SUPREMO AMICUS

VOLUME 27 | DECEMBER, 2021 ISSN 2456-9704

INDIA'S TRYST WITH INVESTMENT ARBITRATION

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ABSTRACT

One of the most important considerations for any foreign investor looking to invest abroad is the Host State's (country where foreign investment is located) ability to protect their investments. This ability is generally determined by formal declarations of obligations by States. Such declarations are indispensable in today's times to protect foreign investment from harmful governmental measures like subsidies, taxes, etc.

Generally, India is a big player in foreign direct investment. FDI is an important monetary source for India's economic development. Economic liberalisation started in India in the wake of the 1991 crisis and since then, FDI has steadily increased in the country. India, today is a part of top 100-club on Ease of Doing Business (EoDB). India is among the top 10 investment importing countries and among the top 20 of Investment exporting countries.

In this paper the author analyses the recent trends of Investment Arbitration to which India was a party to and critically analyses the recent Arbitral Awards passed against India. Then in the light of these judgements, he goes on to suggest some improvements in India's Foreign Direct Investment Framework.

INTRODUCTION TO INVESTMENT ARBITRATION

Investment arbitration is a procedure to resolve disputes between foreign investors and host States (also called **Investor-State Dispute Settlement** or **ISDS**). The possibility for a foreign investor to sue a host State is a guarantee for the foreign investor that, in the case of a dispute, it will have access to independent and qualified arbitrators who will solve the dispute and render an enforceable award.

This allows the foreign investor to bypass national jurisdictions that might be perceived to be biased or to lack independence, and to resolve the dispute in accordance to different protections afforded under international treaties.[1]

For a foreign investor to be able to initiate an investment arbitration, a host State must have given consent to this.

BILATERAL INVESTMENT TREATIES (BITs)

Bilateral investment Treaties (BITs) are agreements made between two countries containing reciprocal undertakings for the promotion and protection of private investments made by nationals of the signatories in each other's territories. These agreements establish the terms and conditions under which nationals of one country invest in the other, including their rights and protections.

BITs provide protection against illegal nationalisation and expropriation of foreign assets and other actions by a signatory of the BIT that may undermine the ownership or

[1] INTERNATIONAL-ARBITRATION-ATTORNEY, https://www.international-arbitration-attorney.com/investment-arbitration/ (last visited on October 23,2021).

economic interest of a national of the other signatory. As BITs are negotiated agreements between the signatory parties, their terms vary.[2]

The following are the essential clauses covered under BITs:

i. Applicability
ii. Fair and Equitable Treatment and Full Protection & Security
iii. National treatment and Most-favored-nation treatment,
iv. Expropriation,
v. Dispute settlement mechanisms, both between States and between an investor and a State.[3]

BITs encourage foreign investors to invest in a State and there by contributing towards overall developments and advancements of the economy.

INDIA'S EXPERIENCE WITH INVESTMENT ARBITRATION

Investment protection law deals with the substantive protections available to foreign investments and foreign investors with respect to their investments. These protections are ensured by virtue of a Bilateral Investment Treaty (hereinafter referred to as 'BIT') between the foreign investor's home state and the Host State. The protections majorly include ensuring non-discriminatory treatment, use of the due process, absence of arbitrariness, providing effective means, etc. The grant of these obligations creates an extremely "investor-friendly" reputation for the country. India was not always an investor-friendly country.

In the pre-independence period, India was a controlled, colonised economy that barely had any domestic production. In fact, most Indians were forced to consume British-manufactured products so as to put all sorts of indigenous production at a standstill. Thus, we were at a stage where we could not even think of inviting or sustaining any foreign investment in our territory. Even after independence, as India struggled to unshackle itself from the chains colonial rule, its economy was dwindling and overall production was extremely low. People and the government were both impoverished as they tried to boost internal indigenous industrial growth.

