICC award passed in the investor’s favour back in 2002. The investor had been trying to enforce the award for around ten years and was unable to do so. The investor claimed that long judicial delays in India were the cause of this enforcement delay. Therefore, they used the MFN clause (Art 4(2)), under the India- Australia BIT to get the ‘effective means’ protection granted under the Indian-Kuwait BIT (Art 4(5)). The tribunal found for the investor on the issue of long judicial delays stating that these days amounted to a denial of effective means and thereby a denial of justice under the India- Australia BIT<sup>[5]</sup>.

### **This Was the First Case in Which Bit was Effectively Used Against India.**

Within a year, six other foreign investors had sent notices to the Government of India, invoking arbitration under various BITs, with regard to their investments in India<sup>[6]</sup>.

Other Rights under a Bilateral Investment Treaty

BITs are agreement between two countries /states for reciprocal promotion and protection of investments in each other’s territories by individuals and companies situated in either state. Protection under a BIT is protection of foreign investment against expropriation. Expropriation is a bundle of rights which balances the interest of both the host state and the investor. The sovereign right Of the host government under international law to take property of a domestic and foreign investor for social, economic, political, and other reasons is recognized, such as:

1. Whether the property has been taken for a public purpose,
2. Whether the acquisition was non-discriminatory,
3. Whether the acquisition was in accordance of the due process.

The availability of compensation and duties of mitigation

may also be pertinent<sup>[7]</sup>.

### **Most-Favoured-Nation Clause**

The most-favoured-nation clause is a ‘treaty provision whereby a state undertakes an obligation towards another state to accord most-favoured-nation (MFN) treatment in an agreed sphere of relations. MFN treatment is guaranteed to the investor by the host state. It guarantees that an investor from one country would be treated the same way as it would treat an investor in another country.

Thus, for example, if a host state grants a level of protection to an investor from Country X which is higher than that granted to an investor from Country Y, then the investor from Country Y can invoke the MFN clause in his BIT and avail the standards of treatment granted to investors from Country X. However, MFN may be invoked only if the underlying BIT grants the MFN protection<sup>[8]</sup>.

International Law Commission draft articles on MFN clauses defines MFN as a treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable than treatment extended by the granting State or to a third State or to persons or things in the same relationship with that third State<sup>[9]</sup>.

### **Investor State Dispute Settlement (ISDS)**

Investor State Dispute Mechanism (ISDS) is an International law mechanism through which foreign investors seek redressal of investment treaty rights violation by the host country. Bilateral Investment Treaty (BITs), with ISDS, are perceived to be important tools in encouraging the influx of foreign investment. The first Bilateral Investment Treaty (BIT) was signed between Germany and Pakistan in 1959 and contained dispute resolution provisions only between states. This epoch witnessed decolonization and the advent of the World War, represented by the coming together of two major geopolitical formations in the Western world. The BIT that incorporated Investor State Dispute Settlement (ISDS) mechanism was the Netherlands- Indonesia BIT (1968) and the first BIT that included ISDS with unqualified content to ISDS was Chad- Italy BIT in 1969<sup>[10]</sup>.

Development of ISDS

The North American Free Trade Agreement (NAFTA) in 1994, investors began to realize the underlying power of investment treaties and the ISDS mechanism. It was Argentina’s State reforms in response to the 2001 economic and political crisis that brought BITs to the fore with the invocation of almost 40 BIT claims against Argentina. In 1997, there were 19 known ISDS cases, by 2010 there were over 390 cases. It is said that, since the beginning of 2015, almost one new ISDS case is filed per week<sup>[11]</sup>.

### *ISDS Regimes*

Investment arbitrations are conducted either on an ad hoc basis or through established arbitral institutional like ICSID.

<sup>2</sup> Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* 61(Oxford University Press, 2018).

<sup>3</sup> Rituparna Padhy, “Investment Arbitration In India” available at <http://lawtimesjournal.in/investment-arbitration-in-india/> (last visited on July 12, 2020)

<sup>4</sup> UNCITRAL, Award of 30 Nov.2011

<sup>5</sup> Shashank Garg (ed.), *Alternative Dispute Resolution the Indian Perspective* 218 (Oxford University Press, New Delhi, 2018).

<sup>6</sup>Rituparna Padhy, “Investment Arbitration In India” available at <http://lawtimesjournal.in/investment-arbitration-in-india/> (last visited on July 12, 2020)

<sup>7</sup> Shashank Garg (ed.), *Alternative Dispute Resolution the Indian Perspective* 211 (Oxford University Press, New Delhi, 2018).

<sup>8</sup> Shashank Garg (ed.), *Alternative Dispute Resolution the Indian Perspective* 216 (Oxford University Press, New Delhi, 2018).

<sup>9</sup> *ibid*

<sup>10</sup> Shashank Garg (ed.), *Alternative Dispute Resolution the Indian Perspective* 206 (Oxford University Press, New Delhi, 2018).

<sup>11</sup> Shashank Garg (ed.), *Alternative Dispute Resolution the Indian Perspective* 210 (Oxford University Press, New Delhi, 2018).

Appointment of the Permanent Court of Arbitration as the arbitral institution while adopting the UNCITRAL rules to govern the arbitral process has been a recurring trend.

- ICSID, established by the Convention on the Settlement of Investment Disputes between arbitration and conciliation of investment dispute between contracting states and nationals of other contracting states. The executive directors of the International Bank of Reconstruction and Development (WORLD BANK) formulated the convention and submitted it to the World Bank members for their consideration, signature and ratification. With 20 members ratifying it, the Convention came into force on 14<sup>th</sup> October 1996. Currently 161 states have signed the convention and 153 states have ratified it.

**Presently, India is not a signatory to the ICSID convention.**

- The UNCITRAL has three versions of arbitration rules.
- UNCITRAL Arbitration Rules, 1976;
- The UNCITRAL Arbitration Rules, 2010; and
- UNCITRAL Arbitration Rules 2010, modified in 2013, incorporating the UNCITRAL Rules on Transparency for Treaty Based Investor- State Arbitration.

**Conclusion**

The main problem with India's new Model BIT lies in its 'Dispute Resolution' clause. The pre-requisite of exhausting and pursuing all domestic remedies before bringing claims under the BIT could render the whole purpose of BIT futile. However, the Indian government in its counter strike to avoid claims under the BITs is rather creating an excess of future contempts. The need of the hour demands an amended 'Dispute Resolution' clause of the Indian Model BIT of 2015 which is more pragmatic in approach. In order to achieve this, it is critical that India remains engaged in international debates on both incremental and radical reform proposals to ensure a healthy balance of investor and host state's sovereign concerns not only in India but across the world and also the Indian government has to work with the Indian Judiciary to promote a regime of a swift and high speed dispute resolution mechanism.

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