Despite this, the evolution of the modern Indian approach towards investment protection law emerged with the new economic reforms of 1991. This marked a shift in the Indian economic outlook, which moved from having restricted trade to creating a global reputation for trade and investment. As we opened our doors to liberalisation, privatisation and globalisation, we came to realise the multifarious advantages offered by foreign investment, both in terms of capital and goodwill. This led to the drafting of the first Indian Model BIT in 1994. India's first BIT was signed with the United Kingdom in 1994, followed by similar BITs being entered into with other countries.

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[2] THOMSON REUTERS-PRACTICAL LAW, https://uk.practicallaw.thomsonreuters.com/4-502-2491?transitionType=Default&contextData=(sc.Default)&firstPage=true (last visited on October 23,2021).
[3] **Prateek Bagaria and Vyapak Desai**, *Bilateral Investment Treaties & India*, NITISH DESAI ADVOCATES (Oct.23,2021, 10:04 AM), http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Bilateral_Investment_Treaties___India.pdf .

Today, India has signed more than 83 BITs with various nations across the globe, out of which 72 are still in force. We also have an Arbitration and Conciliation Act highlighting procedures for domestic arbitrations and the role of the judiciary in the timely resolution of such disputes. Recently, India was labelled as "one of the most attractive destinations for FDI." Capitalising on what was once our major weakness, we are now a capital-importing and capital-exporting country. Many Indian firms are foreign investors across the world while some of our companies regularly featuring on the Fortune 500 List as well. Foreign investors have also realised the various advantages related to investing in India, such as easy availability of raw material, cheaper manpower.[4]

India's journey with the investor-state dispute settlement (hereinafter referred to as 'ISDS') system has not been a smooth one.

The bumpy ride started in 1989, when White Industries, an Australian company sued India.

WHITE INDUSTRIES V. REPUBLIC OF INDIA

In 1989, White Industries, an Australian mining company, entered into a long-term contract with Coal India Limited (Coal India), a State-owned Indian company, for the supply of equipment to and the development of a coal mine near Piparwar in India's north-eastern state of Bihar (the Mining Contract). Disputes relating to bonus and penalty payments as well as to the quality of the extracted coal arose between Coal India and White Industries, prompting the latter to commence arbitral proceedings under the ICC Arbitration Rules in 1999. In a majority decision, the ICC tribunal awarded a USD 4.08 million (US Dollar Four Decimal Zero Eight Million) to White Industries in May 2002 (the "ICC Award").

In September 2002, Coal India applied to the Calcutta High Court to set aside the ICC Award under the Indian Arbitration and Conciliation Act, (US Dollar Four Decimal Zero Eight Million) (the set-aside proceedings). Nearly simultaneously, White Industries applied to the High Court of New Delhi to enforce the ICC Award in India (the enforcement proceedings). Both proceedings experienced significant delays. The enforcement proceedings were eventually stayed pending a decision in the set-aside proceedings. White Industries appealed to the Supreme Court; in the meantime (in 2006) the High Court of New Delhi stayed the enforcement proceedings. For about ten years White Industries could not get any relief.

After years of fruitless attempts to enforce the ICC Award in the Indian courts, White Industries commenced arbitration proceedings against India in 2010 under the India-Australia BIT dated February 29, 1999 (the "BIT Arbitration"), claiming that the inordinate delay resulted in a breach of the provisions on fair and equitable treatment ("FET"), expropriation, the "effective means" standard incorporated by the MFN clause and free transfer of funds under the treaty. That gives rights to Australian or Indian investors in each other's country, and where those rights are infringed, the investor

[4] Krishnendra Joshi, *India's Tryst with Investor-State Dispute Settlement (ISDS*), BLOG.IPLEADERS, (Oct. 24,2021 10:45 PM), https://blog.ipleaders.in/investor-state-dispute-settlement/ .

can begin arbitration proceedings against the Government of the other contracting State directly. Article 12 of the said Treaty, inter alia, provides for reference of a dispute to an ad hoc tribunal in accordance with the UNCITRAL Arbitration Rules, 1976, with certain modifications. White Industries has reported claimed that the action of the Indian courts and of Coal India.

The tribunal in the case concluded that the ICC Award was enforceable under the laws of India, but it was silent on the breach.[5]

CAIRN ENERGY V. INDIA

Another one of such International investment disputes in which India suffered huge losses is the Cairn Energy versus India case.

On December 21, 2020, the international arbitral tribunal (the "Tribunal") constituted in the Cairn case held that India had failed to uphold its fair and equitable treatment obligations under the BIT and under international law, by imposing the tax liability retrospectively and adopting measures to enforce the liability. The Tribunal ordered India to pay to Cairn USD 1.2 billion in damages for the 'total harm' suffered by Cairn as a result of India's breaches. However, the post award developments in the case exemplify the arduous battle for a foreign investor to enforce the award against a State.

In early 2021, Cairn had reportedly initiated proceedings in courts of the US, UK, France, Netherlands, Quebec and Singapore in order to enforce the award against India. Cairn can initiate proceedings to enforce the award in jurisdictions where India has assets, and which recognise and enforce the award made in Netherlands.[6]

VODAFONE V. INDIA

India lost an arbitration dispute initiated by Vodafone because India had imposed a hefty tax bill of several billion dollars retroactively.

While it is generally accepted that taxation is an exclusive prerogative of every state, this case highlights that bilateral investment treaties (BITs) limit the manner in which states may impose taxes on foreign companies. Indeed, the Vodafone award is another example of an award, which confirms the general opinio juris that the retroactive imposition of taxes is a breach of the obligations generally contained in BITs.

The facts of Vodafone case:

The dispute arose in 2007 when Vodafone acquired Hong Kong-based mobile operator Hutchison Whampoa for $10.9 billion. Vodafone International Holdings BV (Dutch tax resident) acquired the entire share capital

[5] *Case comments on White Industries V. Republic of India*, LAWCTOPUS ACADEMIKE JOURNAL, (Oct. 24,2021 10:30 AM)https://www.lawctopus.com/academike/case-comments-white-industries-v-republic-india/.

[6] Kshama A. Loya & Vyapak Desai, *The Cairn Energy v. India Saga: A Case of Retrospective Tax and Sovereign Resistance against Investor State Awards*, KLUWER ARBITRATION BLOG, (Oct. 24,2021 10:40 AM), http://arbitrationblog.kluwerarbitration.com/2021/07/02/the-cairn-energy-v-india-saga-a-case-of-retrospective-tax-and-sovereign-resistance-against-investor-state-awards/

of CGP Investments (Holdings) Ltd (tax resident of Cayman Islands) (CGP), from Hutchison group, with headquarters in Hong Kong. CGP indirectly owned 67% of Hutchison Essar Limited (HEL), an Indian entity which carried out telecommunication business in India. Soon after the transaction was completed, the Indian income tax authorities issued a notice demanding payment of $2.2 billion as capital gains tax. However, Vodafone contended it was not liable to pay.

The Indian tax authorities sought to tax the capital gains arising from the sale of the share capital of CGP on the basis that CGP, whilst not a tax resident in India, held the underlying Indian assets.

The dispute went first through the domestic Indian court system. In 2012, the Indian Supreme Court as the highest Indian court finally resolved the issue by deciding in Vodafone's favour, thus discharging the company of its tax liability. Essentially, the Supreme Court found that the Indian Income Tax Act 1961 did not provide a sufficient legal basis for taxing a transaction that took place outside India.

However, very soon afterwards, the Finance Bill 2012 was adopted by parliament, which amended the relevant provisions of the Income Tax Act 1961 in such a way that transactions such as the Vodafone one would retrospectively fall with the Tax Act. 1961, the Indian tax authorities renewed the tax demand on Vodafone, at which point Vodafone resorted to arbitration under the India-Netherlands BIT in 2012.

The PCA tribunal dismissed India's jurisdictional objections and held that the imposition of the tax demand was a violation of the fair and equitable treatment (FET) standard of the Netherlands-India BIT. In its award issued in late September 2020, the tribunal is understood to have found that India had violated the FET standard by imposing the tax liability on Vodafone, even though it had been Hutchinson who made the immediate financial gain.

Finally, India was ordered to cease its conduct in question, that is the attempt to collect the unlawfully imposed taxes from Vodafone. Any failure by India to comply with this order will engage its international responsibility. The arbitral tribunal ordered India to pay the majority of Vodafone's costs and for the parties to evenly split the administrative fees of the arbitration.[7]

At this point of time, India had lost many Investment Arbitration cases. So, it was thought drafting a new well balanced BIT would be a good idea. Thus, the 2016 Model BIT was drafted.

ANALYSIS OF THE MODEL BIT,2016 AND ITS CONSEQUENCES DISCUSSED

The model BIT of 2016, being a knee-jerk reaction to the White Industries case and the series of notices that India received, reflects a muddled approach. It is clear that the model BIT is reactionary in nature and was not

[7] Nikos Lavranos, *Vodafone v India award: Risky Business of retroactive taxation*, THOMSONS REUTERS ARBITRATION BLOG, (Oct. 24,2021 9:40 AM), http://arbitrationblog.practicallaw.com/vodafone-v-india-award-risky-business-of-retroactive-taxation

prepared as part of a regular exercise to reform the existing framework.

The BIT has more exceptions to protections than protections themselves. The sole focus on the entire model BIT is to limit the liability for the host state and raise the bar required to bring a claim under the BIT. It narrows down the definition of "investment," creates high threshold of breaches, and removes much of the protections that investors largely rely upon.

Even a cursory examination of the 2016 Model BIT reveals the Indian government's intention to provide greater legitimacy to the State's right to regulate in public interest. This right is further expanded within Article 16 of the BIT, which provides a list of circumstances where the right to regulate precludes overall applicability of the treaty. To prevent being held liable for unanticipated liabilities, Article 1.19 provides that in the absence of definitions of any specific term, the ordinary definitions of such words under Indian law are to apply. The further concretisation of the same is found in Article 3.1 (a FET guarantee) that prescribes an extremely high threshold upon the Claimant to satisfy. This has most likely been done to reduce the discretion in the hands of arbitrators and keep broader interpretations at bay.

Article 3.1 (ii) qualifies a due process violation to become a FET violation only if it is un-remedied. The inspiration for this clause appears to have come from the White Industries case. It is quite clear that the Indian government intends for India to assume liability only when **no** remedy is provided. If a remedy has been provided, the duration/quality/delay accompanying the remedy cannot be treated as grounds for an FET violation.

However, the biggest disappointment of the model BIT is its insistence on the investor exhausting the domestic remedies for at least five years before commencing an arbitration under the BIT. Another new feature added to the Model BIT is the doctrine of exhaustion of local remedies. Article 14.3 provides for an elaborate timeline within which an investor has to file any disputes before "relevant domestic authorities." Only after this procedure is undertaken and a compelling reason to opt for an alternative dispute resolution mechanism is made out by the Claimant, can the proceedings be submitted to an arbitral tribunal.

The most shocking highlight of this analysis, however, is the absence of the MFN clause from the text. This implies reduced protections being accorded to investors, for they do not have the choice to import provisions that were absent from the original treaty. Such intention is additionally found within the wordings of Article 3.2, according to which no substantive/procedural provisions from any other international treaty (regardless of nature) can be imported and read as being a violation of the treaty. This substantially reduces ordinarily available investment protection and diverges from general practice in investment arbitration, which provides for import of similar substantive and procedural protections to aid the investor.

A direct consequence of White Industries, this low level of right protection can be significantly detrimental to attracting foreign investors. India may also have a hard time negotiating such low standards with other countries in the future. Developed countries would not agree with such conditions, thus reducing a major potential clientele for India. A major challenge for India, thus, will be to woo nations to accept this BIT model.[8]

Another unintended consequence of the model BIT is that Indian companies investing abroad will also have similar limitations on protections and be subject to the local judicial bottlenecks, as discussed next. Since the release of the model BIT in 2016, India has signed a grand total of four BITs. India has signed BITs with Belarus, Kyrgyzstan, Taiwan, and Brazil and is in the process of signing one with Cambodia and negotiating another with Philippines. Except Taiwan, all the other nations are recipients of substantial Indian investments, significantly more than what India receives from these countries. While the BIT with Brazil is fairly balanced (and a substantive departure from the model BIT), the others are largely based on the model BIT.

However, even if BITs based on the model BIT are signed, will they actually be in India's interest? The answer may not be in affirmative. Think of it in terms of an Indian investor seeking to make substantial investments in a Middle Eastern or African country with a relatively volatile political environment. It would be subject to the same exceptions, limitations, and lack of protections that the model BIT contemplates for foreign investors in India. In fact, countries characterized by political instability and judicial corruption would be more than willing to sign BITs based on the model BIT as investments flowing from such countries into India would be a rare occurrence, whereas Indian investors will be left in a lurch at the mercy of the legal and political instability that characterizes such jurisdictions. Adding to that, it is unlikely that the developed countries, which are home to the biggest investors in India, will sign BITs on the terms the model BIT proposes. BITs are meant to protect both the inflow and outflow of the investments, which the model BIT fails to do.[9]

It is not decided what the future holds for investment arbitration in India. On the one hand, one could see the current status as opposition to the investment arbitration regime as a whole. The Indian government does not appear to move towards ratifying the ICSID Convention. Moreover, its BIT with Brazil excludes investment arbitration in total. Additionally, investment awards cannot be enforced in India, currently. The government even explores the possibility of creating specialist-courts that hear potential investor claims. One may conclude that India's experiences as a respondent State in investment arbitration has pushed the State into a rather protectionist and State-centric state of mind

Perhaps, and hopefully, India will eventually re-enter the period of **openness** while being a more pro-active actor in shaping the investment arbitration regime. India now has the experiences necessary to lead itself and other countries away from a **State-centric** and **protectionist** era and into one that further strengthens the enforcement of a global rule of law[10].

[8] Krishnendra Joshi, *India's Tryst with Investor-State Dispute Settlement (ISDS*), BLOG.IPLEADERS, (Oct. 24,2021 10:45 PM), https://blog.ipleaders.in/investor-state-dispute-settlement/ .

[9] Id.

[10]Simon Weber, *what happened to investment arbitration in india*, KLUWER ARBITRATION BLOG, (Oct. 24.2021 7:30 AM), http://arbitrationblog.kluwerarbitration.com/

CONCLUSION

The Indian approach to BITs is confused, self-defeating, and will end up being a cause of worry for the Indian investors. The model BIT does not act as the cushion investors need while venturing into a foreign territory. There is no win for India or its investors in signing such BITs. Rather than pursuing a confused BIT approach, India should focus on reforming its domestic judicial system.

While a few steps have been taken in the right direction through the Commercial Courts Act, 2015 and the amendments to the Arbitration and Conciliation Act, 1996, there are a number of administrative and substantive aspects that need a complete overhaul.

If that is not enough and India wishes to regulate foreign investments with absolute control, it should rather enact a legislation like South Africa's Protection of Investment Act, 2015 and discard BITs completely. Such a legislation will allow India to make its commitments to foreign investors embedded in the domestic law. The said legislation will not only provide requisite comfort to foreign investors, but it will also align with India's ultimate goal to avoid international litigations. However, it can have no protections for Indian entities investing in foreign countries.[11]

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